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ProPhase Labs (NASDAQ: PRPH) Neutral Rated

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ProPhase – Growth Appears to Have Stalled

ProPhase announced third quarter revenues that are flat with the prior period, although management noted a pickup in testing revenues in October. We are skeptical that it will be enough and be sustainable to drive the company towards real growth and profitability. The company is pushing the recent acquisition (whole genome sequencing) in an effort to compete with services like Ancestry.com and enter the cancer diagnostics space. We feel this is folly. At this point, ProPhase needs to “show us” that the company can deliver sustainable growth in testing revenues beyond just Covid such as, Flu.

Highlights:

Quarter’s Results: Total revenues of \$9.4M vs. \$9.1M in the prior period split between the legacy OTC business and Diagnostics. COGS rose to 58% of sales (disappointing), and G&A came in very high at \$5.9M. This translated into a loss of \$4M in the quarter, draining the cash balance to \$23M. We question the rationale behind the decision to use cash to buy back stock. ProPhase previously announced plans to repurchase stock (up to \$6M). For a micro-cap company with just over a year’s worth of cash to be repurchasing stock seems ill-advised and, in our opinion, sets up a dilutive raise in the future. Management will review the results at 11:00 AM today.

A Whole Genome Sequencing Acquisition? In the past quarter, the company announced the acquisition of Nebula Genomics, which provides a whole genomic sequencing service, for \$14.6M. We can certainly appreciate that whole genomic sequencing represents the future, but we are skeptical of how the data can be monetized today. In fact, when we challenged the CEO, he related that part of the business plan is to provide a more comprehensive product versus that of ancestry.com. That’s fine, but it’s hard to understand what the real synergy is with building a COVID/Flu testing machine. In terms of competing in the personalized medicine space, such as cancer (which the CEO suggested is also the plan), we see the naivety in the company’s thinking, dramatically underestimating how that market works and how it’s dominated by some very big players today.

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 \$5.00.

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	\$5.31		
Price Target	\$5.00		
Estimates	F2020A	F2021E	F2022E
Revenues (\$000s)	\$ 14,514	\$ 43,721	\$ 34,602
1Q March	\$ 1,888	\$ 15,271	\$ 8,812
2Q June	\$ 3,623	\$ 9,142	\$ 7,804
3Q September	\$ 3,840	\$ 9,076	\$ 8,820
4Q December	\$ 5,163	\$ 10,232	\$ 9,166
	F2020A	F2021E	F2022E
EPS (diluted)	\$ (0.18)	\$ 0.17	\$ 0.35
1Q March	\$ (0.07)	\$ 0.06	\$ 0.10
2Q June	\$ 0.01	\$ (0.09)	\$ 0.07
3Q September	\$ (0.04)	\$ 0.07	\$ 0.09
4Q December	\$ (0.08)	\$ 0.13	\$ 0.09
EBITDA/Share	(\$0.18)	\$0.18	\$0.49
EV/EBITDA (x)	-391.3	390.9	147.3
Stock Data			
52-Week Range	\$4.41	-	\$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)	120		
Insider Ownership	18.3%		
Institutional Ownership	10.9%		
Short interest (mil.)	1.6%		
Dividend / Yield	\$0.00/0.0%		



Model. We lower our assumptions (again) on market share and the percentage of the U.S. population, which is tested once annually. We assume \$50.00 per test in net revenue. This results in 2030E revenues of \$64M. 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
5% Testing (annual)	5%	16,500,000	16,500,000	16,665,000	16,831,650	16,999,967	17,169,966	17,341,666	17,515,082	17,690,233	17,867,136	18,045,807
Market Share of Testing		0%	2%	3%	5%	6%	7%	8%	9%	10%	10%	10%
No. of Tests		0	330,000	499,950	841,583	1,019,998	1,201,898	1,387,333	1,576,357	1,769,023	1,786,714	1,804,581
Net Margin per test	\$50	\$50	\$51	\$51	\$51	\$51	\$51	\$51	\$51	\$51	\$51	\$51
Annual Operating Income (\$M)		0	17	25	42	52	61	70	80	89	90	91
Risk Adjusted		70%	70%	70%	70%	70%	70%	70%	70%	70%	70%	70%
Risk Adjusted Operating Income (\$M)		\$0	\$12	\$18	\$30	\$36	\$42	\$49	\$56	\$63	\$63	\$64

Valuation: We now assume just 5% of the U.S. population is tested annually at a margin per test of \$50. Our operating model applies a 70% success probability to the revenue assumptions and the valuation models, free cash flow to the Firm (FCFF), discounted EPS (dEPS), and Sum-of-the-Parts (SOP) models use a 30% discount rate. The result is equal-weighted and averaged, and rounded to the nearest whole number.

Exhibit 1. Free Cash Flow Model

Average	\$	5
Price Target	\$	3
Year		2022

DCF Valuation Using FCF (mln):

units ('000 - Cnd\$)	2020E	2021E	2022E	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E
EBIT	(2,134)	2,769	7,474	14,630	18,667	22,832	27,131	31,569	36,154	37,420	38,778
Tax Rate	0%	0%	15%	20%	25%	28%	30%	31%	32%	33%	33%
EBIT(1-t)	(2,134)	2,769	6,353	11,704	14,001	16,439	18,992	21,783	24,585	25,071	25,982
CapEx	(3,000)	(1,000)	-	-	-	-	-	-	-	-	-
Depreciation	248	536	-	-	-	-	-	-	-	-	-
Change in NWC											
FCF	(4,886)	2,305	6,353	11,704	14,001	16,439	18,992	21,783	24,585	25,071	25,982
PV of FCF	(8,257)	2,996	6,353	9,003	8,284	7,483	6,649	5,867	5,093	3,996	3,185
Discount Rate	30%										
Long Term Growth Rate	1%										
Terminal Cash Flow	90,487.37										
Terminal Value YE2030	11,093										
NPV	61,745										
NPV-Debt	14										
Shares out (thousands)	18,586	2030E									
NPV Per Share	\$ 3										

Exhibit 2. Discounted EPS Model

Current Year	2022
Year of EPS	2030
Earnings Multiple	30
Discount Factor	30%
Selected Year EPS	\$ 1.40
NPV	\$ 5

Discount Rate and Earnings Multiple Varies, Year is Constant						
2030 EPS						
Earnings Multiple	5%	10%	15%	20%	25%	30%
2	\$6.98	\$4.81	\$3.37	\$2.40	\$1.73	\$1.26
5	\$17.45	\$12.03	\$8.43	\$6.00	\$4.33	\$3.16
10	\$34.91	\$24.06	\$16.86	\$11.99	\$8.65	\$6.32
15	\$52.36	\$36.09	\$25.29	\$17.99	\$12.98	\$9.48
20	\$69.81	\$48.12	\$33.72	\$23.99	\$17.31	\$12.64
25	\$87.27	\$60.15	\$42.15	\$29.99	\$21.63	\$15.81
30	\$104.72	\$72.18	\$50.58	\$35.98	\$25.96	\$18.97
35	\$122.18	\$84.21	\$59.01	\$41.98	\$30.28	\$22.13

Exhibit 3. Sum-of-the-Parts Model

Sum of the Parts	LT Gr	Discount Rate	Yrs. to Mkt	% Success	Peak Sales MMs	Term Val
OTC	1%	30%	0	100%	\$31	\$108
NPV						\$2.91
COVID	1%	30%	1	70%	\$64	\$220
NPV						\$3.19
Net Margin						50%
MM Shrs OS						19
Total						\$6

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 4. Income Statement

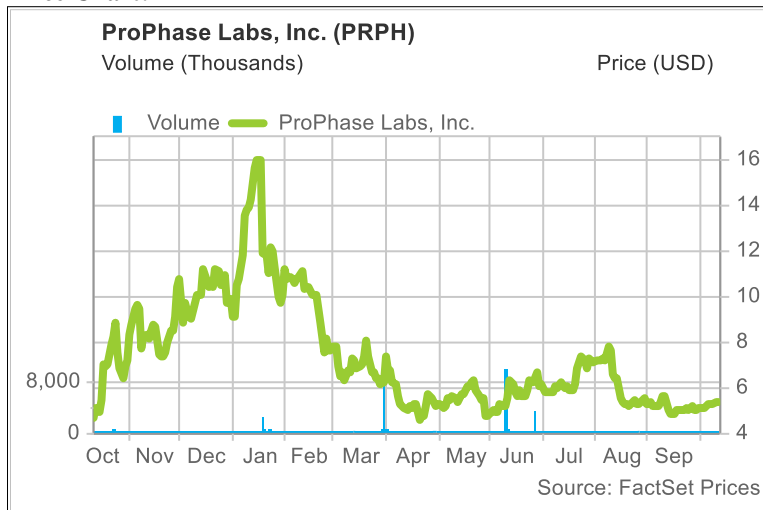
PRPH, Inc. Income Statement (\$000)																				
YE Dec. 31	2020A	1Q21A	2Q21A	3Q21A	4Q21E	2021E	1Q22E	2Q22E	3Q22E	4Q22E	2022E	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E	
Revenue (\$000)																				
OTC Consumer Healthcare Products	14,514	4,232	3,135	4,472	3,836	15,675	4,571	3,386	4,402	4,571	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	6,007	5,000	6,000	28,046	4,242	4,418	4,418	4,595	17,673	29,750	36,057	42,487	49,042	55,724	62,535	63,160	63,792	
Total Revenues	14,514	15,271	9,142	9,472	9,836	43,721	8,812	7,804	8,820	9,166	34,602	48,033	55,803	63,813	72,074	80,598	89,399	92,174	95,127	
Expenses																				
COGS	9,908	6,344	4,676	5,495	5,706	22,221	3,966	3,512	3,969	4,125	15,571	21,615	25,111	28,716	32,433	36,269	40,230	41,478	42,807	
% COGS	68%	42%	51%	58%	58%	51%	45%	45%	45%	45%	45%	45%	45%	45%	45%	45%	45%	45%	45%	
Gross Profit	4,606	8,927	4,466	3,977	4,130	21,500	4,847	4,292	4,851	5,041	19,031	26,418	30,692	35,097	39,641	44,329	49,170	50,696	52,320	
Real estate Gain	633																			
Sales (Advertising & Marketing) expense	1,287	3,809	830	1,478	2,000	8,117	1,364	1,420	1,420	1,477	5,682	5,796	5,911	6,030	6,150	6,273	6,399	6,527	6,657	
General and administrative	6,671	3,782	4,993	5,938	1,800	16,513	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	
Research & Development	633	115	93	208	84	500	122	128	128	133	510	520	531	541	552	563	574	586	598	
Total expenses	8,591	7,706	5,916	7,624	3,884	25,130	2,686	2,798	2,798	2,910	11,192	11,416	11,644	11,877	12,114	12,357	12,604	12,856	13,113	
Operating Profit	(2,093)	1,221	(1,450)	(3,647)	246	(3,630)	2,161	1,494	2,053	2,131	7,839	15,003	19,048	23,220	27,526	31,973	36,566	37,840	39,207	
Oper Margin																				
Unrealized gain on debt securities	62	87	214	230		531					-	-	-	-	-	-	-	-	-	
Interest expense	(295)	(251)	(323)	(296)		(870)					-	-	-	-	-	-	-	-	-	
Income discontinued ops	201		164	(265)		(101)					-	-	-	-	-	-	-	-	-	
Other (loss)	(9)					-					-	-	-	-	-	-	-	-	-	
Pre-tax income	(2,134)	1,057	(1,395)	(3,978)	246	(4,070)	2,161	1,494	2,053	2,131	7,839	15,003	19,048	23,220	27,526	31,973	36,566	37,840	39,207	
Pretax Margin																				
Income Tax (Benefit)		11	(67)	(33)			324	224	308	320	1,176	3,001	4,762	6,502	8,258	9,911	11,701	12,487	12,938	
Tax Rate							15%	15%	15%	15%	15%	20%	25%	28%	30%	31%	32%	33%	33%	
GAAP Net Income	(2,134)	1,046	(1,462)	(4,011)	246	(4,181)	1,837	1,270	1,745	1,812	6,663	12,002	14,286	16,719	19,268	22,061	24,865	25,353	26,268	
GAAP-EPS	(0.18)	0.07	(0.09)	(0.26)	0.02	(0.26)	0.10	0.07	0.10	0.10	0.36	0.65	0.78	0.91	1.04	1.19	1.34	1.37	1.41	
Non GAAP EPS (dil)	(0.18)	0.06	(0.09)	(0.26)	0.02	(0.28)	0.10	0.07	0.10	0.10	0.36	0.65	0.78	0.91	1.04	1.19	1.34	1.37	1.41	
Wgtd Avg Shrs (Bas) - '000s	11,595	14,563	15,154	15,439	15,470	15,156	15,501	15,532	15,563	15,594	15,547	15,672	15,798	15,925	16,052	16,181	16,311	16,442	16,574	
Wgtd Avg Shrs (Dil) - '000s	11,595	18,200	15,154	15,439	15,470	16,066	18,236	18,273	18,309	18,346	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
- Price Target Change – Buy – August 13, 2021 – Price Target lowered from \$25.00 to \$9.00
- Update – Buy – September 8, 2021 – Price Target \$9.00
- Rating Change – Neutral – October 13, 2021 – Price Target \$5.0
- Update – Neutral – November 12, 2021 – Price Target \$5.

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Ratings Distribution	# of Companies	% of Total	# of Companies	% of Totals
Market Outperform (Buy)	25	69%	4	16%
Market Perform (Neutral)	11	31%	0	0%
Market Underperform (Sell)	0	0%	0	0%
Total	36	100%	4	11%

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