

ProPhase Labs (NASDAQ: PRPH) Neutral Rated

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Is ProPhase a One Hit Wonder? – Maybe

ProPhase benefited from the recent surge in testing relating to Omicron variant delivering a blowout quarter (\$45M in revenues) and raising guidance for next quarter. We have increased our revenue assumptions for 2022 but our model suggests its not enough to raise projected valuation and support a Buy Rating. For that to happen, we need to see the outyear revenue numbers rise. Our confidence that lab testing around Covid in the future is sustainable at current levels is low. We are seeing 10 minute point of care testing now “everywhere”. These rapid tests should cut into “bulk” testing in the future. If that’s the case, then what’s the plan to replace Covid revenues? Retail Genomic Testing – competing with Ancestry.com?

Highlights:

ProPhase reported a strong quarter but is it sustainable? The bottom line for us is No. We expect to see waves of Covid, but the evolution of rapid on-site tests is likely to reduce the need for lab tests to confirm positive results. ProPhase reported \$45M in 4th Quarter revenues, translating into \$10M in net income. The company ended the year with \$8M in cash and \$37M in receivables.

A Whole Genome Sequencing Acquisition? Last year, 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 naivety in the company’s thinking, dramatically underestimating how that market works and how it's dominated by some 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	\$7.00
Price Target	\$5.00

Nebula Genomics



Source: ProPhase

Stock Data

52-Week Range	\$4.41	-	\$8.08
Shares Outstanding (mil.)	15.5		
Market Capitalization (mil.)	\$108		
Enterprise Value (mil.)	\$100		
Debt to Capital	0%		
Book Value/Share	\$2.86		
Price/Book	-		
Average Three Months Trading Volume (K)	47		
Insider Ownership	17.7%		
Institutional Ownership	9.9%		
Short interest (mil.)	0.7%		
Dividend / Yield	\$0.00/0.0%		



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	\$	5
Year		2022

DCF Valuation Using FCF (mln):

	2020E	2021E	2022E	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E
units ('000 - Cnd\$)											
EBIT	(2,134)	5,305	40,809	24,265	18,257	22,413	26,703	31,133	35,710	36,966	38,316
Tax Rate	0%	0%	15%	20%	25%	28%	30%	31%	32%	33%	33%
EBIT(1-t)	(2,134)	5,305	34,687	19,412	13,692	16,138	18,692	21,482	24,282	24,767	25,672
CapEx	(3,000)	(1,000)	-	-	-	-	-	-	-	-	-
Depreciation	248	536	-	-	-	-	-	-	-	-	-
Change in NWC											
FCF	(4,886)	4,841	34,687	19,412	13,692	16,138	18,692	21,482	24,282	24,767	25,672
PV of FCF	(8,257)	6,293	34,687	14,932	8,102	7,345	6,545	5,786	5,031	3,947	3,147
Discount Rate	30%										
Long Term Growth Rate	1%										
Terminal Cash Flow	89,407.71										
Terminal Value YE2030	10,960										
NPV	98,519										
NPV-Debt	14										
Shares out (thousands)	18,586	2030E									
NPV Per Share	\$ 5										

Exhibit 2. Discounted EPS Model

Current Year	2022
Year of EPS	2030
Earnings Multiple	15
Discount Factor	30%
Selected Year EPS	\$ 1.38
NPV	\$ 3

		Discount Rate and Earnings Multiple Varies, Year is Constant					
		2030 EPS					
Earnings Multiple		5%	10%	15%	20%	25%	30%
		2	\$1.91	\$1.32	\$0.92	\$0.66	\$0.47
5	\$4.78	\$3.30	\$2.31	\$1.64	\$1.19	\$ 0.87	
10	\$9.57	\$6.59	\$4.62	\$3.29	\$2.37	\$ 1.73	
15	\$14.35	\$9.89	\$6.93	\$4.93	\$3.56	\$ 2.60	
20	\$19.13	\$13.19	\$9.24	\$6.57	\$4.74	\$ 3.47	
25	\$23.91	\$16.48	\$11.55	\$8.22	\$5.93	\$ 4.33	
30	\$28.70	\$19.78	\$13.86	\$9.86	\$7.11	\$ 5.20	
35	\$33.48	\$23.08	\$16.17	\$11.50	\$8.30	\$ 6.06	

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	90%	\$64	\$220
NPV						\$4.10
Net Margin						50%
MM Shrs OS						19
Total						\$7

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)

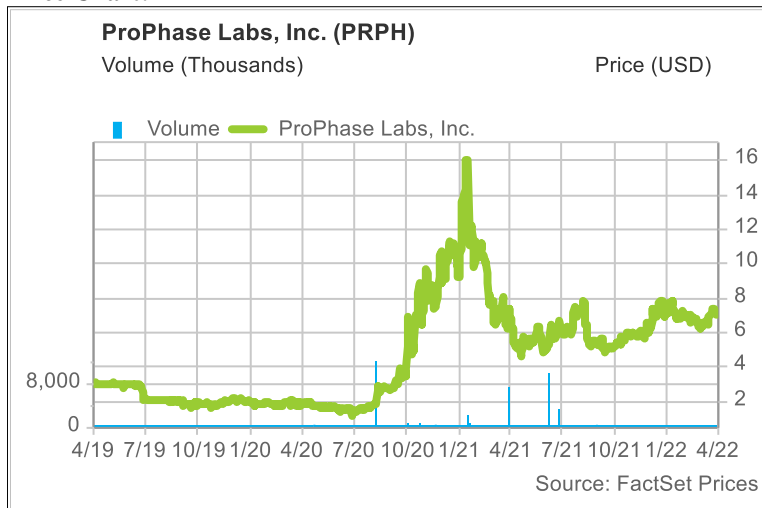
YE Dec. 31	2020A	1Q21A	2Q21A	3Q21A	4Q21E	2021E	1Q22E	2Q22E	3Q22E	4Q22E	2022E	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E
Revenue (\$000)																			
OTC Consumer Healthcare Products	14,514	4,232	3,135	4,472	3,836	15,675	4,571	3,386	4,402	4,571	16,929	18,283	19,746	21,326	23,032	24,874	26,864	29,014	31,335
Other Business																			
COVID & Flu Diagnostics		11,039	6,007	5,000	12,000	34,046	12,000	10,000	8,000	6,000	36,000	32,725	36,057	42,487	49,042	55,724	62,535	63,160	63,792
Total Revenues	14,514	15,271	9,142	9,472	15,836	49,721	16,571	13,386	12,402	10,571	52,929	51,008	55,803	63,813	72,074	80,598	89,399	92,174	95,127
Expenses																			
COGS	9,908	6,344	4,676	5,495	9,187	25,702	7,457	6,024	5,581	4,757	23,818	22,954	25,111	28,716	32,433	36,269	40,230	41,478	42,807
% COGS	68%	42%	51%	58%	58%	52%	45%	45%	45%	45%	45%	45%	45%	45%	45%	45%	45%	45%	45%
Gross Profit	4,606	8,927	4,466	3,977	6,649	24,019	9,114	7,362	6,821	5,814	29,111	28,055	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)	2,765	(1,111)	6,428	4,564	4,023	2,904	17,919	16,639	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)	2,765	(1,551)	6,428	4,564	4,023	2,904	17,919	16,639	19,048	23,220	27,526	31,973	36,566	37,840	39,207
Pretax Margin																			
Income Tax (Benefit)		11	(67)	(33)			964	685	603	436	2,688	3,328	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)	2,765	(1,662)	5,464	3,880	3,419	2,468	15,231	13,311	14,286	16,719	19,268	22,061	24,865	25,353	26,268
GAAP-EPS	(0.18)	0.07	(0.09)	(0.26)	0.18	(0.10)	0.30	0.21	0.19	0.13	0.83	0.73	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)	0.18	(0.11)	0.30	0.21	0.19	0.13	0.83	0.73	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 \$5.0
- Update – Neutral – December 30, 2021 – Price Target \$5.0
- Update – Neutral – February 16, 2022 – Price Target \$5.0
- Update – Neutral – April 1, 2022 – Price Target \$5.0

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Current as of... 15-Mar-22

	Company Coverage		Investment Banking	
Ratings Distribution	# of Companies	% of Total	# of Companies	% of Totals
Market Outperform (Buy)	31	74%	4	13%
Market Perform (Neutral)	11	26%	0	0%
Market Underperform (Sell)	0	0%	0	0%
Total	42	100%	4	10%

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