

## ProPhase Labs (NASDAQ: PRPH): Lowering from Neutral to Sell Rated

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### Is ProPhase Now an Oncology Company? If You Read The Press Release – What’s a Co-Therapy? Lowering Our Rating from Neutral to Sell

*ProPhase announced a license agreement with Global BioLife, Inc. (“Global BioLife”) for the Linebacker portfolio (LB-1 and LB-2), two patented small molecule PIM kinase inhibitors with significant potential across multiple therapeutic indications. The language of the press release is unusual and, in our opinion, reflects the company’s lack of understanding as a drug developer: ProPhase’s initial focus for LB-1 is as a potential co-therapy for the following four drugs: Taxol, Doxorubicin, Topotecan, and Cisplatin. What’s my issue? The beauty of ProPhase was that the company was supposed to be a pure play diagnostics company initially focused on Covid. We believe management sees the writing on the wall, so as Covid testing dwindles, management is scrambling to figure out how to refocus the company. A push towards genomics and ancestry.com was our first warning. News today that ProPhase now wants to become a biotech company developing oncology drugs adds to our skepticism. Given the rise in the stock we are lowering our rating from Neutral to Sell.*

#### Highlights:

So, What’s the Data to Support these LB compounds?

#### LB-1 Co-Therapy with TAXOL

- LB-1 alone inhibited cell proliferation at 69.94% at 100uM
- TAXOL alone inhibited cell proliferation at 41.96% at 200nM
- LB-1 and TAXOL combined inhibited cell proliferation at 75.5% (100uM of LB1 + 200nM Taxol)

What we see is a pre-clinical idea. We believe the development of such compounds to commercialization is a 5–10-year proposition costing \$100M. Isn’t this outside the scope of ProPhase? We believe it is.

**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	\$13.72
Price Target	\$5.00

#### Nebula Genomics



Source: ProPhase

#### Stock Data

52-Week Range	\$4.76	-	\$15.25
Shares Outstanding (mil.)	15.5		
Market Capitalization (mil.)	\$212		
Enterprise Value (mil.)	\$204		
Debt to Capital	0%		
Book Value/Share	\$2.86		
Price/Book	-		
Average Three Months Trading Volume (K)	33		
Insider Ownership	19.0%		
Institutional Ownership	10.2%		
Short interest (mil.)	1.5%		
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):

units ('000 - CndS)	2020E	2021E	2022E	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E
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											
Long Term Growth Rate											
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									

Source: Dawson James Estimates

### 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					
		5%	10%	15%	20%	25%	30%
Earnings Multiple	2	\$1.91	\$1.32	\$0.92	\$0.66	\$0.47	\$0.35
	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

Source: Dawson James Estimates

### 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

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 4. Income Statement**

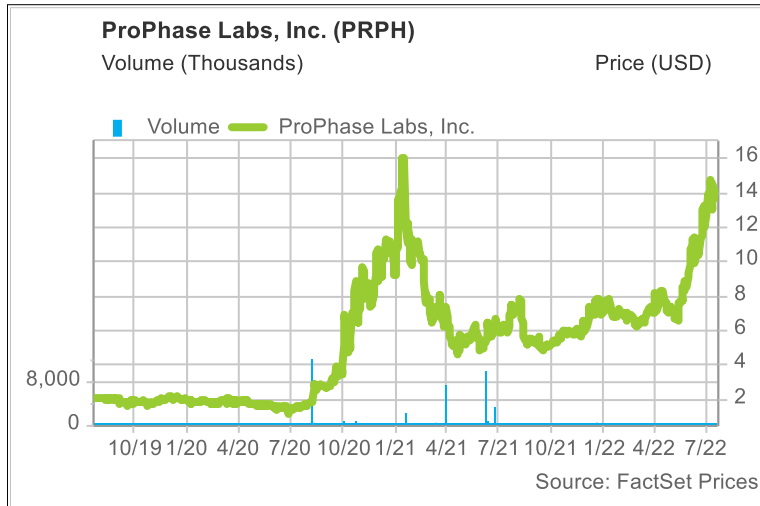
PRPH, Inc. Income Statement (\$000)																			
YE Dec. 31	2020A	1Q21A	2Q21A	3Q21A	4Q21E	2021E	1Q22E	2Q22E	3Q22E	4Q22E	2022E	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E
<b>Revenue (\$000)</b>																			
OTC Consumer Healthcare Products	14,514	4,232	3,135	4,472	3,836	15,675	4,571	3,386	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
<b>Total Revenues</b>	<b>14,514</b>	<b>15,271</b>	<b>9,142</b>	<b>9,472</b>	<b>15,836</b>	<b>49,721</b>	<b>16,571</b>	<b>13,386</b>	<b>12,402</b>	<b>10,571</b>	<b>52,929</b>	<b>51,008</b>	<b>55,803</b>	<b>63,813</b>	<b>72,074</b>	<b>80,598</b>	<b>89,399</b>	<b>92,174</b>	<b>95,127</b>
<b>Expenses</b>																			
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
<b>% COGS</b>	<b>68%</b>	<b>42%</b>	<b>51%</b>	<b>58%</b>	<b>58%</b>	<b>52%</b>	<b>45%</b>	<b>45%</b>	<b>45%</b>	<b>45%</b>	<b>45%</b>	<b>45%</b>	<b>45%</b>	<b>45%</b>	<b>45%</b>	<b>45%</b>	<b>45%</b>	<b>45%</b>	<b>45%</b>
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
<b>Total expenses</b>	<b>8,591</b>	<b>7,706</b>	<b>5,916</b>	<b>7,624</b>	<b>3,884</b>	<b>25,130</b>	<b>2,686</b>	<b>2,798</b>	<b>2,798</b>	<b>2,910</b>	<b>11,192</b>	<b>11,416</b>	<b>11,644</b>	<b>11,877</b>	<b>12,114</b>	<b>12,357</b>	<b>12,604</b>	<b>12,856</b>	<b>13,113</b>
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)										-	-	-	-	-	-	-	-	-
<b>Pre-tax income</b>	<b>(2,134)</b>	<b>1,057</b>	<b>(1,395)</b>	<b>(3,978)</b>	<b>2,765</b>	<b>(1,551)</b>	<b>6,428</b>	<b>4,564</b>	<b>4,023</b>	<b>2,904</b>	<b>17,919</b>	<b>16,639</b>	<b>19,048</b>	<b>23,220</b>	<b>27,526</b>	<b>31,973</b>	<b>36,566</b>	<b>37,840</b>	<b>39,207</b>
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
<b>Tax Rate</b>							<b>15%</b>	<b>15%</b>	<b>15%</b>	<b>15%</b>	<b>15%</b>	<b>20%</b>	<b>25%</b>	<b>28%</b>	<b>30%</b>	<b>31%</b>	<b>32%</b>	<b>33%</b>	<b>33%</b>
<b>GAAP Net Income</b>	<b>(2,134)</b>	<b>1,046</b>	<b>(1,462)</b>	<b>(4,011)</b>	<b>2,765</b>	<b>(1,662)</b>	<b>5,464</b>	<b>3,880</b>	<b>3,419</b>	<b>2,468</b>	<b>15,231</b>	<b>13,311</b>	<b>14,286</b>	<b>16,719</b>	<b>19,268</b>	<b>22,061</b>	<b>24,865</b>	<b>25,353</b>	<b>26,268</b>
<b>GAAP-EPS</b>	<b>(0.18)</b>	<b>0.07</b>	<b>(0.09)</b>	<b>(0.26)</b>	<b>0.18</b>	<b>(0.10)</b>	<b>0.30</b>	<b>0.21</b>	<b>0.19</b>	<b>0.13</b>	<b>0.83</b>	<b>0.73</b>	<b>0.78</b>	<b>0.91</b>	<b>1.04</b>	<b>1.19</b>	<b>1.34</b>	<b>1.37</b>	<b>1.41</b>
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
- Rating Change – Sell – July 21, 2022 – Price Target \$5.0

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Current as of 21-Jul-22

	<b>Company Coverage</b>		<b>Investment Banking</b>	
<b>Ratings Distribution</b>	# of Companies	% of Total	# of Companies	% of Totals
Market Outperform (Buy)	29	67%	4	14%
Market Perform (Neutral)	13	30%	0	0%
Market Underperform (Sell)	1	2%	0	0%
<b>Total</b>	<b>43</b>	<b>100%</b>	<b>4</b>	<b>9%</b>

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