

Source: Eikon Thomson Reuters

Market data		
EPIC/TKR		COS
Price (p)		5.5
12m High (p)		10.1
12m Low (p)		4.5
Shares (m)		324.3
Mkt Cap (£m)		17.8
EV (£m)		10.7
Free Float*		67%
Market		AIM

*As defined by AIM Rule 26

Description

COS develops, manufactures and supplies medical grade collagen biomaterials, tissues and devices. Its products are used in research, *in vitro* diagnostics, medical devices and regenerative medicine. The company provides R&D and contract services to a global and diverse customer base.

Company information

CEO	Jamal Rushdy
CFO	Gill Black
Chairman	David Evans

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www.collagensolutions.co.uk

Key shareholders	
Directors + management	20.7%
Seneca	13.2%
Calculus Capital	9.5%
Livingbridge	4.6%
Helium Rising Stars	4.0%
Rathbones IM	4.0%

Diary	
Jly-17	Finals
Aug-17	AGM
3Q-17	CM CE Mark filing

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Collagen Solutions

Trading update indicates earnings above forecasts

Collagen Solutions is a biomaterials company developing and manufacturing medical grade collagen components for use in medical devices, research, and regenerative medicine. A number of investment initiatives have been introduced recently to accelerate the rate of growth, including global commercial infrastructure and development of a pipeline of finished medical devices, the first of which will be ChondroMimetic for repair of small cartilage lesions. The recent trading update for FY 2017 indicated a slight sales shortfall being offset by higher grant income and lower costs, such that the bottom line may well be above market expectations.

- ▶ **Strategy**: Management has embarked on an investment strategy through a series of initiatives to increase the growth opportunities. This strategy to move COS from a reliable collagen supplier to one that also has proprietary products will move it into profitability and cash generative at a faster pace.
- ▶ Trading update: The sales trajectory has benefited from nine new supply, development and distribution agreements, however with the majority being signed in the 2H'17, this contributed to a modest sales shortfall. This was offset by higher grant income and some reduced costs that improved the bottom line.
- ▶ Corporate changes: COS has announced the relocation of its US HQ to Minneapolis so that global commercial and R&D functions can work more closely together under the leadership of Chris Wattengel. Dr White will step down from the board and as CSO, but will continue to consult on the SAB.
- ▶ Smart Matrix deal: An agreement has been signed with Smart Matrix for development and manufacturing of sponge-like advanced woundcare scaffolds that encourage tissue growth, to help closure of full thickness wounds and to avoid the need for skin grafts. Manufacturing should commence next quarter.
- ▶ Investment summary: The trading update hints that the realigned strategy onto an accelerated growth platform is starting to bear fruit. Investment in new opportunities (China JV, Orthomimetics, and additional new products) continues to build a pipeline of strategic relationships that is expected to drive long term growth. The recent capital increase is expected to see COS through to EBITDA profitability in 2019 and to cashflow break-even.

Financial summary and valuation								
Year end March (£000)	2014	2015	2016	2017E	2018E	2019E		
Sales	24	973	3,130	3,950	5,200	7,270		
Underlying EBITDA	-364	-663	-374	-1,248	-1,040	12		
Underlying EBIT	-381	-793	-721	-1,694	-1,566	-535		
Underlying PBT	-381	-920	-983	-1,797	-1,738	-674		
Statutory PBT	-480	-1,102	-866	-2,141	-1,838	-774		
Underlying EPS (p)	-0.87	-0.98	-0.64	-1.06	-0.61	-0.28		
Statutory EPS (p)	-1.10	-1.17	-0.57	-1.25	-0.64	-0.31		
Net (debt)/cash	1,492	3,282	2,384	7,054	3,655	509		
Capital increase	3,374	5,422	207	7,743	1,000	0		
P/E (x)	-6.3	-5.6	-8.6	-5.2	-9.0	-19.5		
EV/sales (x)	-	11.0	3.4	2.7	2.1	1.5		
EV/EBITDA (x)	-	-	-	-	-	-		

Source: Hardman & Co Life Sciences Research



Corporate update

Trading statement

Following the year end, management issued a trading statement to the market. Overall, while sales are a little lower than forecast due to some tissue sourcing shortages and the timelines for signing new deals, this was compensated for by increased grant income and lower costs, such that the bottom line looks set to be ahead of forecasts.

- ▶ Sales: Underlying growth was around +14.0% compared to our forecast of +20%, with reported numbers receiving a forex benefit of about £380k to £3,950k (£3,130k), such that reported growth will be +26%
- ▶ Asia: Growth continues as new customers have come on-line, benefiting from sales channel investment last year. New distributors have recently cleared import documentation, and first shipments have been exported to the Chinese JV
- ▶ **US accounts:** While some benefits of increased investment in marketing have been observed, the time taken to close deals with new customers has taken longer is some cases management estimates the sales cycle at 12-18 months
- ► **Tissue:** The pericardium tissue business continued to grow strongly (+30% est) but this was still below demand, hence the recent tissue supply initiatives
- ▶ **Grant income:** Considered to be 'other income' rather than product sales and is not included in our sales forecasts, the company includes in its total revenue figures. The outcome was £150k receivable compared to our forecast of £100k
- ► Costs: Overall costs look set to emerge slightly lower than expected. COGS have not increased as much as forecast, while some expenditure and personnel hires have moved into fiscal 2018, suggesting a better EBITDA outcome

t summary				
2016	2017	CER Growth	2017	Delta
actual	indicative	%	forecast	
3,130	3,950	+14.5%	4,080	-130
-811	-1,045		-1,080	+35
74.1%	73.5%		73.6%	
114	150		100	+50
-374	-1,248		-1,277	+29
-721	-1,694		-1,724	+30
-0.64	-1.06		-1.08	+0.02
	2016 actual 3,130 -811 74.1% 114 -374 -721	2016 actual 2017 indicative 3,130 3,950 -811 -1,045 74.1% 73.5% 114 150 -374 -1,248 -721 -1,694	2016 actual 2017 indicative CER Growth 3,130 3,950 +14.5% -811 -1,045 74.1% 73.5% 114 150 -374 -1,248 -721 -1,694 -0.64 -1.06	2016 actual indicative 2017 cer Growth forecast 2017 forecast 3,130 3,950 +14.5% 4,080 -811 -1,045 -1,080 74.1% 73.5% 73.6% 114 150 100 -374 -1,248 -1,277 -721 -1,694 -1,724 -0.64 -1.06 -1.08

Summary only – some cost lines not shown Source: Hardman & Co Life Sciences Research

Corporate evolution

- ► The Board has decided to relocate its US HQ from San Jose to Minneapolis during the first half of fiscal 2018 in order to bring closer together the global commercial function and the R&D teams
- ► The team will be led by Chris Wattengel who recently joined the company after 16 years at Kensey Nash (now DSM) where he was closely involved product development, licensing and M&A, and in 510(k) and CE Mark regulatory approvals
- ► This combination of activities will result in cost savings which will be re-invested in future product development projects, particularly cartilage/bone repair products
- ▶ Dr Stewart White, current CSO and formerly CEO, is standing down from the Board to pursue other opportunities. He will continue to consult to the SAB

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Financial summary

Forecast summary						
Year end March (£000)	2014	2015	2016	2017E	2018E	2019E
GBP:USD	1.590	1.574	1.459	1.304	1.304	1.304
Profit & Loss:						
Sales	24	973	3,130	3,950	5,200	7,270
COGS	-12	-214	-811	-1,045	-1,350	-1,800
Gross profit	12	759	2,319	2,905	3,851	5,471
Gross margin (%)	49.7%	78.0%	74.1%	73.5%	74.0%	75.2%
SG&A	-376	-1,325	-2,440	-3,338	-3,900	-4,399
R&D	0	-160	-367	-965	-1,140	-1,210
EBITDA	-364	-663	-374	-1,248	-1,040	12
EBITDA margin (%)	-	-	-	-	-20.0%	0.2%
Depreciation	-17	-130	-347	-447	-527	-547
EBIT	-381	-793	-721	-1,694	-1,566	-535
EBIT margin (%)	-	-	-	-	-30.1%	-7.4%
Net interest	0	-128	-262	-103	-172	-139
Pre-tax profit	-381	-920	-983	-1,797	-1,738	-674
Tax	0	-21	-114	-148	-193	-241
Net income	-381	-942	-1,097	-1,946	-1,931	-916
Weighted av. shares (m)	43.7	96.4	171.2	183.5	317.0	324.5
Underlying EPS (p)	-0.87	-0.98	-0.64	-1.06	-0.61	-0.28
Fully diluted EPS (p)	-0.87	-0.98	-0.64	-1.06	-0.61	-0.28
Balance sheet:						
Share capital	683	1,755	1,759	1,759	1,839	1,919
Reserves	5,573	11,099	12,137	20,347	19,236	18,140
Provisions	0	285	253	189	142	106
Debt	0	109	109	2,109	3,989	2,769
less: Cash	1,492	3,391	2,493	9,163	7,644	3,278
Invested capital	7,174	14,176	14,203	17,678	18,798	19,685
Net cash/debt	1,492	3,282	2,384	7,054	3,655	509
Cashflow:						
Operating profit	-381	-793	-721	-1,694	-1,566	-535
Working capital	-86	-228	422	-512	-225	-196
Tax & interest	0	-228	-191	-106	-320	-332
Operational cashflow	- 525	- 1,180	-338	-1,996	-1,9 05	- 1,737
Capital expenditure	0	-159	-464	-130	- 1,303	-200
Free cashflow	-525	-1,326	-801	-2,126	-2,199	-1,937
Acquisitions	-1,357	-2,192	-207	-1,027	-2 ,1 55	-1,209
Share issues	3,374	5,422	207	7,743	1,000	0
Change in net debt	1,492	1,790	-898	4,670	-3,399	-3,146
Hardman FCF/sh. (p)	-1.20	-1.22	-0.20	-1.09	-0.60	-0.54

Source: Hardman & Co Life Sciences Research

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