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AtCor Medical Holdings Limited (ACG)

Speculative Buy

Value Creation Ahead Post CPT1 Code Award

\$0.20

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Summary

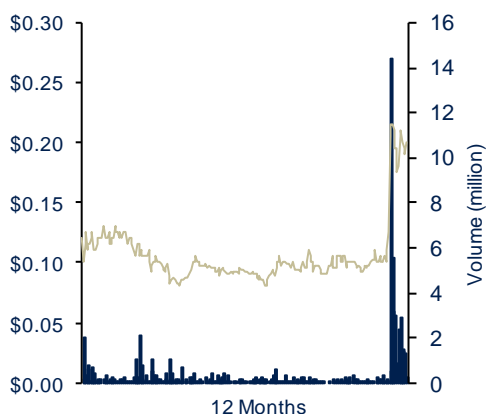
Market capitalisation (M)	\$33.8
Share price	\$0.20
52 week low	\$0.08
52 week high	\$0.27
Ave Monthly Vol (12M)	6.0
Cash as at 31/1/15 (M)	\$2.9
NTA per share	\$0.02

Key Financials (A\$'000)

Year End	1H15	2015	2016
	Actual	Est.	Est.
Product Sales	2,868	6,791	8,412
Total Revenue	3,570	7,514	8,435
COGS	(441)	(944)	(1,169)
Net Op. Rev	(360)	(580)	(571)
EBITDA	(360)	(602)	(594)
EBIT	(410)	(697)	(669)
Reported Profit	45	(214)	(147)
Adjusted NPAT*	(1,111)	(1,376)	(647)
Reported EPS (c)	0.0	(0.1)	(0.1)
PE Ratio (x)	n/a	n/a	n/a

*NPAT (ex-FX, R&D Tax Rebate)

Share Price Graph (A\$)



Our View

We re-emphasize our view that ACG is significantly de-risked following the AMA's initial acceptance of the RPAs' Category 1 CPT Code application, and see further, substantial share price upside as the remaining process plays out over CY15. While this decision from the AMA does not necessarily guarantee Medicare reimbursement, we believe it is highly likely that this decision will lead to further positive outcomes in the remaining process and act as catalysts for further re-rating. We point to the on-market success of listed peer, Impedimed Limited (ASX:IPD), as an example of the potential share price upside following a similar AMA decision and successful transition through the process. Trading at a steep discount to both IPD (93%) and biotech peers (37%) with a number of definable near term value drivers, we reiterate our Speculative Buy recommendation with a \$0.46/sh price target.

Re-rating comparison – IPD's share price rose from 22.5c to a high of \$1 in the 14 months after announcing the AMA's initial acceptance of its application for a CPT-1 code, which led to a \$152m increase in its market cap (ex cap raising shares). If ACG were to replicate 10% of this re-rating, this implies a c\$15m uplift in market cap or 42% increase from the current share price. A 50% replication would lead to a c212% share price rise, while a 100% replication of the IPD experience would see ACG stock increase five-fold. While acknowledging the differing products, likely Medicare subsidy rates and addressable market sizes of both companies, we believe this highlights the significant near term upside potential for ACG.

Value creation ahead – the key near term catalysts for ACG will be 1) the release of new CPT-1 Codes (August); 2) announcement of new Medicare subsidy rates (November) and 3) implementation of CPT-1 code and new Medicare subsidy rates (January). We believe the most influential value driver over this period will be the level of the Medicare subsidy rate awarded in November, which remains a key unknown in our thesis.

Forecast changes – we increase our FY16 and FY17 clinical sales estimates by c7% and c59% respectively to reflect higher clinician adoption rates in a post-CPT 1 environment and increased sales and marketing efforts. We now forecast revenue of \$8.4m in FY16 (+12%) and \$12.3m in FY17 (+46%), driving a loss of \$147k and NPAT of \$2.6m respectively.

Valuation & recommendation - ACG trades on a EV/Sales multiple of 3.9x in FY15 and 3.5x in FY16, which represents a discount of c37% to listed biotech peers (6.3x) and c93% discount to IPD (47.9x). Given 1) our confidence in the CPT-1 code and Medicare rebate becoming effective in CY16; 2) the attractive payback metrics for ACG's device (detailed below); 3) the significant addressable market (c\$180m pa) for ACG's device and 4) the company's robust medium term growth profile; we believe a 10x EV/Sales multiple is defensible. Applying this to FY16 revenues implies a \$0.46/sh price and 142% uplift from current trading levels, which underpins our positive investment thesis.

Impedimed Limited (ASX:IPD) Experience

Impedimed Limited (ASX:IPD) is a developer and distributor of medical devices employing BIS technologies for use in the non-invasive clinical assessment and monitoring of fluid status. IPD's primary product range consists of a number of medical devices that aid surgeons, oncologists, therapists and radiation oncologists in the clinical assessment of patients for the potential onset of secondary lymphoedema. IPD has the first medical device with an FDA clearance in the US to aid health care professional, clinically assess secondary unilateral lymphoedema of the arm and leg in women and the leg in men.

An overview of IPD's financials in comparison to ACG is detailed below in Figure 1.

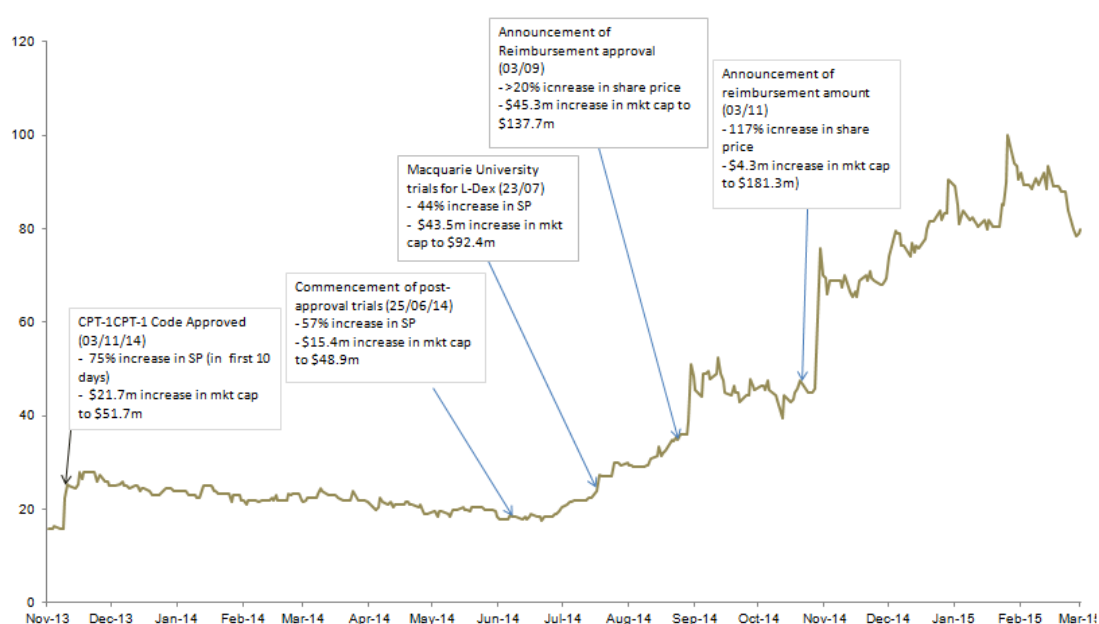
Figure 1: IPD/ACG Financial Metrics

	IPD	ACG
Market Cap (\$m)	253.62	32.15
Net Debt (Cash) (\$m)	(38.24)	(2.52)
EV (\$m)	215.38	29.64
FY15 Sales (\$m)	4.50	7.51
EV/Sales (FY15)	47.9x	3.9x
FY15 NPAT (\$m)	(9.20)	(0.21)
FY16 Sales (\$m)	9.37	8.41
EV/Sales (FY16)	23.0x	3.5x
FY16 NPAT (\$m)	(6.90)	(0.15)

Source: : Company reports, Bloomberg, TC estimates

Below we provide an analysis of the IPD share price performance as it transitioned through the Category 1 CPT Code approval process. In the below chart, we derive the market capitalisation increases based on the number of IPD shares on issue prior to the initial CPT-1 announcement on 3 November 2014, being 181.23m, to remove the impact of capital raisings and options exercises that were carried out during the period.

Figure 2: IPD Share price analysis



Source: : Company reports, Bloomberg, TC estimates

Figure 3: IPD Share Price performance

Announcement	SP increase (first ten days)	Cumulative SP increase
CPT 1 Code Approved	75%	75%
Post approval trials	57%	72%
Macquarie university trials	44%	143%
Reimbursement approval	35%	228%
Reimbursement amount	117%	525%

Source: : Company reports, Bloomberg, TC estimates

From this, it can be seen that IPD experienced numerous, significant share price re-ratings as it progressed through the remaining procedural requirements of the CPT-1 Code implementation following its initial AMA acceptance in November 2013.

IPD had a share price of 16c and market cap of \$29m prior to the first announcement mentioned above, based on 181.23m shares on issue. Over the course of the next 14 months of periodic catalysts, mostly relating to additional progress in the CPT-1 code approval process, the share price increased by 525% to \$1 at its peak (30/01/15) with a market cap of \$292.8m. Excluding the additional 111.64m shares issued during this period pursuant to capital raisings and option exercises, the implied market capitalisation increase of IPD was \$152.2m.

While acknowledging the differing products, likely Medicare subsidy rates and addressable market sizes of both companies, we believe this highlights the significant near term upside potential for ACG.

ACG now finds itself at the start of this journey following its announcement on 10 March that the AMA accepted the Renal Physician Associations (RPA) application for the addition of a Category 1 CPT Code relating to ACG's SphygmoCor product.

As earlier noted, while this decision from the AMA does not necessarily guarantee Medicare reimbursement, we believe it is highly likely that this positive decision will lead to further positive outcome in the remaining process, which is as follows;

- April/May 2015 – RUC committee considers specialty data and recommendations and submits final recommendation to CMS (Centre for Medicare & Medicaid Services)
- October/November 2015 – new CPT codes are released
- November 2015 – CMS announces new Medicare payment rates
- January 2016 – CPT code and new Medicare payment rates implemented

Reimbursement amount will be the key...

In our view, the most influential share price driver for ACG in both the short and longer term will be the dollar amount of reimbursement awarded by the CMS for the company's flagship SygphmoCor product. In simple terms, the higher the reimbursement level, the more attractive the economics are for clinicians to use the product and the higher the sales for ACG will be.

Given the opaque nature of the reimbursement assessment process and the fact that limited guidance has been given on the parameters used for determining the reimbursement amount, we refrain from speculating on the eventual outcome for now.

However, below we provide a sensitivity analysis on payback periods for clinicians using different reimbursement levels to demonstrate what we believe to be favourable metrics for adoption of the SphygmoCor product. We note that this is based on an assumed average purchase price of \$US15,000 and that a typical useful life for ACG's product is 5 years (or 60 months).

Figure 4: Reimbursement payback matrix

	Reimbursement per test (\$)									
	10	20	30	40	50	60	70	80	90	100
	Payback period in months									
10	37.5	18.8	12.5	9.4	7.5	6.3	5.4	4.7	4.2	3.8
15	25.0	12.5	8.3	6.3	5.0	4.2	3.6	3.1	2.8	2.5
20	18.8	9.4	6.3	4.7	3.8	3.1	2.7	2.3	2.1	1.9
25	15.0	7.5	5.0	3.8	3.0	2.5	2.1	1.9	1.7	1.5
30	12.5	6.3	4.2	3.1	2.5	2.1	1.8	1.6	1.4	1.3

Source: : TC estimates

Re-rating comparative analysis

We provide a rudimentary overview of potential share price re-ratings for ACG based on various discounts to the IPD experience, which is detailed below. Again, we emphasize that the companies are by no means appropriately comparable and there are many other factors at play, however we believe this illustrates the potential upside to come for ACG as the remaining process plays out.

Figure 5: Reimbursement payback matrix

Rerate Analysis	IPD Re-Rate	ACG Implied Uplift
	152.23	
5%	7.6	21%
10%	15.2	42%
15%	22.8	64%
20%	30.4	85%
25%	38.1	106%
30%	45.7	127%
35%	53.3	149%
40%	60.9	170%
45%	68.5	191%
50%	76.1	212%
55%	83.7	234%
60%	91.3	255%
65%	99.0	276%
70%	106.6	297%
75%	114.2	318%
80%	121.8	340%
85%	129.4	361%
90%	137.0	382%
95%	144.6	403%
100%	152.2	425%

Source: : TC estimates

Still cheap on an EV/Sales basis..

Notwithstanding the uplift in ACG's share price since the AMA announcement, the stock remains fundamentally cheap on an EV/Sales basis relative both to IPD and the broader ASX biotech index.

We forecast revenues of \$7.5m in FY15 and \$8.4m in FY16, which implies an EV/Sales ratio of 3.9x and 3.5x respectively. As demonstrated below, this represents a steep discount to both IPD and biotech peers, which we believe is excessive.

Figure 6: Comparative valuation analysis

	FY15 Sales	EV/Sales	FY16 Sales	EV/Sales
ACG	7.51	3.9x	8.41	3.5x
IPD	4.50	47.9x	9.37	23.0x
<i>ACG discount</i>		<i>(91.8%)</i>		<i>(84.7%)</i>
ASX Biotech Index		6.3x		5.5x
<i>ACG discount</i>		<i>(37.3%)</i>		<i>(36.5%)</i>

Source: : TC estimates, Bloomberg

In our view, IPD trades at such a high multiple due to 1) its fully implemented and active CPT-1 Code; 2) relatively high Medicare reimbursement rate (\$112); 3) significant near term growth profile (consensus revenue growth of 108% in FY15 and 152% in FY16) and 4) strong Balance Sheet.

ACG deserves to trade at a discount given it is only part way through the CPT-1 Code approval process and the level of Medicare reimbursement is still unknown, making it difficult to properly assess the company's long term growth potential.

That said, we believe that the current trading discount to IPD is excessive and warrants re-rating due to the following key factors;

- 1) The strong likelihood that ACG will successfully transition through the remaining process and be granted a CPT-1 Code later in CY15;
- 2) The associated Medicare reimbursement, which we believe will significantly improve the adoption metrics for the US clinician market;
- 3) The attractive pay-back metrics associated with various reimbursement levels detailed above;
- 4) The significant addressable market for ACG's device; and
 - a. We estimate that ACG's total addressable market in the US is c\$900m based on c40k to 50k unique practices, some of which will acquire more than one device, and an average unit price of \$US15k.
 - b. Given a 5 year typical useful life, this implies an annual addressable market of c\$180m for ACG's device
- 5) ACG's considerable medium term earnings growth profile, the momentum of which we expect to accelerate from FY17 onwards as the benefits of widespread Medicare reimbursement drives strong sales growth in the US clinician market. To this end, we forecast revenue growth of 46% in FY17 and 57% in FY18.

Figure 7: ACG/IPD Relative Valuation Metrics

	FY15				FY16			
	Prem/Disc	Multiple	Share price	Implied upside	Prem/Disc	Multiple	Share price	Implied upside
IPD	0%	47.9x	1.92	910%	0%	23.0x	1.04	446%
	(10%)	43.1x	1.73	810%	(10%)	20.7x	0.94	392%
	(20%)	38.3x	1.54	709%	(20%)	18.4x	0.83	338%
	(30%)	33.5x	1.35	609%	(30%)	16.1x	0.73	285%
	(40%)	28.7x	1.16	509%	(40%)	13.8x	0.63	231%
	(50%)	23.9x	0.97	409%	(50%)	11.5x	0.53	177%
	(60%)	19.1x	0.78	308%	(60%)	9.2x	0.42	123%
	(70%)	14.4x	0.59	208%	(70%)	6.9x	0.32	69%
	(80%)	9.6x	0.39	108%	(80%)	4.6x	0.22	15%
	(90%)	4.8x	0.20	7%	(90%)	2.3x	0.12	(39%)

Source: : TC estimates, Bloomberg

Given the above, we believe that ACG should trade at a more reasonable discount of ~50% to IPD and at a notable premium to the ASX Biotech Index detailed in Figure 6.

Applying a 10x EV/Sales multiple to ACG's FY16 revenues implies a \$0.46/sh price and 142% uplift from current trading levels, which underpins our positive investment thesis.

Figure 6: ACG & ASX-Biotech Peers

	FY15				FY16			
	Prem/Disc	Multiple	Share price	Implied upside	Prem/Disc	Multiple	Share price	Implied upside
	50%	9.4x	0.39	105%	50%	8.3x	0.38	102%
	40%	8.8x	0.36	92%	40%	7.8x	0.36	89%
	30%	8.2x	0.34	78%	30%	7.2x	0.33	76%
	20%	7.5x	0.31	65%	20%	6.7x	0.31	63%
	10%	6.9x	0.29	52%	10%	6.1x	0.29	50%
Median Peer Average	0%	6.3x	0.26	39%	0%	5.5x	0.26	37%
	(10%)	5.7x	0.24	26%	(10%)	5.0x	0.24	24%
	(20%)	5.0x	0.21	12%	(20%)	4.4x	0.21	11%
	(30%)	4.4x	0.19	(1%)	(30%)	3.9x	0.19	(2%)
	(40%)	3.8x	0.16	(14%)	(40%)	3.3x	0.16	(15%)
	(50%)	3.1x	0.14	(27%)	(50%)	2.8x	0.14	(28%)

Source: : TC estimates, Bloomberg

ACG - Summary of Forecasts

PROFIT & LOSS SUMMARY (A\$000s)				
Period	FY 14 A	FY 15 E	FY 16 E	FY 17 E
Product Sales	5,053	6,791	8,412	12,302
<i>growth (%)</i>	-44.2%	34.4%	23.9%	46.3%
Total Revenue	5,293	7,514	8,435	12,327
Cost of Goods Sold	(943)	(944)	(1,169)	(1,710)
<i>Gross Margin</i>	81.3%	86.1%	86.1%	86.1%
Total Operating Expenses	(7,213)	(7,150)	(7,837)	(8,420)
Direct R&D Expenses	0	0	0	0
EBITDA	(2,871)	(602)	(594)	2,175
Dep'n/Other Amort'n	(99)	(95)	(76)	(75)
EBIT	(2,969)	(697)	(669)	2,100
Net Interest	8	22	22	23
Pre- Tax Profit	(2,961)	(675)	(647)	2,123
Tax Expense	0	0	0	0
Minorities	0	0	0	0
NPAT Adjusted*	(2,961)	(1,376)	(647)	2,123
<i>Growth (pcp)</i>	-293.9%	53.5%	53.0%	428.2%
Net Abnormals	411	461	500	500
Reported Profit	(2,550)	(214)	(147)	2,623

PER SHARE DATA				
Period	FY 14 A	FY 15 E	FY 16 E	FY 17 E
Reported EPS (c)	(1.6)	(0.1)	(0.1)	1.6
<i>Growth (pcp)</i>	-189.1%	-92.2%	-31.3%	na
EPS Adjusted (c)	(1.9)	(0.8)	(0.4)	1.3
<i>Growth (pcp)</i>	-285.3%	-56.5%	-53.0%	-428.2%
Dividend (c)	0.0	0.0	0.0	0.0
Franking	0%	0%	0%	0%
Gross CF per Share (c)	(1.1)	0.1	0.1	1.5
NTA per share (c)	2.1	1.9	1.8	3.4

KEY RATIOS				
Period	FY 14 A	FY 15 E	FY 16 E	FY 17 E
EBITDA/Sales Margin %	-56.8%	-8.9%	-7.1%	17.7%
EBIT/Sales Margin %	-58.8%	-10.3%	-8.0%	17.1%
Current ratio (x)	3.3	2.8	2.2	2.6
Net Debt : Equity (%)	-66.0%	-70.0%	-75.0%	-82.3%
ROE (%)	-62.5%	-6.6%	-4.7%	59.1%
Dividend Payout Ratio (%)	0.0%	0.0%	0.0%	0.0%

VALUATION MULTIPLES				
Period	FY 14 A	FY 15 E	FY 16 E	FY 17 E
PERatio (x)	n/a	n/a	n/a	12.8
PEAdj. (x)	n/a	n/a	n/a	15.8
Dividend Yield (%)	0.0%	0.0%	0.0%	0.0%
EV/Sales (x)	6.2	4.6	3.7	2.3
EV/EBITDA (x)	n/a	n/a	n/a	13.3
EV/EBIT (x)	n/a	n/a	n/a	13.8

ACG \$ 0.200

BALANCE SHEET SUMMARY				
Period	FY 14 A	FY 15 E	FY 16 E	FY 17 E
Cash	2,168	2,247	2,330	4,749
Receivables	1,548	2,037	2,523	3,691
Pre Payments	0	0	0	0
Inventories	538	272	336	492
Investments	0	0	0	0
Other	98	158	158	158
Total Current Assets	4,352	4,715	5,348	9,090
Investments	0	0	0	0
Inventories	0	0	0	0
Receivables	0	0	0	0
Property Plant & Equip	280	237	233	241
Intangibles	0	0	0	0
Other	0	0	0	0
Total Non- Current Assets	280	237	233	241
TOTAL ASSETS	4,631	4,952	5,581	9,332
Accounts Payable	1,216	1,630	2,355	3,445
Borrowings	0	0	0	0
Provisions	111	40	40	25
Other	0	0	0	0
Total Current Liab	1,326	1,670	2,395	3,470
Borrowings	0	0	0	0
Provisions	21	70	80	90
Other	0	0	0	0
Total Non- Current Liab	21	70	80	90
TOTAL LIABILITIES	1,347	1,740	2,475	3,560
TOTAL EQUITY	3,284	3,212	3,106	5,772

CASH FLOW SUMMARY				
Period	FY 14 A	FY 15 E	FY 16 E	FY 17 E
EBIT (excl Abs/Extr)	(2,969)	(697)	(669)	2,100
Add: Depreciation	99	95	76	75
Amortisation	0	0	0	0
Change in Pay.	(179)	414	725	1,089
Less: Tax paid	400	500	500	500
Net Interest	8	22	22	23
Change in Rec.	1,118	(493)	(493)	(1,178)
Change in Inv.	(212)	266	(65)	(156)
Gross Cashflows	(1,735)	107	96	2,453
Capex	(44)	(57)	(75)	(80)
Free Cashflows	(1,780)	50	21	2,373
Other	82	29	61	46
Share Issue Proceeds	700	0	0	0
Dividends Paid	0	0	0	0
Net Cash Flow	(998)	79	82	2,419
Effect of FX on Cash	0	0	0	0

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