

Protech Home Medical (PHM – V) The Break-Out Quarter – Raise Target

May 16, 2018

Doug Cooper, MBA

Analyst - (416) 643-3863

dcooper@beaconsecurities.ca

- PHM released its Q2/FY18 (March) results that showed much better EBITDA than anticipated. Revenue/EBITDA was \$18.7m/\$2.24m (12%) versus our expectations of \$18.7m/\$1.7m (9%). We note that this was not only a dramatic improvement versus our expectation but also versus the Q1/FY18 EBITDA margin of 8%.
- While at first glance the y/y growth in revenue and EBITDA may not look too impressive, we would highlight the following:
 - The company reports in C\$ yet its business is entirely in the US. On a y/y basis, the C\$ strengthened by 4.4%. As such on a US\$ basis, revenue was +6%. Such an organic growth rate is in-line with the industry;
 - PHM is focusing on its re-supply business/ancillary revenue market for CPAPs. This high margin business grew 33% y/y and helps drive its respiratory segment by 11% as well as the q/q EBITDA expansion;
 - While EBITDA margin in Q2/FY17 was 12.3%, we believe this was overstated given the large adjustment the company made to bad debt expense in Q4/FY17. As such, we believe on an adjusted basis, the company grew EBITDA from ~\$0.5 million in Q2/FY17 to \$2.24 million in Q2/FY18 – a material and significant improvement. Since the end of FY17, we believe the company's A/R is fully representative of what is collectible. Bad debt provision in Q2 was 12.7% of revenue, which we believe is in-line with industry averages, albeit company believes it can get bad debt to ~10%, which will also help to drive EBITDA margins.
 - The company generated FCF of \$1 million in the quarter as its cash balance grew to \$4 million from \$3 million in Q1. We believe this is the first quarter of positive FCF generation in the company's history.
- In other words, since Greg Crawford (who owns ~10% of the company) took over operations of the company, he has done an outstanding job of streamlining the costs, restoring margins and generating FCF. **Management indicated its turnaround is not yet complete and expects to grow EBITDA margins further, to 15%+ by Q4/FY18 or Q1/FY19.**
- Interestingly, while re-impbursement cuts are always the largest risk, we believe PHM's product lines are fully mature and are not likely to see further cuts. In fact, CMS has implemented new temporary rates effective June 1, 2018 – Dec 31, 2018 which actually INCREASE prices for some of PHM's products. While this may not be permanent, we also believe it is a signal that rates are a likely not going lower in the near future.
- From a growth perspective, we expect PHM to continue to post single digit organic growth with margin expansion over the back half of the year. We now forecast FY18 rev/EBITDA of \$77m/\$9.4m. We are also introducing our FY19 forecast of \$81m/\$12.1m. These forecasts do not include any acquisitions, which, now that the turnaround is virtually complete, is likely to augment growth.
- The healthcare service sector universe is being driven by an aging population, which is driving demand for their products/services. On average, they trade at 12x EV/EBITDA and as high as 16x, with many now trading at 52-week highs. At 3.3x, PHM trades at a 70% discount, yet now shows similar financial metrics as the other players. We believe this valuation gap will narrow in the coming quarters. Maintain Buy and raise target to \$0.40 (was \$0.35) based on 12x our FY19 EBITDA forecast.

Q2/FY18 Results

BUY (Unch) **\$0.40** (Was \$0.35)

| | |
|-----------------------|------------------|
| Closing Price | \$0.10 |
| 12-month Target Price | \$0.40 |
| Potential Return | 321% |
| 52 Week Price Range | \$0.075 - \$0.52 |

Estimates

| YE: Sept. 30 | FY17 | FY18E | FY19E |
|----------------|---------|---------|---------|
| Revenue (\$MM) | \$76.4 | \$77.1 | \$81.0 |
| EBITDA (\$MM) | \$1.1 | \$9.4 | \$12.1 |
| Adj EPS | -\$0.03 | -\$0.02 | -\$0.01 |

Valuation

| | FY17 | FY18E | FY19E |
|-----------|-------|-------|-------|
| EV/Sales | 0.5x | 0.5x | 0.5x |
| EV/EBITDA | 38.4x | 4.3x | 3.3x |
| P/E | - | - | - |

Stock Data (MM)

| Shares Outstanding | |
|--------------------|--------|
| Basic | 380.0 |
| FD | 380.0 |
| Market Cap (C\$) | |
| Basic | \$36.1 |
| FD | \$36.1 |
| Net Debt | \$5 |
| EV (C\$) | \$41 |

About the Company

PHM is focused on a highly fragmented and developing market of small privately-held US companies servicing chronically ill patients with multiple disease states. PHM is actively working to identify and evaluate profitable, annuity-based companies to acquire their patient databases and technical expertise at favorable prices. PHM's post acquisition organic growth strategy is to increase annual revenue per patient by offering multiple services to the same patient, consolidating the patient's services and making life easier for the patient.

All prices in C\$ unless otherwise stated

Stock Performance



Disclosure Requirements

Does Beacon, or its affiliates or analysts collectively, beneficially own 1% or more of any class of the issuer's equity securities? Yes No

Does the analyst who prepared this research report have a position, either long or short, in any of the issuer's securities? Yes No

Has any director, partner, or officer of Beacon Securities, or the analyst involved in the preparation of the research report, received remuneration for any services provided to the securities issuer during the preceding 12 months? Yes No

Has Beacon Securities performed investment banking services in the past 12 months and received compensation for investment banking services for this issuer in the past 12 months? Yes No

Was the analyst who prepared this research report compensated from revenues generated solely by the Beacon Securities Investment Banking Department? Yes No

Does any director, officer, or employee of Beacon Securities serve as a director, officer, or in any advisory capacity to the issuer? Yes No

Are there any material conflicts of interest with Beacon Securities or the analyst who prepared the report and the issuer? Yes No

Is Beacon Securities a market maker in the equity of the issuer? Yes No

Has the analyst visited the head office of the issuer and viewed its operations? Yes No

Did the issuer pay for or reimburse the analyst for the travel expenses? Yes No

All information contained herein has been collected and compiled by Beacon Securities Limited, an independently owned and operated member of the Investment Industry Regulatory Organization of Canada (IIROC). All facts and statistical data have been obtained or ascertained from sources, which we believe to be reliable, but are not warranted as accurate or complete.

All projections and estimates are the expressed opinion of Beacon Securities Limited, and are subject to change without notice. Beacon Securities Limited takes no responsibility for any errors or omissions contained herein, and accepts no legal responsibility from any losses resulting from investment decisions based on the content of this report.

This report is provided for informational purposes only and does not constitute an offer or solicitation to buy or sell securities discussed herein. Based on their volatility, income structure, or eligibility for sale, the securities mentioned herein may not be suitable or available for all investors in all countries.

| As at April 30, 2018 | # Stocks | Distribution |
|----------------------|-----------|--------------|
| Buy | 66 | 71% |
| Speculative BUY | 11 | 12% |
| Hold | 8 | 9% |
| Sell | 0 | 0% |
| Under Review | 7 | 8% |
| Tender | 1 | 1% |
| Total | 93 | 100% |

| | |
|-----------------|--|
| Buy | Total 12-month return expected to be >15% |
| Speculative Buy | Potential total 12-month return is high (>15%) but given elevated risk, investment could result in a material loss |
| Hold | Total 12-month return expected to be between 0% and 15% |
| Sell | Total 12-month return expected to be negative |
| Under Review | No current rating/target |
| Tender | Clients are advised to tender their shares to takeover bid or similar offer |

Dissemination

Beacon Securities distributes its research products simultaneously, via email, to its authorized client base. All research is then available on www.beaconsecurities.ca via login and password.

Analyst Certification

The Beacon Securities Analyst named on the report hereby certifies that the recommendations and/or opinions expressed herein accurately reflect such research analyst's personal views about the company and securities that are the subject of the report; or any other companies mentioned in the report that are also covered by the named analyst. In addition, no part of the research analyst's compensation is, or will be, directly or indirectly, related to the specific recommendations or views expressed by such research analyst in this report.