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Stock Data

Price (11/18/22): \$12.08
52-Week High: \$15.25
52-Week Low: \$5.55
Avg. Daily Volume: 101,041 shares
Market Capitalization: \$196 million
Enterprise Value: \$183 million
Shares Outstanding: 15.9 million
Free Float: 12.3 million
Cash & Equivalents: \$26.5 million
Insider Ownership: 21.9%
Institutional Ownership: 13.7%

ProPhase Labs, Inc. (Nasdaq: PRPH)

Update Report on ProPhase Labs, Inc.

BUY- Long-term market outperformance.

ProPhase reported its financial and operational results for the third quarter ended September 30, 2022. In the seasonally weakest quarter of the year, PRPH achieved record Q3 revenues and EBITDA:

- Revenues of \$24.2 million, increased 155% year-over-year.
- Net income of \$1.0 million versus a loss in Q3 2021.
- Adjusted EBITDA of \$6.3 million versus a loss in Q3 2021.

The increase in revenues stemmed from a \$13.4 million increase in net revenue from diagnostic services and \$1.3 million increase in consumer products.

Overall gross margin improved year-over-year, rising to 49.5% from 42.0%, although it declined significantly in comparison to the two previous quarters. Q3 gross margin for diagnostic services was 58.9%, up from 43.9% in Q3 2021. The year-over-year increase was mainly due to increased efficiencies in lab processing, a decrease in sample collection costs, and a decrease in cost of test materials.

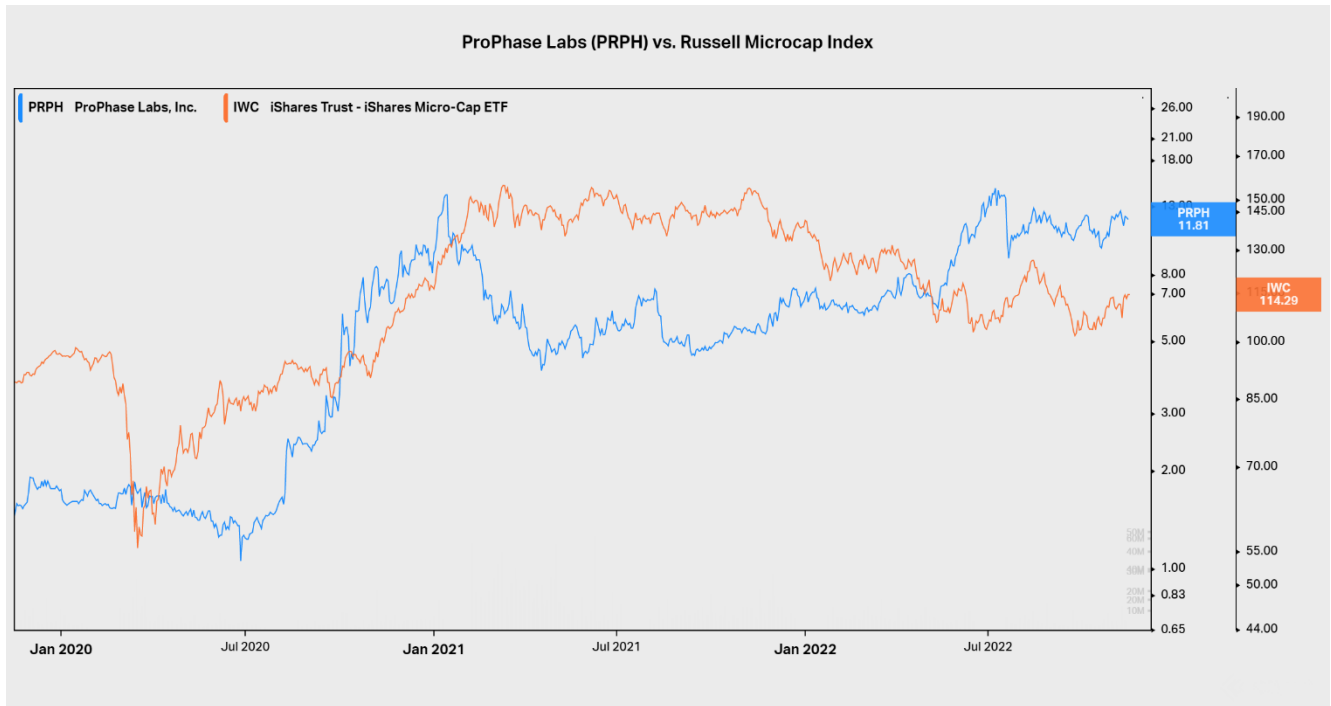
ProPhase ended Q3 with cash, cash equivalents and marketable securities of \$26.5 million and net working capital of \$53.6 million.

Third Stream Research initiated PRPH coverage on October 18, 2022; download report [here](#).

Investment Highlights

- Despite a slowdown in the prevalence of COVID-19, testing levels increased due to expansion and diversification of ProPhase's customer base over the past year, comprising independent pharmacies, schools, concierge services in multiple states, and municipal contract wins. Management reports that PCR and antigen testing has been consistent entering Q4, a period when the cough/cold/flu season takes hold.
- ProPhase's New York CLIA laboratory is expected to expand its offerings beyond COVID-19 testing in Q1 2023. The menu will include traditional testing (i.e., hematology, chemistry, immunoassays, coagulation, STDs, urinalysis, etc.), with the capacity to also address the specific needs of research organizations and physicians.
- In parallel, the company plans to build a genetics laboratory outfitted with Next Generation Sequencing to perform Whole Genome Sequencing and an array of genetic diagnostic test offerings, both clinical and for research. Expectations are that this facility will attract academic institutions with a growing demand to conduct genetic research. ProPhase also reiterated plans to leverage its distribution in tens of thousands of large food, drug and mass retail stores to accelerate growth for direct-to-consumer sales of its genomic sequencing products, and ultimately expand to a variety of diagnostic tests.
- On October 19, 2022, ProPhase announced a collaboration with G42 Healthcare Inc., a health-tech company that is part of the Abu-Dhabi based Group42 (G42), an AI and cloud computing company developing and implementing scalable AI solutions. G42 recently launched a \$10 billion fund to invest in late-stage technology companies. ProPhase's agreement with G42 Healthcare covers several collaborative opportunities including genomic sequencing, artificial intelligence, and sharing of genomic data insights.

- A major goal of the ProPhase-G42 Healthcare collaboration is to enable G42 to acquire consumer-facing capabilities in providing patient-specific data, supporting gene therapy programs, and developing personalized medical treatment and therapies. The companies intend to target high-growth and underserved markets during the initial phase but will consider all global markets and opportunities as well.
- G42 Healthcare is an enabler of the world’s largest and most comprehensive population genomics initiative – the Emirati Genome Program – which aims to move the traditional ecosystem from sick care to preventive healthcare for UAE’s citizens. ProPhase views G42 Healthcare as an ideal strategic partner as PRPH looks to enhance its next generation sequencing capabilities and build a new state-of-the-art genomic sequencing facility.
- On November 8, 2022, ProPhase BioPharma entered into a two-year collaborative agreement with Dana-Farber Cancer Institute to further the research and development of a small molecule, Linebacker-1, an anti-cancer agent to be used as a co-therapy that targets PIM kinase receptors, a growth factor expressed in cancer. In preclinical laboratory studies, LB-1 inhibited PIM, which could potentially slow the growth of the cancer and allow for better efficacy of the co-therapy drug or treatment being used. The estimated budget for the Linebacker portfolio (LB-1 and LB-2) continues to be under \$5 million over the next 12-18 months for animal studies and an initial human clinical study.



FINANCIAL HIGHLIGHTS

ProPhase Labs' financial outlook has improved over the last two years, catapulted by soaring demand for COVID-19 testing at its high-efficiency diagnostics laboratory. PRPH's financials reflect a pattern of minimally dilutive financings, strong revenue, earnings and margin growth, and a markedly improved balance sheet. Virtually all gains over the last 12 months are attributed to organic growth. We refrain from earnings estimates and other financial projections due to the complete uncertainty of assumptions in the analysis of development-stage technology and life science companies.

ProPhase Labs, Inc. – Financial Highlights: Fiscal Year 2017 to Present

Fiscal Years (Dec. 31)	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021	LTM (Q3-22)
(In millions)						
Total Revenues	9.9	13.1	9.9	14.5	79.0	146.0
Total Revenues (CAGR 1Y %)	134	33	(25)	47	444	274
Gross Profit	1.9	4.8	2.6	4.6	42	84.0
Gross Profit Margin %	19.7	36.4	26.5	31.7	53.1	57.5
EBITDA	(3.7)	(1.3)	(2.8)	(3.5)	13.0	47.3
EBITDA Margin %	-	-	-	-	16.5	32.4
Net Income	41.8*	(1.6)	(3.1)	(2.3)	6.3	31.5
Net Income Margin %	-	-	-	-	7.9	21.6
Diluted EPS (\$)	2.69	(0.14)	(0.27)	(0.20)	0.40	1.53
<i>Capital Structure</i>						
Diluted Shares Outstanding	15,696	11,396	11,564	11,595	18,393	19,504
Total Cash and Short Term Invest.	21.9	8.2	1.4	8.5	17.3	26.5
Total Debt	-	-	-	14.7	14.9	12.6
Enterprise Value (EV)	10.1	27.2	21.2	118.3	106.8	182.8
<i>Cash Flow Analysis</i>						
Cash from Operations	(2.8)	(2.1)	(0.8)	(2.6)	(13.6)	23.1
Capital Expenditure	(0.2)	(0.1)	(0.2)	(1.7)	(4.2)	(2.3)

Source: Koyfin, FactSet

*As a consequence of the sale of the Cold-EEZE® business to Mylan in March 2017, ProPhase realized a gain, net of income tax, of \$27.0 million for the year ended December 31, 2017. The gain on the sale of the Cold-EEZE® Business is classified as a component of discontinued operations at December 31, 2017 and is net of approximately \$18.8 million for estimated income taxes arising from the sale. For the year ended December 31, 2017, the company also realized an income tax benefit from continuing operations of \$18.0 million as a consequence of the utilization of the federal and state net operating losses.

RISK FACTORS

Numerous risks exist for any development stage company in the life science industry. ProPhase is not immune to potential setbacks, despite vastly improved fundamentals over the last two years. We highlight primary factors that deserve recognition:

- CEO and Chairman Ted Karkus owns 21.3% of ProPhase common stock. He exerts significant influence over the outcome of all matters submitted to stockholders for approval, including the election of directors. Consequently, he exercises substantial influence over major decisions including those which could result in or prevent a change of control of the company. Also, circumstances may occur in which the CEO's interests could be in conflict with the interests of other stockholders, thus limiting a stockholder's ability to influence the company through voting their shares.
- The diagnostic service business is subject to extensive federal, state, and local laws and regulations, all of which are subject to change, as well as laws and regulations governing the submission of claims for payment for ProPhase services, such as those relating to: coverage of services under Medicare, Medicaid and other federal health care programs; the amounts that the company may bill for its services; and the party to which it must submit claims. Also, reimbursement policies and requirements for some payers and procedures are ambiguous, which could lead to billing errors and related disputes. There can be no assurance that ProPhase's efforts to offer and perform COVID-19 or other diagnostic testing will be successful in the future or that the revenue and operating profits from such business will increase or maintain their current level.
- ProPhase's customer base for its COVID-19 tests is principally comprised of governmental bodies, municipalities, and large corporations who pay the company directly or through third-party payors. In March 2020, the \$2.2 trillion Coronavirus Aid, Relief, and Economic Security Act passed in response to the economic fallout of the COVID disease. The 'CARES Act' enabled reimbursement to healthcare providers for COVID-19 tests provided to uninsured individuals, subject to continued available funding.
- The Affordable Care Act brought significant changes to the way healthcare is financed by both the government and private insurers, and significantly impacted the U.S. pharmaceutical industry, including expanding the list of covered entities eligible to participate in the 340B drug pricing program and establishing a new Medicare Part D coverage gap discount program. In the future, these and other healthcare reform measures may result in more rigorous coverage criteria and lower reimbursement, and in addition, exert downward pressure on pricing for any of ProPhase's approved products. Any reduction in reimbursement from Medicare or other government-funded programs may result in a similar reduction in payments from private payors. The implementation of cost containment measures or other healthcare reforms may hinder ProPhase in generating revenue, attaining profitability, or commercializing products once, and if, marketing approval is obtained.
- Diagnostic services revenues are subject to fluctuations in COVID-19 testing demand. The demand for COVID-19 tests has been, and ProPhase expects it to continue to be, highly volatile, primarily driven by the emergence and severity of new variants, which are unpredictable.
- ProPhase is involved in the early development of biopharma compounds and drugs. Clinical trials are expensive, time consuming, and subject to uncertainty. There is no guarantee that any of the company's clinical trials will be conducted as planned or completed on schedule, if at all. Issues may arise that could suspend or terminate clinical trials. A failure of one or more of the company's clinical trials may occur at any stage of testing. Clinical trials may fail to adequately demonstrate the safety and efficacy of product candidates and the development of product candidates may be delayed or unsuccessful, which could prevent or delay regulatory approval and commercialization.



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Joshua Levine, principal at Third Stream Research, has more than 30 years of experience in the financial markets, most recently as Senior Research Analyst for 451 Research, a division of S&P Global Market Intelligence, where he established the research channel focusing on the intersection of macroeconomic and IT industry trends.

Synthesizing top-down and bottom-up analysis into a third stream, TSR connects patterns of innovation, macroeconomic structures and behavior, and qualitative research to identify decisive factors influencing valuation. This approach was the basis for the creation of Third Stream Research.

Apart from independent research, TSR provides sponsored research and advisory services to help companies build recognition of intrinsic value in the Wall Street community, strengthen the foundation of shareholders, raise trading volume/liquidity, and lower the cost of capital.

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