ImmunoPrecise Antibodies Ltd. (IPA-TSXV)
FQ2/19: Timing Off But Thesis Intact

Unless otherwise denoted, all figures shown in C$

FQ2/19 Miss: Last week, IPA released Q2 results (quarter ending October 31, 2018), which were well short of our projected numbers (Figure 1). Revenue of $2.7 MM was up 106% Y/Y but missed our $3.5 MM forecast. Moreover, a lower margin service mix and jump in SG&A yielded an adjusted EBITDA loss of $0.7 MM, missing our $0.3 MM loss estimate. Continuing to invest in building out the global infrastructure to prepare for an expected significant jump in revenue over the next 1-2 years, net loss of $1.5 MM also worsened Y/Y, missing our $1.1 MM loss estimate. Diluted loss per share of $0.02 was flat Y/Y and a penny shy of our forecast. With the help of proceeds from the $9.1 MM private placement which closed in September, IPA exited the quarter with $8.8 MM of cash. This will go toward continuing to build out the service offering, expanding the management team and investing in capital equipment to improve operational efficiency.

Seasonal Weakness Impacts Revenue: When we published our initiation report, we highlighted that our quarterly revenue forecast at this early stage is still speculative. FQ2’s miss is a clear example of this. Revenue of $2.7 MM missed our $3.5 MM forecast by a significant margin. We attribute most of this miss to a lower-than-expected contribution from IPA’s high priced, high margin B-cell and transgenic animal antibody discovery services. There is no question that demand for these services has been strong. For example, the B-cell facility in Victoria, B.C. is booked out months in advance, which prompted IPA to expedite the launch of its European B-cell offering at ModiQuest in July. However, the high price tag has caused many potential customers to delay closing of these service contracts until the new year. This has to do exclusively with budgeting and not industry demand.

Making matters worse, we witnessed some weakness in European sales as business tends to slow down over the summer holidays. Management anticipates that revenue for FQ2 will be the weakest for the year. As such, we maintain our revenue forecast for the remainder of the fiscal year, assuming any pending high value contracts close early in C2019. Despite the top line miss, organic growth for the quarter was nothing to balk at. Backing out revenue contributions from U-Protein ($1.0 MM) and ModiQuest ($0.7 MM), IPA’s legacy business grew 62% Y/Y, similar to that witnessed over the prior three quarters.

Service Mix In Transition: Gross profit of $1.4 MM was up 240% Y/Y, however, also missed our $2.0 MM forecast. In addition to the impact of the revenue miss, gross margins slipped from 55% to 52% Q/Q (we had predicted flat margins). This is due to service mix, namely one large lower margin project, which skewed numbers, as well as lower-than-expected contribution from B-cell and transgenic projects. IPA expects gross margins to remain above 50% for the balance of F2019. We are more confident in our projections, forecasting that margins will inflect back up to 55-60% in FH2/19 (similar to performance in FH2/18), especially as B-cell and transgenic work grow as a proportion of sales.

Our disclosure statements are located on the second last page of this report.
Still In The Build Out Phase: SG&A expenses jumped to 79% of gross revenue from 67% Q/Q (vs our 64% forecast). This stems from IPA continuing to invest in building out its infrastructure to support long-term growth initiatives. For example, in an effort to better manage the now global landscape, continued integration of the new European operations caused professional fees to jump >20% Q/Q. Further, IPA adopted a new ERP/CRM system for marketing and sales management, financial reporting, resource planning and project management. It has also been growing its scientific and management teams and has adopted new HR initiatives, including linking remuneration to targeted revenue, and updating job descriptions and compensation plans. During the quarter, IPA incurred one-time costs of $141,000 (without which, SG&A would have been 74% of revenue). This included expenses related to improving operational efficiency, paying out former consultants, integrating ModiQuest and U-Protein and continuing to establish a global platform for reporting and oversight. The quarter also included an annual profit sharing payment of $289,576 to former U-Protein shareholders, which will cease after 2020. We now anticipate these one-time restructuring costs will persist over the near term before subsiding in F2020.

Tweaking Our Forecast: The only change we’ve made to our go forward revenue has been to take down Q2/F20 numbers from $7.7 MM to $7.2 MM to account for client budgeting and European summer seasonality. We’ve made no changes to our gross margin forecast assuming the backlog of high value deals close at the beginning of C2019. Lastly, we have increased SG&A expenses assuming temporary restructuring costs persist for the next 6-12 months as IPA continues to work toward repositioning itself for long term success. SG&A now averages 69% and 54% of our gross revenue for F2019 and F2020, respectively, up from 62% and 53% previously.

Not For The Faint Of Heart: We remind investors that IPA is still in the very early stages of repositioning itself in the antibody discovery CRO market. In our opinion, it now has all the markings of a company positioned to thrive. This includes an experienced management team (last week added a VP of Operations and new CFO expected to be announced any day), a one-of-a-kind service offering and the cash/infrastructure to support growing market demand. While our view on timing remains speculative, we remain confident in our thesis with respect to IPA’s growth trajectory.

We maintain our Buy (S) recommendation and $1.00 price target.

Figure 1: FQ2/19 Summary Results

<table>
<thead>
<tr>
<th>$000s (except per share)</th>
<th>FQ2/19E</th>
<th>FQ2/19A</th>
<th>Delta</th>
<th>FQ1/19A</th>
<th>Q/Q %</th>
<th>FQ2/18A</th>
<th>Y/Y %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>3,550</td>
<td>2,717</td>
<td>(23.5%)</td>
<td>2,873</td>
<td>(5.4%)</td>
<td>1,316</td>
<td>106.4%</td>
</tr>
<tr>
<td>COGS</td>
<td>1,580</td>
<td>1,315</td>
<td>(16.8%)</td>
<td>1,305</td>
<td>0.8%</td>
<td>905</td>
<td>45.3%</td>
</tr>
<tr>
<td>Gross Profit</td>
<td>1,970</td>
<td>1,402</td>
<td>(28.9%)</td>
<td>1,568</td>
<td>(10.6%)</td>
<td>411</td>
<td>240.9%</td>
</tr>
<tr>
<td>Gross Margin</td>
<td>55.5%</td>
<td>51.6%</td>
<td>-391bps</td>
<td>54.6%</td>
<td>-298bps</td>
<td>31.2%</td>
<td>2035bps</td>
</tr>
<tr>
<td>SG&amp;A</td>
<td>2,272</td>
<td>2,146</td>
<td>(5.6%)</td>
<td>1,916</td>
<td>12.0%</td>
<td>931</td>
<td>130.5%</td>
</tr>
<tr>
<td>Adj. EBITDA</td>
<td>(302)</td>
<td>(744)</td>
<td>146.6%</td>
<td>(348)</td>
<td>114.0%</td>
<td>(520)</td>
<td>43.1%</td>
</tr>
<tr>
<td>Adj. EBITDA Margin</td>
<td>-8.5%</td>
<td>-27.4%</td>
<td>-1889bps</td>
<td>-12.1%</td>
<td>-1528bps</td>
<td>-39.5%</td>
<td>1211bps</td>
</tr>
<tr>
<td>Net Income</td>
<td>(1,099)</td>
<td>(1,486)</td>
<td>35.1%</td>
<td>(1,102)</td>
<td>34.8%</td>
<td>(903)</td>
<td>64.5%</td>
</tr>
<tr>
<td>Diluted EPS</td>
<td>($0.01)</td>
<td>($0.02)</td>
<td>35.6%</td>
<td>($0.02)</td>
<td>16.1%</td>
<td>($0.02)</td>
<td>(2.9%)</td>
</tr>
<tr>
<td>BVPS</td>
<td>$0.33</td>
<td>$0.31</td>
<td>(6.8%)</td>
<td>$0.22</td>
<td>41.8%</td>
<td>$0.22</td>
<td>36.9%</td>
</tr>
</tbody>
</table>

Source: Company Reports, Cormark Securities Inc.
ImmunoPrecise Antibodies Ltd.
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