

## Corporate

 Current price **52p**

 Sector **Healthcare Equipment and Services**

 Code **FAB.L**

 Listing **AIM**

### Share Performance



% Change	1m	3m	12m
<b>FAB.L</b>	-40.0	-1.9	-58.0

Source: Thomson Reuters, Allenby Capital

### Share Data

 Market Cap (£m) **13.5**

 Shares in issue (m) **26.0**

52 weeks	High	Low
	<b>137p</b>	<b>36p</b>

 Financial year end **31 March**

Source: Company Data, Allenby Capital

### Key Shareholders

Invest Northern Ireland 12.3%

Amati Global Investors 9.0%

Viridian Growth Fund 7.0%

Octopus Investments 5.9%

Hargreave Hale 5.4%

Source: Company Data, Allenby Capital

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## Fusion Antibodies plc (FAB.L)

### *New impetus for growth*

Fusion's recent FY 22 results showed solid 15% growth in revenues – helped by two milestones earned from previous client projects - and a reduction in loss at the EBITDA level, despite an increased investment in R&D. Cash at the period end was £2m providing a runway well into FY24. We expect a 12% growth in revenue in FY23 with a H1:H2 split biased towards the second half of the year. We expect the new CEO to provide an impetus to sales & marketing efforts and spearhead the launch of the new OptiMAL service, a key event, later in the year. We expect a small contribution to revenue from OptiMAL in FY23 and continued growth in RAMP, together with a move towards larger and longer-term RAMP contracts. Both have the potential to generate downstream payments in the future, building long term value.

- Sales forecasts for FY23 maintained.** We are maintaining our FY23 revenue forecast of just over £5m (+12%), although expect there to be a bias towards the second half of the year. We believe this figure to be conservative as it makes no assumption of future milestones (which may be received) or the fact that sterling-translated US-dollar revenues should benefit from the weak pound. We have not assumed price inflation, although understand that Fusion has also been able to implement some price rises with recent contract wins.
- Costs held vs FY22.** We assume general/admin costs will be held level in FY23 relative to FY22, which included some one-off items in relation to personnel and professional fees. As a result, we expect an EDITDA loss of c. £1.3m in FY23.
- Key year with OptiMAL launch ahead.** Fusion is now approaching the final stages of developing its higher-value OptiMAL service and hopes to undertake some demonstration projects this year. Fusion could be the first in the industry to offer a service that generates antibodies that includes manufacturability optimisation and other desirable characteristics, potentially saving time and cost for clients. A key target is to generate the first commercial revenues from this service in FY23.
- Sensitivities.** We note the adverse stock market conditions for biotech over the past year could feed through to weakness in the market for antibody development services but understand Fusion has not seen evidence of this yet with inbound client inquiries remaining robust.
- Valuation:** Fusion's market capitalisation of £12m places it on an EV/sales of about 2.4x (based on FY22YE cash) or 2.2 on a prospective FY23 basis. This seems undemanding for a growth business about to launch an important new service. Fusion has a financial interest in 13 client projects under active development, four of which provide fixed success payments (with a maximum potential income of £1.2m) and nine with royalty interests.

Year End: March					
(£'000)	2020	2021	2022A	2023E Old	2023E New
REVENUE	3,895	4,165	4,799	5,040	5,040
ADJ. EBITDA	-437	-535	-573	-20	-1,172
ADJ. PBT	1,073	-1,264	-1,397	-384	-1,368
ADJ. EPS (p)	-3.2	-11.3	-3.8	-1.3	-4.8
NET CASH (£m)	1.38	2.52	2.00	0.65	0.56
EV/EBITDA (x)	NEG	NEG	NEG	NEG	NEG

Source: Company; Allenby Capital. Allenby Capital acts as Nomad &amp; Broker to Fusion Antibodies.

## Investment summary

Fusion Antibodies is a specialist contract research company that offers bespoke services in therapeutic and diagnostic antibody development/optimisation for clients worldwide. It is based in Belfast, Northern Ireland, having been formed as a spin-out from Queen's University. It has a staff of 55 people, the majority of which are scientists. Fusion recently appointed a new CEO, Dr Adrian Kinkaid, who is expected to spearhead the final development and commercialisation of a new technology, OptiMAL.

### Rational Affinity Maturation Platform (RAMP)

Fusion offers a package of services based around its Rational Affinity Maturation Platform (RAMP), which optimises candidate monoclonal antibodies to improve binding affinity and manufacturing yield. This can be applied to antibodies derived from standard high-throughput bacterial systems to more unusual ones, for example, those derived from camelids (Nanobodies). Within this market, Fusion has a strong reputation for being able to rescue non-optimised candidates that either have poor characteristics for use as a therapeutic or low production yields.

### Optimized Mammalian Antibody Library – next technological step

OptiMAL (Optimized Mammalian Antibody Library) is the next technological step. This technology has been developed over several years and potentially represents an industry first. The system is designed to work with stable, non-immunogenic human antibodies from the outset and performs screening and maturation on a focussed, high-quality human antibody gene library in mammalian cells. This means that the antibodies are immediately compatible with standard cell production systems and their structures are inherently more stable. As the genes are human in origin, the antibodies should also have much a lower risk of immune reactions in patients. As a premium service, this could become the major revenue generator in future.

### Financial interests in 13 client projects

Fusion typically offers its services on a project basis using fixed contracts. Academic customers work is usually performed on a pure fee-for-service, whereas agreements with commercial parties tend to include success milestones and/or a small royalty. As of 31 March 2022, Fusion held financial interests in 13 client projects it has previously worked on that are under active development, four of which offer fixed success payments (with a maximum potential income of £1.225m) and nine with royalty interests. Fusion has several prestige academic customers in the US and last year won an important potentially multiple product deal with a US VC funded start-up (this company is operating in stealth mode and its name has not been disclosed).

### Reputation for quality and reliability

Fusion operates in a competitive space and tends to have to win business based on its reputation for quality and reliability rather than price – it often has to compete against companies from lower-cost geographies (India, China etc). However, its fixed cost base in Northern Ireland is relatively low by Western standards, especially in comparison with the big US biotech centres (Massachusetts and California).

### Monoclonal antibodies - a mainstay of biotech drug development

Monoclonal antibodies have become a mainstay of biotech drug development in part because they are particularly attractive to pharmaceutical companies as a result of their favourable economics relative to traditional small molecules. Primarily this arises because antibodies are difficult to manufacture but conversely this means they are hard to copy, and thus, if successful, tend to have a longer effective commercial lives (before becoming subject to generic competition). Antibody drugs have to be manufactured in large-scale (and expensive) bioreactors and manufacturing yield is important for profitability.

The industry is now moving on from traditional monoclonal antibodies towards more complex antibody-based products, including bispecific antibodies or bispecific T-cell engagers (BiTEs). Fusion can help improve these products through optimisation of binding and manufacturing in the design stage. This is non-trivial since bispecific products require up to four genes to be inserted into the production cell line and combined correctly to make products, which makes manufacturing at high yield much more complex.

## Runway well into FY24

### FY22 results

Fusion Antibodies' recent FY22 results (12 months to end March) showed 12% underlying growth in sales (+15% including milestones). This was consistent with our forecasts and with the trading update issued in May. The company recorded an EBITDA loss of £0.6m (versus a loss of £0.5m in FY21) after R&D expenditure of £0.7m (vs £0.6m). Fusion ended the year with cash of £2.0m, which provides a runway well into FY24. One notable observation in the results was an increase in inventories of consumables (by c. 20% or £105k), which we understand was to avoid potential difficulties sourcing products in connection with the Northern Ireland-protocol/Brexit issue.

We have updated our forecasts and are maintaining our existing FY23 revenue of just over £5m (+12%). We believe this to be conservative as it does not assume any future milestones (although some may be received) or the fact that sterling-translated US-dollar revenues may benefit from the currently weak pound. In addition, we have not envisaged price rises, which are becoming a feature in the economy generally. We understand Fusion has also been able to implement some price rises with recent contract wins, without adverse consequences.

## H2 weighting

We expect the balance of revenue between the first and second halves of FY23 to favour the latter, in part because of personnel changes in sales and the absence of a CEO (from March to July) in the former period. Traditionally, the second half is stronger for antibody-based service companies (reflecting the timing of the academic budgeting cycles), although this was not the case in FY22 (possibly COVID related).

We have reviewed our assumptions around costs in FY23. We expect general and administrative costs, excluding R&D, to remain at around £3.1m in FY23. Fusion incurred some one-off professional and personnel costs (recruitment & training) in FY22 that are not expected to be repeated in FY23, and thus this figure allows for some inflationary growth in the underlying cost base. We have assumed R&D of £700k (£671k in FY22), although note this is to some extent discretionary. Our new model suggests an EBITDA loss of £1.2m and FY23 year-end cash of £0.6m.

## Finalising the development of OptiMAL

The company is approaching a key event as it finalises the development of OptiMAL and prepares for demonstration projects with potential beta-test partners. We understand there have been some delays to the development of OptiMAL caused by difficulties in sourcing specialist consumables over the last year, but Fusion has now managed to find a number of alternative suppliers.

### Sensitivities

We highlight that a potential consequence of the current adverse stock market conditions for funding biotech could be weakness in the market for antibody development services, although we understand that Fusion has not seen this to date and inbound customer inquiries remain strong. We also note there are multiple other longer-term macro-economic uncertainties, including the effect of inflation, strengthening US dollar, spiking energy costs and heightened geo-political uncertainty that may adversely affect results.

### Valuation

Fusion's market capitalisation of £12m places it on an EV/sales of about 2.4x (based on FY22 cash) or 2.2x on a prospective FY23 basis. We note Fusion has £10m of accumulated tax losses, which would in principle represent a deferred tax asset of c. £2m (i.e. this could be applied to future taxable profits). This is currently unrecognised (although it was recognised up to FY2021, prior to a change in accounting standards).

The new CEO appointment should allow Fusion to increase its visibility with investors, which has been lacking for a period and is probably, at least in part, a cause of its languishing share price.

**Exhibit 1: Summary income statement**

Year end March (£000s)	2021	2022	2023E
<b>Revenues</b>	<b>4,165</b>	<b>4,799</b>	<b>5,039</b>
Cost of goods sold	-2,141	-2,333	-2,570
<b>Gross Profit</b>	<b>2,024</b>	<b>2,466</b>	<b>2,469</b>
<i>Gross margin</i>	<i>48.6%</i>	<i>51.4%</i>	<i>49.0%</i>
Other income	194	30	20
R&D Expense	-613	-669	-700
G&A Expenses	-2,835	-3,131	-3,131
<b>Underlying operating profit</b>	<b>-1,230</b>	<b>-1,304</b>	<b>-1,342</b>
Share based payments	-19	-21	-21
<b>Adjusted EBITDA</b>	<b>-535</b>	<b>-573</b>	<b>-1,172</b>
<b>Operating Profit</b>	<b>-1,249</b>	<b>-1,324</b>	<b>-1,362</b>
Interest income	-15	-8	-6
<b>Profit Before Taxes</b>	<b>-1,264</b>	<b>-1,332</b>	<b>-1,368</b>
Current tax income	-1,635	120	126
<b>Net Income</b>	<b>-2,899</b>	<b>-1,212</b>	<b>-1,242</b>
<b>EPS (p)</b>	<b>-11.3</b>	<b>-4.7</b>	<b>-4.8</b>
Average no. of shares (m)	25.6	25.8	26.0

Source: Company; Allenby Capital

**Exhibit 2: Summary balance sheet**

Year end March (£000s)	2021	2022	2023E
<b>Current assets</b>	<b>4,705</b>	<b>4,282</b>	<b>2,880</b>
Cash and cash equivalents	2,686	2,049	629
Accounts receivable	1,440	1,517	1,588
Inventories	480	585	563
Other current assets	99	131	100
<b>Non-current assets</b>	<b>1,125</b>	<b>633</b>	<b>538</b>
Property, plant & equipment	1,123	633	538
Intangible assets	2	0	0
Other non-current assets	0	0	0
<b>Current liabilities</b>	<b>-996</b>	<b>-1,208</b>	<b>-1,257</b>
Short-term debt	-163	-66	-66
Accounts payable & accruals	-344	-466	-515
Accruals/deferred revenues	-373	-561	-561
Tax payables	-71	-68	-68
<b>Non-current liabilities</b>	<b>-87</b>	<b>-23</b>	<b>-23</b>
Other non-current liabilities	-87	-23	-23
<b>Equity</b>	<b>4,747</b>	<b>3,684</b>	<b>2,138</b>

Source: Company; Allenby Capital

**Exhibit 3: Summary cash flow**

Year end March (£000s)	2021	2022	2023E
<b>Operating cash flow</b>	<b>-1,136</b>	<b>-325</b>	<b>-1,325</b>
Net income	-2,899	-1,200	-1,242
Non-cash adjustments	748	780	211
Change in working capital	-688	127	0
Interest paid/(received)	0	0	6
Taxes paid/(received)	1,703	-32	-300
<b>Investing cash flow</b>	<b>-362</b>	<b>-257</b>	<b>-95</b>
Capex on tangible assets	-365	-258	-95
<b>Financing cash flow</b>	<b>2,647</b>	<b>-46</b>	<b>0</b>
Proceeds from equity	2,815	116	0
Repayment of borrowings	-182	-162	0
Other financing cash flow	14	0	0
<b>Net increase in cash</b>	<b>1,149</b>	<b>-637</b>	<b>-1,420</b>
<b>Cash at start of year</b>	<b>1,537</b>	<b>2,686</b>	<b>2,049</b>
<b>Cash at end of year</b>	<b>2,686</b>	<b>2,049</b>	<b>629</b>
<b>Net cash at end of year</b>	<b>2,523</b>	<b>1,983</b>	<b>563</b>

Source: Company; Allenby Capital

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