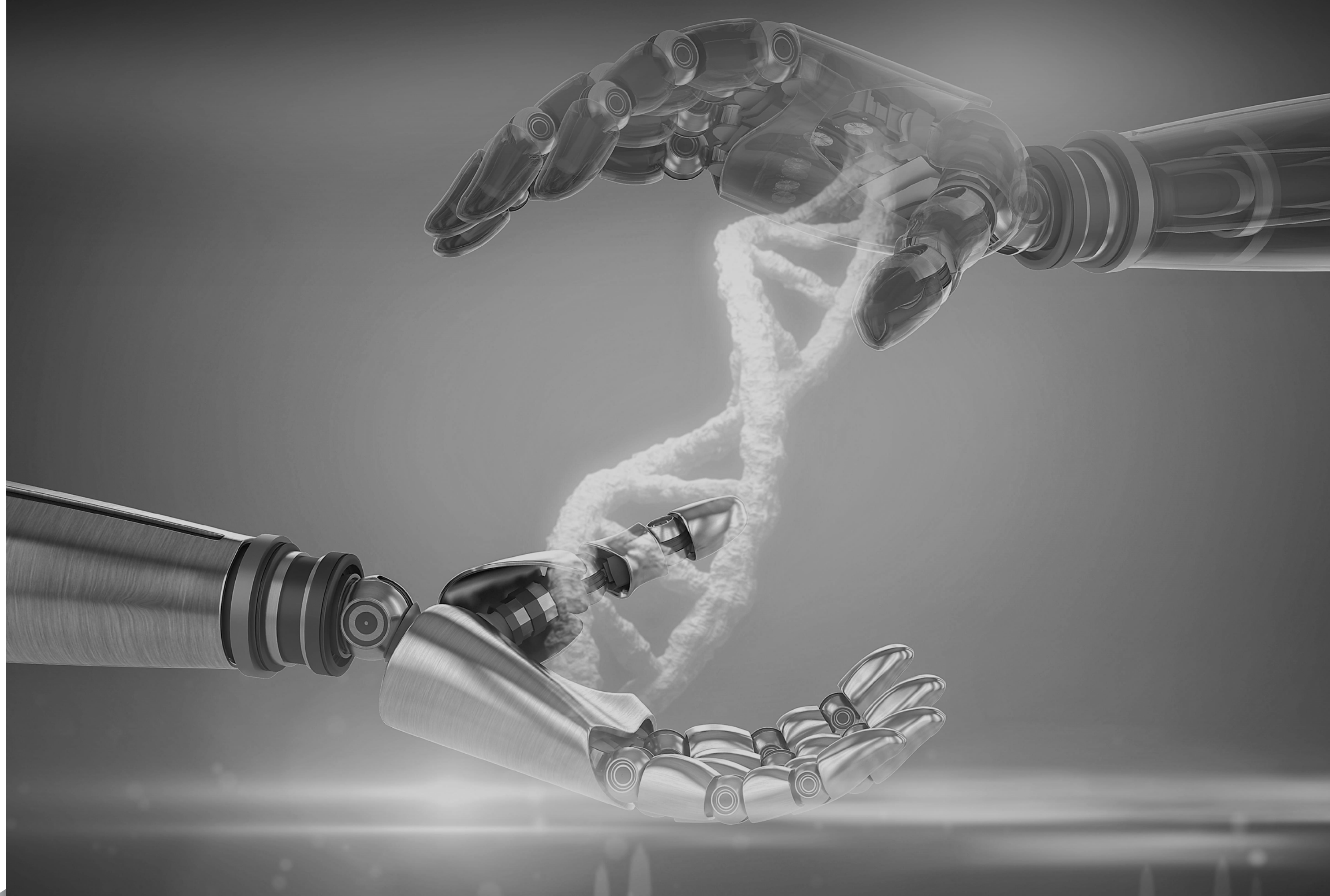
STOCKS DOWN UNDER

7 JUNE 2022

Emerging Stocks Down Under

Risk is what you make of it.

- Kenneth Griffin (b. 1968), CEO of Citadel



POLYNOVO

The pandemic has only delayed its dreams, not ended them

POLYNOVO

The pandemic has only delayed its dreams, not ended them

Stocks Down Under rating: ★★★★

ASX: PNV
Market cap: A$757.7M

52-week range: A$0.84 / A$2.94
Share price: A$1.135

Capped at over $820m and up nearly 500% in five years, Polynovo (ASX: PNV) has been one of the ASX's most prominent Biotechs. Its NovoSorb technology has been commercialised but has barely reached its full potential. Polynovo's path has not been without setbacks and investors have punished the company in the past year. But if market conditions return to normal, we believe there is a significant opportunity for the company to capture.

Share price chart

Source: Tradingview

Meet NovoSorb

Polynovo's signature technology is NovoSorb – a technology developed at the CSIRO and bought by the company in 2008, then known as Metabolic. Before picking up NovoSorb, Polynovo hung its hat on the infamous peptide AOD9604, conducting an obesity trial in 2007 that ultimately failed its trial endpoint.

NovoSorb is for ailments where the body may struggle to rebuild its own cells, particularly severe burns and wounds. It is a 2mm thick biodegradable polymer foam wound scaffolding that provides faster and better results compared to rival lattice products or skin grafts in treating severe wounds or burns resulting in the dermal layer of skin being lost. Essentially it provides a home for cells to migrate and disrupts the ability of collagen protein fibres to form knots and bundles.

Externally, NovoSorb looks like your typical foam parcel packaging, but it has multiple layers that cover the full dermis. It has no aromatic isocyanates or solvents and biodegrades through hydrolysis – through sweating and urine. In other words, it dissolves by itself over time, but lasts long enough to act as a scaffold to allow the company to rebuild its own cells. And it is less conducive to infection. The company's patent is the polymers themselves, but these can be produced in a range of different formats with different degradation properties and in different products.

NovoSorb was commercialised targeting wounds and burns use in the US and became FDA approved in 2015. This was a major step, but just the beginning given that burns were only 10% of its target market. The company kept growing as it sought to expand into new target markets, including reconstructive surgeries, hand surgeries, hernia repair and breast implants.

Pandemic setbacks

COVID-19, however, was a difficult time for the company. Initially the company appeared resilient to COVID-19 restrictions but by the northern winter of 2020-21, the company revealed it underperformed in certain markets. During this time, hospitals in northern hemisphere markets were full of COVID-19 patients leaving little room for Polynovo or for doctors to follow through on their reported thoughts on using Polynovo for indications the company hadn't pondered before. Even patients that would've found NovoSorb useful for what it was already approved for, couldn't use it because their elective surgeries were deemed non-essential and were consequently postponed. It also saw long-term managing director Paul Brennan depart.

The situation has gradually improved for the company. It achieved $18.2m revenue in 1HY22, up 41% from the year before and in January of FY22 surpassed $4m for the first time in the company's history. Although the US remains its largest market, it is also gaining traction in other markets such as the UK and Ireland where its sales grew 255% compared to 12 months ago.

Polynovo's last financial update came on 6 April 2022 in which it announced quarterly revenue of $12.3m and YTD revenue of $30.4m. In the US, its quarterly and annual sales were $9.5m and $23.7m respectively – up 79% and 66% over last year's March quarter. Unfortunately, the company has so far been unable to find a replacement CEO, but hopes to find one soon.

Here's why the dream is still alive

Consensus estimates are confident about the company's future, forecasting $67.2m in revenue and $11.0m in EBITDA in FY23, which would be up 60% and 1,060% from FY22 consensus estimates. Further improvement is expected in FY24 with $91.7m in revenue and $25.1m in EBITDA, up 35% and 127% from FY23. The stock is trading at high multiples; at 79.1x EV/EBITDA and 102.4x P/E for FY23, and at 34.8x EV/EBITDA and 45.5x P/E for FY24.

Polynovo is forecast to reach positive EBITDA faster than its closest peer Avita Medical (ASX: AVH), which is not expected to be EBITDA-positive until at least FY25. And one person who believes Polynovo can bounce back is chairman David Williams. During May 2022, he bought over $4m in shares on market. His name might ring a bell to some ASX investors as he also serves on the board of Medical Developments (ASX: MVP), which is selling the Penthrox front-line pain relief product, as well as his own advisory company Kidder Williams. And he is Chairman at RateMyAgent (ASX: RMY).

Polynovo is developing further products, hoping to file the 510K approval for its Matrix product before the end of FY22. It is recruiting for another pivotal burn trial, enrolling the first patients for a diabetic foot ulcers trial and is working on prototypes for a Hernia-focused version of NovoSorb. With all this R&D activity you might be forgiven for thinking this is another early-stage Biotech. But it already has a product on market that is recovering momentum lost during the worst of the pandemic in the Northern Hemisphere.

We think this stock is four stars, even if it had nothing further to offer shareholders other than its NovoSorb sales for wounds and burns. But it's R&D work provides hope not only that the stock can recover to highs seen in the recent past, but that new heights could be reached.

Pitt Street Research Pty Ltd

3 Spring Street, Sydney, NSW 2000, Australia