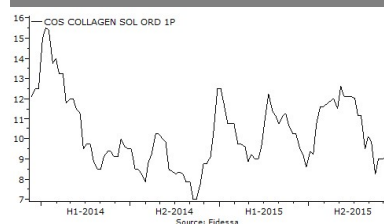


Healthcare Equipment & Services



Source: Fidessa

Market data

Price (p)	9.25
12m High (p)	14.75
12 Low (p)	6.75
Shares (m)	171.0
Mkt Cap (£m)	15.8
EV (£m)	14.3
EPIC	COS
Free Float* (%)	78%
Market	AIM

*As defined by AIM Rule 26

Description

Collagen Solutions is a biomaterials company developing and manufacturing medical grade collagen components for use in medical devices, regenerative medicine, and in vitro diagnostic products. It supplies value-added bio-functional collagen, provides R&D and contract manufacturing services to a broad range of clients, ranging from research organisations to multi-national corporates.

Company information

CEO	Stewart White
CFO	Gill Black
Chairman	David Evans

www.collagen-solutions.com

Tel 0141 558 9838

Next Event

Full year results	Jul 2016
AGM	Aug 2016

Analysts

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Collagen Solutions plc

Solid interim results

First half results to 30th September demonstrate clear progress against the Board's objective of creating a business with at least a £100m valuation by 2020. Proforma sales growth of 97%, driven by new customer contract wins and by pipeline progress from existing customers' medical device programmes. The potential for operations in China (via joint venture) and the development of a new production facility for a global device manufacturer are both in late stage discussions which would underpin longer term growth, if successfully executed. The long term pipeline continues to build with strategic collaborations.

- **Interim results:** Results benefited from the inclusion of the SLB acquisition, (Dec 2014), driving sales to £1.46m (£0.14m) although strong performance was also reported in the heritage business. A LBITDA of £79k was reported. Net cash outflow of £0.2m due to phased capex resulted in net cash of £3.1m.
- **Momentum building:** The market has often questioned the likelihood of meeting what are quite demanding growth expectations but evidence to date suggests that Company is on track. On a proforma basis assuming SLB inclusion in prior periods, sales growth was 97% and 38% on half yearly sequential basis.
- **Valuation:** Our DCF valuation remains unchanged at £73m or 39p per share. Whilst this is driven by the terminal value, which itself, is dependent on achieving year 5 free cashflow of c.£5.5m, the trajectory of travel in these results, together with the potential pipeline, provides us with confidence.
- **Risks:** Exact timing of development and manufacturing contracts and supply agreements remains uncertain, but recurring revenues do exist. Regulatory delays for client products remains a source of risk. Route to Chondromimetic commercialisation is currently in early stage planning.
- **Investment summary:** The Board's objective is to create a £100m business by 2020. We have not changed our forecasts for the current year and beyond. Not only has the company described two significant new opportunities (China JV and new dedicated collagen production facility) but it continues to build a pipeline of strategic relationships that should underpin and drive long term growth, whilst retaining a clear focus on delivering short term financial objectives.

Financial summary and valuation

Year end Mar (£000s)	2014	2015	2016E	2017E	2018E
Sales	24	973	3,700	6,500	10,500
Underlying EBITDA	-364	-726	-273	1,707	4,086
Reported EBIT	-480	-975	-768	1,147	3,456
Underlying PTP	-381	-921	-701	1,211	3,521
Statutory PTP	-480	-1,102	-751	1,161	3,471
Underlying EPS (p)	-0.9	-1.0	-0.4	0.5	1.4
Statutory EPS (p)	-1.1	-1.2	-0.4	0.5	1.4
Net (debt)/cash	1,492	3,282	1,951	1,095	2,493
Shares issued	3,374	5,422	0	0	0
P/E (x)	-10.6	-9.5	-21.9	17.9	6.5
EV/sales (x)	608.0	15.0	3.9	2.2	1.4
EV/EBITDA (x)	-40.2	-20.1	-53.6	8.6	3.6

Source: Hardman & Co Research

Investment summary

Demonstrable progress in 1H to achieving Board's 2020 goal of creating a business worth at least £100m

... illustrated by in-licensing opportunities and IP acquisition...

... with potentially more to come

Net cash of £2m and expectations of being EBITDA positive in 2H, the outlook is for self-funding business

Forecasts unchanged

Company travelling in the right direction

Albeit there remains uncertainty of exact timing on contract orders

First half results to 30th September demonstrate clear progress against the Board's objective of creating a business with at least a £100m valuation by 2020. There was clear evidence of underlying growth in the business, as illustrated by the supply agreements announced during the period, coupled with a full six-months' contribution from the Southern Lights Biomaterials (SLB) acquisition which completed in December 2014.

Furthermore, management demonstrated their collective capabilities of bringing in-licensing opportunities to the Company as well as acquiring additional intellectual property (IP) and assets that we expect will contribute to this target over the next 4 years. With a diversified and internationalised business already, the Chairman, in his statement and highlighted also in the results presentation, described the potential establishment of a joint venture in China during 2016 which should add further to the revenue base, given the potential demand within this market.

With c. £2m net cash expected at the year end 31 March 2016 (£3.1m at 30 September) and the expectation that the business will become EBITDA positive in the second half (confirmed in the Chairman's statement), the outlook is for a self-funding, high growth business that should supplement this organic growth with further bolt-on acquisitions and in-licensing opportunities.

We are leaving our forecasts unchanged. Whilst the forecast suggests a further step up in sales in the second half to £2.2m from the £1.46m reported in the first half (£3.7m for the full year), the opportunities for incremental growth remain strong, given contract wins and existing customer product approvals. Whilst the Company accepts there remains "a degree of uncertainty regarding the exact timing of contract execution", the progress in the first half should provide investors with a high degree of confidence that the Company is travelling in the right direction.

Our DCF valuation remains unchanged at £73m or 39p per share. This is based on forecast cashflows to 2018, projected cashflows thereafter to 2021 and a 2% terminal growth rate. As visibility to contracts improves so too are forecasts likely to be underpinned/rise, with the full value of the technology platforms increasingly being reflected in the share price.

Interims to 30 September 2015

Summary of Interim results					
£,000	1H 15	2H 15	FY 15A	1H 16	Delta
Sales	143	830	973	1,442	1,299
Gross Profit	12	119	759	1,091	1,079
Underlying EBITDA	(510)	(216)	(726)	(74)	436
Reported EBITDA	(522)	(168)	(690)	(79)	443
Underlying EBIT	(549)	(244)	(793)	(211)	338
Reported pre-tax	(561)	(542)	(1,102)	(356)	204
Underlying net income	(549)	(393)	(942)	(425)	123
Underlying Basic EPS					
(p)	(0.86)	(0.12)	(0.98)	(0.25)	0.61
Statutory basic EPS (p)	(0.88)	(0.29)	(1.17)	(0.26)	0.62
Net cash (£m)	3.3		3.3	3.1	(0.20)
<i>Underlying EBITDA excludes share based compensation and other income (grants)</i>					

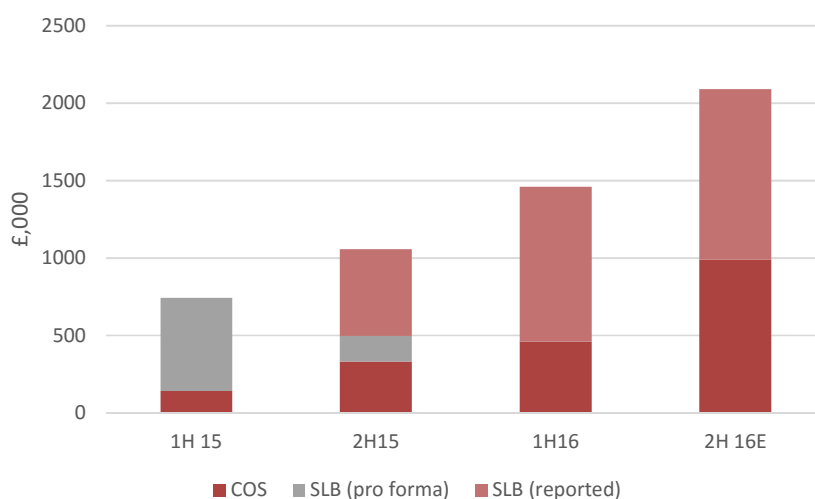
Source: Hardman & Co Life Sciences Research

Summary of 1H results

**Proforma YoY growth of 97%,
driven by both SLB and Collagen**

Revenues were £1.46m against £0.14m in the comparative period, driven to a significant extent by a full six months' contribution from the December 2014 acquisition of Southern Lights, which contributed c.£1.0m to sales, up c.70% over the comparable period (on a pro-forma 6-month basis). This implied proforma sales growth for the Group of 97% in 1H 2016, assuming proforma sales of c.£0.74m in the comparative period.

Proforma sales growth



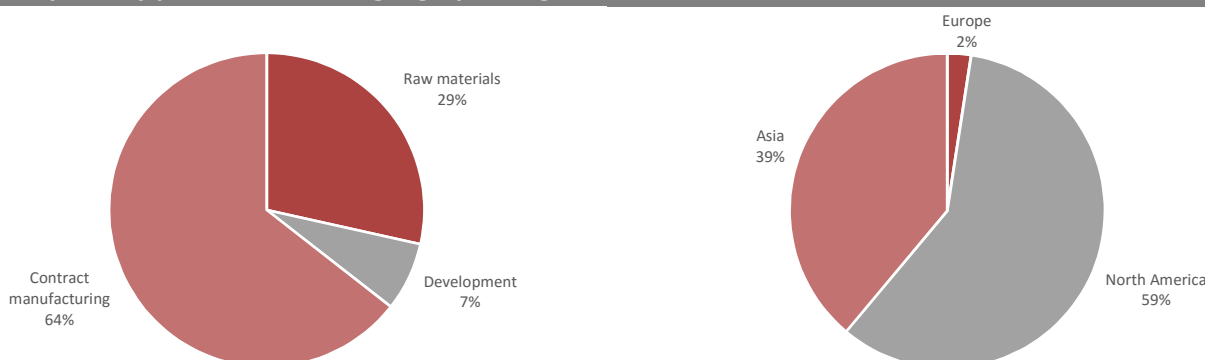
**Proforma sequential 1H 16 vs 2H
15 growth of 38%**

Source: Hardman & Co Life Sciences Research

For the sake of completeness, proforma sales for 2H 15, assuming a full 6 months contribution from SLB rather than the 4 months in which it was actually consolidated, were c.£1.06m (vs. £0.89m reported). This implied sequential growth (1H 16 vs 2H 15) of c.38% and reflected the strong demand for across Collagen's product range.

The split of sales by activity and geography are highlighted below.

Sales analysis – by product area and geographic region



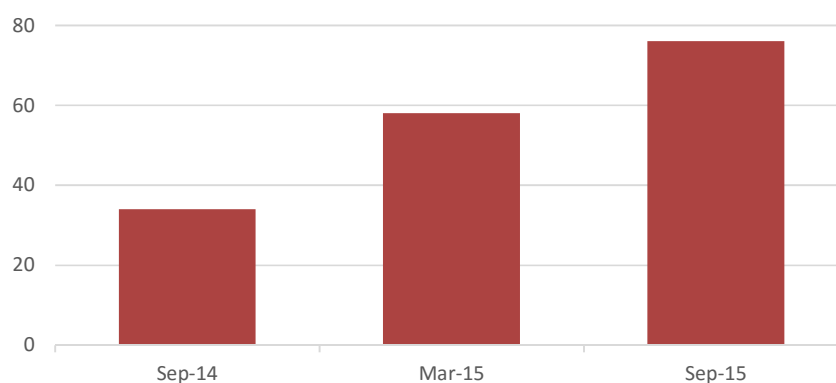
Source: Hardman & Co Life Sciences Research

Compared with the full year 2014/15, contract manufacturing sales have risen as a percent of total sales, reflecting the growth in new customer wins over the past 12 months.

**Customer based more than doubled
over the past 12 months**

As of 30th September 2015, Collagen Solutions had 76 active customers compared with 58 at the end of March 2015. On a proforma basis the comparative number of active customers at 30th September 2014 was 34, implying 124% growth in customers over the past year. This should provide further evidence that Collagen's breadth of offering, resonates well with the broad and diverse customer base.

Active customers



Source: Hardman & Co Life Sciences Research

Whilst the average revenue per customer is still relatively low, implying a large number of small academic clients, it has approximately doubled to an annualised £36k per customer at the half year. This trend is expected to continue and whilst it generates only marginal economies of scale at the gross margin, there are clearly benefits at the EBITDA level.

**A geographically diverse customer
base: US 59% and Asia 39%**

With respect to geographical exposure North America remains the largest marketplace accounting for 59% of sales. Asia, given a full 6 months contribution from SLB's largest customer in Korea, now represents 30% of group sales. Europe will be an area of focus for the Company in the coming months once Desu Medical receives CE Mark approval.

Whereas the Korean customer represented c.63% of SLB sales in 2014 prior to the acquisition, it now represents c.30% of group sales (c.£0.44m).

**LBITDA of £79k, but lower than
anticipated**

Collagen Solutions reported a LBITDA of £79,000 which compares with a loss of £522,000 in the comparative period. Stripping out share based compensation of £24,000 and other income of £18,352, our underlying adjusted LBITDA was £74,000. Two opposing factors influenced the lower than anticipated loss:

- ▶ Gross margins for the period were 75.7%, lower than the 78% reported for the full year. This was attributed to a relatively large contract supplying lower margin pericardium (for use in a heart valves). We don't expect pericardium sales in the second half to be such a high proportion of sales and consequently anticipate gross margin to be c.78% for the full year
- ▶ Operating expenditures were lower than anticipated, amounting to £1.165m (£0.629m in 1H 15), which were attributed to delays in certain headcount hires as well as phasing of R&D. These are expected to be broadly in line with previous expectations for the full year.

As a consequence of amortisation and depreciation charges (£156k) and a finance expense (£126k) relating to the interest accruing on the deferred portion of the SLB acquisition costs, a pre-tax loss of £356,000 was reported which compared with

£560,000 in the comparative period. A statutory loss per share of 0.26p was reported; a loss of 0.25p once adjusted for share based compensation and amortisation.

The Group ended the half-year with net cash balances of £3.1m, implying a cash outflow of £0.2m in 1H 2016 which was largely attributed to £0.149m of capital expenditure on the Glasgow facility and the purchase of ChondroMimetic licensed IP and patents, which amounted to £92,523.

*... expected to be c.£2m at year end
31 March given higher 2H capex*

Capital expenditure for the full year is still expected to be c.£750k, implying 2H 16 expenses of £0.6m which can be attributed to increased capacity at its Glasgow facility and a new multi-purpose processing facility in New Zealand which will enable the Company to prototype new product developments and provide for specialised pericardium processing capabilities.

Key highlights

The Company is considered to have made substantial progress in 1H 2015/16, increasing the number of customers from 58 to 76, as well as broadening the product offering to include pericardium as well as functional collagens.

The following table illustrates the geographical spread of customers as well as the type of product area in which Collagen is able to supply relevant functional collagens.

Customer base		
Company	Product area	Opportunity
Desu Medical (Turkey)	Brain, spine	Awaiting CE Mark in 2H which should lead to increased volume sales of functional collagen
Histogenics (USA)	Cartilage repair	Approached COS to supply functional collagen in US Phase III study for an autologous cartilage repair product. Histogenics is targeting a 2018 launch but revenues will be generated in 2016/17
Globus Medical (USA)	Bone graft	Supplying collagen as part of Kinex resorbable osteoconductive scaffold for European use
NovaBone (USA)	Bone graft	Included in 5 FDA-approved products
Kyeron Medical (Holland)	Woundcare	Development work on woundcare products but opportunity to up sell
Customer X (Korea)	Dental	Currently 30% of group sales but looking to cross sell other products to this undisclosed company
Customer Y (Canada)	Heart valves	Supplying pericardium for use in a next generation heart valves as well as transcatheter heart valves

Source: Hardman & Co Life Sciences Research

Outlook

Our forecasts for the current year assume another step up in revenues in 2H FY16 which we consider achievable given the momentum already established following the integration of SLB into the group as depicted by the increased number of active customers. Sequential proforma growth in 2H FY 15 and 1H FY 16 was 42% and 38%, respectively with actual proforma sales increases of £0.3m and £0.4m, respectively. Our forecasts for FY 16 imply 2H FY 16 incremental sales growth of 53% and sales of £0.78m.

Given the successful technology transfer of bone graft processing from California to Glasgow during 1H, together with the anticipated CE Mark for Desu Medical in 2H FY 16, amongst other initiatives, this is not an unattainable target although clearly the exact timing of contracts is difficult to predict.

Three potentially significant growth opportunities

... Chinese joint venture

Collagen referenced three potentially significant growth opportunities beyond the current strategic goals of winning new customers as well as upselling volumes and cross selling products to its existing customer base, which it hopes will crystallise during 2016, namely:

- ▶ Establishment of a joint venture company in China to exploit this large and growing market. The Company envisages selling a range of collagen products (liquid, powder, gel and pericardium) through a joint venture partnership. In addition, it will potentially develop and manufacture devices in China for both local consumption as well as exports, given the quality systems that already exist within Collagen Solutions.

... Dedicated processing facility in New Zealand

- ▶ Construction of a dedicated processing facility to satisfy the needs of an undisclosed large global medical device manufacturer. Whilst final terms have still be agreed, the customer is looking to have its functional collagen production manufactured in New Zealand. Whilst such a project is unlikely to impact 2016, given the time needed for construction and validation, it could significantly underpin 2017 and 2018 forecasts.

... Chondromimetic family of products

- ▶ ChondroMimetic opportunity. This follows the September announcement (Hardman & Co report, 14 September 2015) of the acquisition of IP and related assets of ChondroMimetic, a collagen implant for the repair of small articular cartilage defects. The Company has indicated that the exploitation of this technology platform, which could generate multiple product opportunities (cartilage, ligament, rotator cuff, meniscus and bone graft), will require a separate management team. It is hoped that in early 2016, Collagen Solutions will be able to outline its proposed strategic review and commercialisation plan for ChondroMimetic.

3-year supply agreement for soluble collagen to be used in in vitro diagnostics products

Post results announcement

Collagen Solutions announced on 7th December that it has signed a three year (with subsequent one year rolling) supply agreement to provide soluble collagen to BBI Solutions OEM Limited, a UK-based business that develops and manufactures both raw materials and finished test platforms for the *in vitro* diagnostics market. Not only does this provide exposure of the Company to the IVD reagents market, but it begins to address one of the short term revenue targets that management has been discussing; utilising some of the spare capacity for soluble collagen at its Glasgow facility (indications that peak capacity at median prices is c.\$5m) as well as polymeric collagen at its New Zealand facility (\$8m of revenues at median prices).

Financial summary

Profit & Loss Account					
Year end Mar (£000s)	2014	2015	2016E	2017E	2018E
Sales	24	973	3,700	6,500	10,500
Cost of goods	-12	-214	-798	-1,469	-2,415
Gross Profit	12	759	2,903	5,032	8,086
Administrative expenses	-304	-1,266	-1,575	-1,500	-1,800
Selling and marketing costs	-72	-219	-1,150	-1,275	-1,550
R&D	0	0	-450	-550	-650
Underlying EBITDA	-364	-726	-273	1,707	4,086
Depreciation	-13	-75	-200	-265	-335
Amortisation	-4	-55	-245	-245	-245
Other income	0	63	0	0	0
Underlying EBIT	-381	-793	-718	1,197	3,506
Share based costs	-25	-27	-50	-50	-50
Exceptional items	-75	-155	0	0	0
Statutory Operating profit	-480	-975	-768	1,147	3,456
Net financial income	0	-128	17	15	15
Underlying Pre-tax profit	-381	-921	-701	1,211	3,521
Exceptional items	0	0	0	0	0
Reported pre-tax	-480	-1,102	-751	1,161	3,471
Reported taxation	0	-21	-18	-323	-854
Underlying net income	-381	-942	-719	888	2,666
Statutory net income	-480	-1,124	-769	838	2,616
Period-end shares (m)	63.8	171.0	179.0	187.0	187.0
Weighted average shares (m)	43.7	96.4	171.0	172.3	187.0
Fully diluted shares (m)	47.7	102.3	176.9	178.2	192.9
Underlying Basic EPS (p)	-0.87	-0.98	-0.42	0.52	1.43
U/I fully-diluted EPS (p)	-0.87	-0.98	-0.42	0.50	1.38
Statutory basic EPS (p)	-1.10	-1.17	-0.45	0.49	1.40
Statutory fully-diluted EPS (p)	-1.10	-1.17	-0.45	0.47	1.36
DPS (p)	0.00	0.00	0.00	0.00	0.00
Key metrics	2014	2015	2016E	2017E	2018E
Growth					
Sales		3950%	280%	76%	62%
Gross profit		6257%	282%	73%	61%
Operating profit		n/a	n/a	n/a	193%
EPS		n/a	n/a	n/a	177%
DPS		n/a	n/a	n/a	n/a
Operating ratios					
Cost of goods	50.3%	22.0%	21.6%	22.6%	23.0%
Gross margin	49.7%	78.0%	78.4%	77.4%	77.0%
Admin	1264.0%	130.1%	42.6%	23.1%	17.1%
Sales & Marketing	299.4%	22.5%	31.1%	19.6%	14.8%
EBITDA	nm	-74.6%	-7.4%	26.3%	38.9%
Operating profit	nm	-81.5%	-19.4%	18.4%	33.4%
Reported tax rate	0.0%	-1.9%	-2.5%	27.8%	24.6%

Source: Hardman & Co Life Sciences Research

Balance Sheet					
At 31 March (£000s)	2014	2015	2016E	2017E	2018E
Shareholders funds	6,256	12,853	12,294	14,182	16,849
Cumulated goodwill	0	0	0	0	0
Total equity	6,256	12,853	12,294	14,182	16,849
Share capital	683	1,755	1,835	1,915	1,915
Reserves	5,573	11,099	10,460	12,268	14,934
less: Cash	1,492	3,391	2,061	1,204	2,602
less: Marketable securities	0	0	0	0	0
less: Non-current investments	-2,409	-4,320	-4,320	-911	89
Invested capital	7,174	14,176	14,948	14,283	14,552
Fixed assets	232	794	1,319	1,879	2,494
Intangible assets	6,894	12,919	12,674	12,429	12,184
Stocks	39	219	369	569	819
Trade debtors	0	419	569	794	1,094
Other debtors	167	226	497	-506	-201
Trade creditors	0	-215	-295	-395	-515
Tax liability	0	-40	-40	-342	-1,178
Other creditors	-160	-144	-144	-144	-144
Debtors less creditors	7	245	587	-593	-944
Invested capital	7,174	14,176	14,948	14,283	14,552

Source: Hardman & Co Life Sciences Research

Cashflow					
Year end Mar (£000s)	2014	2015	2016E	2017E	2018E
Operating profit	-381	-793	-718	1,197	3,506
Depreciation	13	75	200	265	335
Amortisation	4	55	245	245	245
Stocks	-13	-127	-150	-200	-250
Working capital	-72	-166	-70	-125	-180
Exceptionals/provisions	-75	-155	0	0	0
Other (Fx)	-1	-87	0	0	0
Net cash used in operations	-525	-1,199	-493	1,382	3,656
Net interest	0	-4	17	15	15
Tax	0	-25	-21	-18	-323
Operational cashflow	-525	-1,227	-497	1,378	3,348
Capital Expenditure	0	-159	-725	-825	-950
Free cashflow	-525	-1,373	-1,222	553	2,398
Dividends	0	0	0	0	0
Acquisitions	-1,357	-2,190	0	-1,409	-1,000
Other investments	0	-68	0	0	0
Cashflow after investments	-1,882	-3,631	-1,222	-856	1,398
Share issues	3,374	5,422	0	0	0
Currency effect	0	0	0	0	0
Change in net debt	1,492	1,791	-1,222	-856	1,398
Opening net cash	0	1,492	3,282	2,061	1,204
Closing net cash	1,492	3,282	2,061	1,204	2,602
Hardman CF/share (p)	-1.20	-1.27	-0.29	0.80	1.79

Source: Hardman & Co Life Sciences Research

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