EQUITY RESEARCH

RBC Capital Markets, LLC

March 1, 2022

RBC Capital Markets U.S. Small Cap Growth Idea List

March Update

RBC Capital Markets US Research is updating its Small Cap Growth Idea list. This is a quarterly list of our highest conviction Small Cap Growth recommendations. The list is an opportunity to highlight companies that have either an attractive normalized growth story or strong durable growth characteristics. We feature companies with market capitalizations below $5 billion (as of joining the list), and a minimum average daily trading value of $10 million.

Our updated list includes software names **JAMF Holdings, Rapid7** and **PING Identity Holding.** We add software name **Varonis Systems** as we believe the company is in the early stages of penetrating a $47 B unstructured data market that includes fragmented competition, while continuing to innovate new technologies that leverage its Metadata Framework. Ad-tech player **Pubmatic** remains on the list and we add **Coursera** for exposure to edtech as we believe education has been irreversibly changed and the company's multi-segmented approach (consumer, enterprise, higher education) creates a powerful flywheel effect and a sustainable economic moat. In Payments, we reiterate our conviction in **Shift4 Payments** and **Flywire.** In healthcare technology and services, **OptimizeRx** remains a high conviction idea as does **Surgery Partners**. **Avid BioServices** is added to the list as a pure-play contract development and manufacturing organization (CDMO) specialized in biologics – the fastest growing segment of drugs in development, which, along with accelerated demand for COVID-related treatments, has created what we view as a sustainable supply-demand imbalance for at least the next few years. In biopharma, we reiterate conviction in **Global Blood Therapeutics, Intra-Cellular Therapies** and **Sarepta Therapeutics.** We add **Pacira Biosciences** which we believe is well positioned to drive continued growth from its flagship product, EXPAREL, while benefiting from several thematic tailwinds including ongoing volume shift to the outpatient/ASC setting. In industrials, **Kratos Defense & Security Solutions** remains a high conviction idea. In energy, **Matador Resources** and **Sunnova Energy International** remain on the list, and we add **Fluence Energy** which is well-positioned as a pure-play leader in the 200 GW+ global grid-scale energy storage market we estimate to grow by 30% CAGR through 2030. Within financials, insurance names **Goosehead Insurance** and **Kinsale Capital Group** remain on the list. Please see the body of this note for additional details on each name's investment thesis and as always, we encourage you to reach out to the team with any questions.

Additions (5): Avid BioServices, Inc., Coursera Inc.; Fluence Energy, Inc.; Pacira Biosciences, Inc.; Varonis Systems, Inc.

Deletions (3): Arena Pharmaceuticals; Cerence; CarGurus

Exhibit 1 - RBC Capital Markets Small Cap Growth Idea List

Company	Pricing Symbol	Analyst	Rating	Trading Currency	Closing Price (02/28/2022)	Market Cap (MM)	Price Target	Dividend Yield (%)	Implied All-in Return (%)
Intra-Cellular Therapies, Inc.	ITCI US	Brian Abrahams	Outperform	USD	55.48	4,925	65.00	0.00	18.0
Sarepta Therapeutics, Inc.	SRPT US	Brian Abrahams	Outperform	USD	76.61	5,976	145.00	0.00	89.3
Avid Bioservices, Inc.	CDMO US	Sean Dodge	Outperform	USD	20.48	1,303	32.00	0.00	56.3
OptimizeRx Corporation	OPRX US	Sean Dodge	Outperform	USD	45.29	833	100.00	0.00	120.8
Goosehead Insurance Inc	GSHD US	Mark Dwelle	Outperform	USD	86.98	3,157	140.00	0.00	61.0
Kinsale Capital Group, Inc.	KNSL US	Mark Dwelle	Outperform	USD	209.76	4,845	225.00	0.25	7.5
Matador Resources Company	MTDR US	Scott Hanold	Outperform	USD	49.60	5,820	57.00	0.63	15.6
Jamf Holding Corp.	JAMF US	Matthew Hedberg	Outperform	USD	34.21	4,475	45.00	0.00	31.5
Ping Identity Holding Corp.	PING US	Matthew Hedberg	Outperform	USD	21.04	1,715	33.00	0.00	56.8
Rapid7, Inc.	RPD US	Matthew Hedberg	Outperform	USD	103.46	6,394	140.00	0.00	35.3
Varonis Systems, Inc.	VRNS US	Matthew Hedberg	Outperform	USD	43.60	4,878	55.00	0.00	26.2
Kratos Defense & Security Solutions, Inc.	KTOS US	Ken Herbert	Outperform	USD	20.92	2,671	24.00	0.00	14.7
Surgery Partners, Inc.	SGRY US	Ben Hendrix	Outperform	USD	52.27	4,312	65.00	0.00	33.9
Coursera Inc	COUR US	Rishi Jaluria	Outperform	USD	20.33	3,343	50.00	0.00	145.9
Flywire Corporation	FLYW US	Daniel R. Perlin	Outperform	USD	27.06	3,207	51.00	0.00	88.5
Shift4 Payments, Inc.	FOUR US	Daniel R. Perlin	Outperform	USD	52.65	4,481	86.00	0.00	63.3
Global Blood Therapeutics, Inc.	GBT US	Gregory Renza	Outperform	USD	30.20	1,948	65.00	0.00	115.2
Pacira Biosciences, Inc.	PCRX US	Gregory Renza	Outperform	USD	66.69	2,974	83.00	0.00	24.5
Sunnova Energy International Inc	NOVA US	Elvira Scotto	Outperform	USD	20.15	2,262	40.00	0.00	98.5
Pubmatic, Inc.	PUBM US	Matthew Swanson	Outperform	USD	30.60	1,726	46.00	0.00	50.3
Fluence Energy, Inc.	FLNC US	Shelby Tucker	Outperform	USD	13.53	2,642	28.00	0.00	107.0

Source: RBC Capital Markets estimates, Bloomberg

Priced as of market close on February 28, 2022, unless otherwise indicated.
All values in USD unless otherwise noted.

For Required Conflicts Disclosures, please see page 32.

Disseminated: Mar 1, 2022 05:58EST; Produced: Mar 1, 2022 05:58EST

Table of Contents

Changes to the list

Recurring names

Company	Pricing Symbol	Analyst	Rating	Trading Currency	Closing Price 02/28/2022	Price Target	Added to the List
Intra-Cellular Therapies, Inc.	ITCI US	Brian Abrahams	Outperform	USD	55.48	65.00	04/27/2021
Sarepta Therapeutics, Inc.	SRPT US	Brian Abrahams	Outperform	USD	76.61	145.00	04/27/2021
OptimizeRx Corporation	OPRX US	Sean Dodge	Outperform	USD	45.29	100.00	04/27/2021
Goosehead Insurance Inc	GSHD US	Mark Dwelle	Outperform	USD	86.98	140.00	02/03/2021
Kinsale Capital Group, Inc.	KNSL US	Mark Dwelle	Outperform	USD	209.76	225.00	04/27/2021
Matador Resources Company	MTDR US	Scott Hanold	Outperform	USD	49.60	57.00	04/27/2021
Jamf Holding Corp.	JAMF US	Matthew Hedberg	Outperform	USD	34.21	45.00	10/13/2021
Ping Identity Holding Corp.	PING US	Matthew Hedberg	Outperform	USD	21.04	33.00	08/27/2021
Rapid7, Inc.	RPD US	Matthew Hedberg	Outperform	USD	103.46	140.00	02/03/2021
Surgery Partners, Inc.	SGRY US	Ben Hendrix	Outperform	USD	52.27	65.00	12/01/2021
Kratos Defense & Security Solutions, Inc.	KTOS US	Ken Herbert	Outperform	USD	20.92	24.00	12/01/2021
Flywire Corporation	FLYW US	Daniel R. Perlin	Outperform	USD	27.06	51.00	08/27/2021
Shift4 Payments, Inc.	FOUR US	Daniel R. Perlin	Outperform	USD	52.65	86.00	12/01/2021
Global Blood Therapeutics, Inc.	GBT US	Gregory Renza	Outperform	USD	30.20	65.00	02/03/2021
Sunnova Energy International Inc	NOVA US	Elvira Scotto	Outperform	USD	20.15	40.00	08/27/2021
Pubmatic, Inc.	PUBM US	Matthew Swanson	Outperform	USD	30.60	46.00	08/27/2021

Source: RBC Capital Markets estimates, Bloomberg

Additions to the U.S. Small Cap Growth Idea List

Company	Pricing Symbol	Analyst	Rating	Trading Currency	Closing Price 02/28/2022	Price Target	Added to the List
Avid Bioservices, Inc.	CDMO US	Sean Dodge	Outperform	USD	20.48	32.00	03/01/2022
Coursera Inc	COUR US	Rishi Jaluria	Outperform	USD	20.33	50.00	03/01/2022
Fluence Energy, Inc.	FLNC US	Shelby Tucker	Outperform	USD	13.53	28.00	03/01/2022
Pacira Biosciences, Inc.	PCRX US	Gregory Renza	Outperform	USD	66.69	83.00	03/01/2022
Varonis Systems, Inc.	VRNS US	Matthew Hedberg	Outperform	USD	43.60	55.00	03/01/2022

Source: RBC Capital Markets estimates, Bloomberg

Deletions from the U.S. Small Cap Growth Idea List

Company	Pricing Symbol	Analyst	Rating	Trading Currency	Closing Price 02/28/2022	Price Target	Added to the list	Removed from the list
Arena Pharmaceuticals, Inc.	ARNA US	Kennen MacKay	Sector Perform	USD	94.97	100.00	08/27/2021	03/01/2022
Cerence Inc	CRNC US	Joseph Spak	Underperform	USD	36.11	37.00	12/01/2021	03/01/2022
CarGurus, Inc.	CARG US	Brad Erickson	Outperform	USD	48.45	48.00	08/27/2021	03/01/2022

Source: RBC Capital Markets estimates, Bloomberg

Investment Summaries – Technology and Payments

Coursera, Inc. (NYSE: COUR)

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Rating: Outperform

Closing Price: $20.33

Price Target: $50.00

Implied All-in Return: 145.9%

Most recent company note: link

Investment summary

We like shares of Coursera for four primary reasons: (1) We believe the multi-segmented approach (consumer, enterprise, higher ed) creates a powerful flywheel effect and a sustainable economic moat. The consumer business, for example, creates brand awareness that has helped drive enterprise traction, while also serving as a funnel for the degree program (and lowering CAC as a result). **(2) Our due diligence on Coursera has been positive.** We spoke to multiple Coursera customers as well as Coursera's industry and education partners; partners praised Coursera for its reach and openness to innovation vs. competitors and consumers praised Coursera for the breadth and depth of its content vs. competitors. **(3) We believe the pandemic has created lasting tailwinds across all segments for Coursera, especially in higher education.** We believe education has been irreversibly changed and we see room for more degrees (graduate and undergraduate) to be fully online. **(4) Rapid growth with room for margin expansion.** Coursera has grown revenue rapidly, with a 45% CAGR from 2017 through 2020, while growth nearly doubled in 2020 as a result of the pandemic. Importantly, rapid growth seems sustainable, with growth accelerating again in 1Q21 and the shift to digital learning still in early innings. We also see room for meaningful margin expansion and Coursera to reach 25%+ FCF margins at scale, driven primarily by revenue mix-shift.

Valuation

Our $50 price target is based on a 10x EV/2023E revenue, a less significant discount to the high-growth peer group median, which we think balances Coursera's competitive positioning and growth profile with an uncertain timeline to profitability. Our price target supports our Outperform rating on the stock.

Risks to rating and price target

Investment risks include: 1) competition, including against 2U, Udemy, Udacity, edX, LinkedIn Learnings, and Pluralsight; 2) Coursera is unprofitable and we do not expect sustained profitability in the near term; 3) Coursera is a Public Benefit Corporation (PBC) and registered b-corp, which requires additional investor disclosures and attention from management; 4) pandemic-related tailwinds may not be sustainable and may cause growth to decelerate; and 5) international risk, with international representing more than half of the business and 80% of total learners.

Flywire Corporation (NASDAQ: FLYW)

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Rating: Outperform
Closing Price: $27.06
Price Target: $51.00
Implied All-in Return: 88.5 %
Most recent company note: link

Investment summary

We believe Flywire is uniquely positioned to solve various payment friction points embedded in its key verticals, which include education, healthcare, and travel. Growth in the company's end markets, high retention rates, market share gains, new products and expansion into additional verticals should support 30%+ revenue CAGR over the next three years. While the company is currently investing in the business to support this revenue growth, we believe it will turn adjusted EBITDA positive in FY23 and long-term adjusted EBITDA margins could approach 25%+ with the revenue CAGR remaining ~30%.

We believe FLYW's success will be underpinned by several attributes, which in our opinion include 1) its focus on large and unique addressable markets, 2) Flywire Advantage, its technology platform, setting itself apart from the peers resulting in high retention rates and new client wins, 3) the competitive moat provided by FLYW's proprietary global payment network (over a decade to build) and vertical-specific software, and 4) the potential call option the company has as it expands into B2B payments.

Valuation

Our price target of $51 is based on an EV/revenue multiple of 25x our CY22 revenue estimate of $223M. This target is in line with the company's peers and reflective of the company's anticipated 30%+ long-term revenue growth CAGR and achieving consistent EBITDA profitability in FY23. The implied upside supports our Outperform rating.

Risks to rating and price target

We believe there are three broad risk categories: (1) macro-economic risks; (2) regulatory & compliance risks; and (3) competitive risks including pricing and technological changes.

In terms of specific risks, we note that since inception, Flywire has incurred net losses from operations and despite significant revenue growth in recent periods, it is uncertain whether the company will obtain high enough volumes to sustain / increase growth or achieve / maintain profitability in the future. The company's key verticals, furthermore, are highly competitive and regulated while evolving rapidly. Finally, a group of major shareholders control a significant portion of FLYW's voting and economic rights.

Jamf Holding Corp. (NASDAQ: JAMF)

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Rating: Outperform

Closing Price: $34.21

Price Target: $45.00

Implied All-in Return: 31.5%

Most recent company note: link

Investment summary

We see Jamf's primary mission as being to help organizations succeed with Apple. As the standard in Apple enterprise management, we think Jamf is in a strong position to leverage the growing preference for Apple in the enterprise. In addition to a TAM that is likely to expand more quickly than previously expected in a post-COVID world, the company's financial profile is unique given rapid growth and high profitability.

Apple innovation has transformed the technology landscape. What started off as a consumer revolution to Apple devices has steadily made its way to the enterprise. As such, there has been a substantial share shift in operating system usage since 2009, with iOS representing 32% of Internet traffic in the US and macOS 12%, for a total of 43%, which is significantly higher than Windows at 31%. To put that into perspective, in 2009 Windows-based devices drove 88% of Internet traffic vs. iOS at 1% and macOS at 10%.

Expanding the TAM. The company has provided a bottom-up estimate of $10.3 billion TAM in 2019, growing at a CAGR of 17.8% to $23.4 billion by 2024.

Potential growth catalysts: (1) A growing acceptance of Mac and iOS in the enterprise (see IBM example in our initiation report on JAMF dated 17 Aug. 2020). (2) Growing preference for BYOD. (3) Consumerization of IT. (4) Shifting demographics in the workforce to Millennials. (5) COVID changes everything as enterprises and employees re-think the value/importance of WFH. (6) The launch of additional Apple products or ability to monetize the Apple Watch. (7) Vertical specific tailwinds in education from e-learning and healthcare from tele-health.

Valuation

Our $45 price target is based on shares trading at 11x our CY/23 EV/S estimate. This is a slight discount to similar growing SaaS peers, which we believe is warranted due to their PE overhang and exposure to Apple. We think if ARR growth were to stay at +30%, in-line with our current CY/21 estimate, one could argue for additional multiple expansion. Our price target supports an Outperform rating.

Risks to rating and price target

(1) The impact on Jamf's operations and financial condition from COVID-19. (2) Changes in Jamf's continued relationship with Apple including the adverse impact of changes in features and functionality by Apple on Jamf's engineering focus or product development efforts. (3) Jamf derives a substantial portion of its revenue from one product; as of CY/19, sales of Jamf Pro accounted for ~78% of total revenue.

Ping Identity Holding Corp. (NYSE: PING)

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Rating: Outperform

Closing Price: $21.04

Price Target: $33.00

Implied All-in Return: 56.8%

Most recent company note: link

Investment summary

Ping has extensive history as a pioneer and thought leader within the Identity industry. From its beginning with single sign-on (SSO) to the addition of multi-factor authentication (MFA) to API security and more, we believe Ping is well suited to manage and secure identities of some of the largest and most complex hybrid-cloud global organizations. Enterprises are undergoing digital transformations while concurrently becoming more distributed, which dissolves the traditional network perimeter. As a result, we believe enterprises require Intelligent Identity solutions that proactively ensure the right user has authorized access to resources at the appropriate time.

Potential Catalysts: (1) A large/expanding market that could be as much as $25B, according to the company, as identity remains top-of-mind with CISOs. (2) Cross-sell of MFA and API into its SSO base. (3) Additional sales productivity from S&M investments. (4) Additional or accelerated share-shift from legacy vendors. (5) Growth in international markets.

Valuation

We calculate our base-case price target of $33 by applying a 6.0x EV/ARR multiple to our CY/23E ARR estimate of $459M. Our price target and multiple reflect peer multiple compression with the multiple a slight discount to 10-20% growing peers. Additionally, our price target is 4x EV/S on our CY/23E revenue estimate of $402M. Our price target and multiple, in our view, are warranted due to an attractive end market and strong historical execution with some elevated risk from a re-accelerating model. Our price target supports an Outperform rating.

Risks to rating and price target

(1) Operates in a market with competition from larger legacy competitors and newer entrants that could lead to potential pricing pressure. (2) Failure to retain existing customers could be a detriment to growth. (3) Needs strong execution to capitalize on R&D and S&M investments. (4) The risk of extended deal cycles as a result of expanded product offerings. (5) COVID-19 could impact company operations or customer demand.

Pubmatic, Inc. (NASDAQ: PUBM)

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Rating: Outperform

Closing Price: $30.60

Price Target: $46.00

Implied All-in Return: 50.3%

Most recent company note: link

Investment summary

PubMatic is one of the largest independent sell-side advertising platforms (SSP) offering buyers and sellers of digital advertising a single partner for transacting globally across a variety of channels, formats, and auction types. In 2021, PubMatic generated $227M in Revenue (+53% Y/Y), driven primarily by growth in the company's faster-growing CTV/OTT, Mobile and Video segments. PubMatic processed 92.2T Ad Impressions in 2021 (+97%) driven by supply path optimization. PubMatic has a multi-year track record of generating positive EBITDA and delivered 42% EBITDA margins in 2021.

Potential positive catalysts: (1) PubMatic is able to gain additional market share from market leaders by targeting emerging spend categories with less entrenched positions from Facebook and Google; (2) PubMatic is able to consolidate market share from smaller SSPs as SPOs continue to gain traction leading to DSPs consolidating the number of SSPs they work with; (3) PubMatic's CTV product (OpenWrap OTT) gains faster-than-expected adoption, generating share gains and significant revenue growth in this fast-growing segment of the market; (4) Alternative Cookie Solutions (TTD's Unified ID 2.0, RAMP's ATS) create a superior targeting and measurement environment on the Open Internet relative to third-party cookies; (5) Regulatory action is taken against Google that limits its ability to aggressively compete in the SSP space, leaving more room for PubMatic to gain market share.

Valuation

We calculate our base-case price target of $46 by applying a 7.3x multiple to our CY/23E revenue estimate. Our target multiple is a premium to ad-tech peers at 5.9x CY/23E EV/S (consensus), in our view, warranted due to the potential for upside to estimates, better profitability and slightly higher growth in its updated outlook. Our price target supports our Outperform rating.

Risks to rating and price target

PubMatic has seen both headwinds and tailwinds resulting from the COVID-19 environment, which could impact the advertising industry and the company's performance. (1) PubMatic is a transactional model; revenue is based on the number of transactions and could lead to more revenue variability based on company specific and macro challenges. (2) PubMatic is tied to the advertising vertical; any macroeconomic event that impacts the supply or demand of digital advertising could cause an adverse impact on their end markets disproportionately to other software markets. (3) PubMatic has created an advantage in CTV/OTT as well as mobile and video channels. Failure to manage and defend these emerging growth opportunities could lead to market share losses.

Rapid7 Inc. (NASDAQ: RPD)

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Rating: Outperform
Closing Price: $103.46
Price Target: $140.00
Implied All-in Return: 53%
Most recent company note: link

Investment summary

Rapid7 is a cyber-security vendor with a unique data- and analytics-driven approach to DevSecOps. Its value proposition is to utilize massive amounts of data collected from the network and endpoints to drive automation and productivity to help customers proactively prevent security breaches. ARR growth is the key metric, and management expects it to remain at or above 20% through 2022.

We are confident about the opportunity in the core-VM market, which is currently over half of the business, with above market growth rates, consistent competitive win rates and minimal pricing pressure while longer-term success in IDR, AppSec and Connect should drive a unique position in the DevSecOps market.

The company has multiple product drivers over multiple years that should help sustain durable growth and measured operating margin expansion. Currently, base growth is via VM with IDR providing higher levels of growth that longer term should be buoyed by AppSec and Connect. The company is looking for ARR to grow at 20%+ through 2022 with 200–300 bps of annual margin expansion expected.

Potential catalysts: (1) Acceleration of new customer additions; (2) increasing dollar renewal rates; (3) increased focus on leveraging data analytics with a growing security-risk landscape (i.e., differentiating Rapid7 from other VM vendors); (4) additional channel investments and international expansion; and 5) potential from IDR, AppSec and Connect.

Where we could be wrong: (1) Increased competition in a highly fragmented market; (2) security stocks could go out of favor; (3) the company is running near break-even; (4) a decline in renewal rates could adversely affect growth; and (5) COVID-19 could impact company operations or customer demand.

Valuation

Our price target of $140 is based on 11.2x CY/23E EV/S. The multiple is a slight discount with security peers, which we believe is reasonable with an above-average growth rate but less profitability. Our price target supports an Outperform rating.

Risks to rating and price target

Risks to our price target and rating could include changes in the macro environment including COVID-19 that could continue on longer than expected, moderating IT spending, limited operating history, or should acceptance of the company's products change.

Shift4 Payments, Inc. (NYSE: FOUR)

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Rating: Outperform

Closing Price: $52.65

Price Target: $86.00

Implied All-in Return: 63.3%

Most recent company note: link

Investment summary

We believe Shift4 offers investors several attractive and unique attributes within the payments industry.

1) The company is tapped into the large and secularly growing payments market in the US, which when combined with its ISV and hospitality focus, provide a backdrop of growth that we forecast to be in the high-single to low-double-digit organic range. 2) The company has an embedded internal mix shift opportunity to convert its existing gateway-only clients to End-to-End (E2E) processing clients, which drives a 4x-6x uplift to gross profit. 3) Shift4 utilizes a partner-centric distribution model whereby roughly 100% of its sales are generated through its +7K software partner network, which is unique in the industry. The benefits to this distribution model are designed to leverage the domain expertise & local relationships that its software partners have already established, while reducing its own customer acquisition costs as the sales & support functions are largely borne by its channel partners. 4) The company has a demonstrated track record of providing client-focused innovation in the hospitality industry, which was illustrated recently during the COVID-19 pandemic, as Shift4 quickly pivoted with its clients to provide solutions that enabled SMBs to quickly adapt to an omni-channel and cashless environment.

Valuation

Our price target of $86 is 30x our CY22 EV/EBITDA estimate or in line with the peer group average, which we think is appropriate given FOUR's faster growth rate as it converts merchants to its end-to-end processing platform. Our price target supports our Outperform rating.

Risks to rating and price target

We believe there are three broad risk categories: (1) the highly focused nature of FOUR's business model on the hospitality industry creates concentration risk were the economic environment to suffer another shock from COVID-19; (2) the company's exposure to SMBs can create variability in its financial results, given the possible churn related to COVID-19; and (3) the company carries a fair amount of leverage, as defined by net-debt-to-TTM EBITDA, which can reduce financial flexibility.

Varonis Systems, Inc. (NASDAQ:VRNS)

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Rating: Outperform
Closing Price: $43.60
Price Target: $55.00
Implied All-in Return: 26.2%
Most recent company note: link

Investment summary

Founded in 2004, Varonis provides a software platform that assists customers in automating unstructured data protection and management, particularly for human-generated data. The core technology behind the products is its proprietary Metadata Framework, which collects and aggregates metadata (or data about data) from human-generated content including emails, documents, spreadsheets, etc. The company's family of five products leverages Metadata Framework for applications focused on security, compliance, access, storage, collaboration, etc.

We believe the company is in the early stages of penetrating a $47 billion market that includes fragmented competition. Through a land, expand, and retain strategy, we believe Varonis has the opportunity to generate strong financial growth for several years while continuing to innovate new technologies that leverage its Metadata Framework. In addition, we believe the company is an attractive acquisition target for larger vendors seeking exposure to innovative big data solutions.

Key points: (1) Large market opportunity; (2) Post COVID beneficiary due to the increased risk of data governance in a work from anywhere environment; (3) Growth strategy = land + expand + retain; (4) Expanded salesforce; (5) Rapid innovation; (6) High barriers to entry; (7) International growth opportunity; (8) Long-term margin expansion.

Valuation

Our $55 price target assumes that shares trade at 11x CY/23 EV/S based on our CY/23 sales estimate, a slight premium to peer multiples. Our price target and multiple reflect peer multiple compression and are warranted in our view by the increased pace of the transition, a near-term headwind to revenue though we expect long-term value of additional subscription revenue, offset by the potential for near-term model volatility due to COVID-19. We believe our rating and price target are justified by the large and expanding end market, growing customer base, execution improvement, and success of the land-and-expand model. Our price target and implied return support our Outperform rating.

Risks to rating and price target

(1) The economic environment remains volatile specifically for COVID-19 impact; (2) The potential for increased competition; (3) ARR growth as the transition normalizes.

Investment Summaries – Biopharma

Global Blood Therapeutics, Inc. (NASDAQ: GBT)

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Rating: Outperform
Closing Price: $30.20
Price Target: $65.00
Implied All-in Return: 115.2%
Most recent company note: link

Investment summary

We believe Oxbryta, GBT's first-in-class FDA-approved sickle hemoglobin (HbS) polymerization inhibitor, could address the unmet need of sickle cell disease patients without suitable donors for hematopoietic stem cell transplant. We see Oxbryta's potential to become SOC in SCD from favorable long-term efficacy and safety profile and enthusiasm from HCP, coupled with label expansion into pediatric population aged 4+ and in ex-U.S. regions, which could also contribute to share appreciation potential.

We expect to see continued market uptake for the Oxbryta launch, while COVID-19 headwinds are real though temporary. We continue to see the value of Oxbryta in the long term with peak global sales potential of over $1.7B in age 12+ in the late 2020s with potential additional sales opportunities from label expansion, though we look to the progress on the clinical and regulatory fronts, as well as receptivity to the company's marketing efforts.

Development efforts of P-selectin antibody inclacumab, next-gen HbS polymerization inhibitor GBT021601, and HbF-inducing gene therapy could contribute to upside potential. The pipeline assets complement Oxbryta in SCD management, add to GBT's revenue, and also contribute to the long-term life-cycle management and pipeline diversity of the company, in our view.

Key positives: (1) Valid scientific and biological rationale demonstrated from favorable efficacy and safety profiles; (2) strong enthusiasm from physicians around the clinical profile of Oxbryta with potential as SOC; (3) continued marketing efforts could drive increased market uptake despite temporary COVID-19 headwinds; (4) pipeline assets could generate additional revenue comp; (5) experienced management team and investor base with proven track record in drug development.

Key potential catalysts: (1) Establish payer coverage for pediatric expansion (mid-'22); (2) EU reimbursment - GER, FRA, UK (mid-'22/2023); (3) Additional ph.I data (EPO) and preclinical data presentations of GBT601 (6/9-12, EHA); (4) initial ph.II data pf GBT601 (Dec 2022, ASH).

Valuation

Our base case is driven by a 90% probability of success for Oxbryta in age 12+ with ~$1.7B global peak sales potential and 90% probability of success for Oxbryta in age 4–11 with ~$300M global peak sales potential. With a 5% probability of success, inclacumab could generate over $300M WW out-year revenues. Our $65 price target is based on a blend of DCF (using 10% discount rate and 0.5% terminal growth rate) and probability-adjusted multiples (20x on 2026E adjusted EPS with a 10% discount) analyses. Our valuation supports an Outperform rating.

Risks to rating and price target

(1) Post-marketing studies fail to demonstrate long-term efficacy and safety; (2) Low market penetration despite efforts to drive market uptake; (3) Increasing competition from chronic or gene therapies for SCD in development; (4) Early pipeline programs pose uncertainty to clinical success and longer-term platform potential; (5) COVID-19 disruption on regulatory, clinical, and commercial fronts.

Intra-Cellular Therapies, Inc. (NASDAQ: ITCI)

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Rating: Outperform
Closing Price: $55.48
Price Target: $65.00
Implied All-in Return: 18 %
Most recent company note: link

Investment summary

Based on unique pharmacology enabling broad activity across a spectrum of brain receptors, a clean safety profile, and positive physician feedback that supports use in schizophrenia, we believe Caplyta could be a highly differentiated schizophrenia and bipolar treatment. Following approval in both indications with what we view as a clean and potentially differentiated label—particularly regarding the safety profile—we model >$450M in out-year WW revenues for Caplyta in schizophrenia and >$700M in bipolar. With lumateperone's commercial potential we believe shares are undervalued and have upside potential into launch in bipolar, and we see further optionality in both mixed features and major depression, along with pipeline opportunities such as further '214 PD readouts.

Key positives: (1) Recent approval in schizophrenia, following mixed ph.III efficacy data; (2) Lumateperone may be uniquely useful against the negative and cognitive schizophrenia symptoms, due to distinct pharmacological properties that enable activity across a number of brain receptors; (3) positive recent BPD data in adjunctive setting; (4) schizophrenia approval may reduce risk to path forward in BPD, given ability to file sNDA; and (5) blockbuster potential of a drug with broad applicability across psychiatric conditions.

Potential catalysts: (1) Launch dynamics of Caplyta in bipolar (2022+); (3) Study 403 readout for mixed features (2H22); (4) Adjunctive MDD study readouts (2H23)

Valuation

Our $65 price target blends DCF (using a 10% discount rate and 2% terminal growth rate) and probability-adjusted multiples (25x on 2025E adjusted EPS with a 10% discount) analyses. Our price target supports an Outperform rating.

Risks to rating and price target

(1) If Caplyta fails to differentiate itself in an increasingly crowded generics space, opportunity in schizophrenia and bipolar may be more limited; (2) ITCI needs to continue to maintain a strong commercial infrastructure to successfully launch, which carries inherent risk for a smaller company; (3) ITI-214 is relatively early-stage with limited data—clinical failure of this compound would reduce revenue potential post-lumateperone patent expiry; (4) Potential COVID-19 impacts on clinical trial conduct and Caplyta launch.

Pacira Biosciences, Inc. (NASDAQ:PCRX)

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Rating: Outperform

Closing Price: $66.69

Price Target: $83.00

Implied All-in Return: 24.5%

Most recent company note: link

Investment summary

We think PCRX is well positioned to drive continued growth from its flagship product, EXPAREL, with several expansion opportunities that can maintain momentum. We also expect the company to benefit from several thematic tailwinds including ongoing volume shift to the outpatient/ASC setting. More near-term, we will continue to monitor the broader recovery from COVID-19, where we assume continued normalization throughout 2022. **(1) Near-term focus will remain on the impact of COVID-19, though rebound under way.** EXPAREL utilization has outperformed the elective surgery market throughout the pandemic, which we expect to continue. We also expect to see benefit from the return of "warehoused" patients. **(2) We expect growing EXPAREL revenues to drive meaningful margin expansion over time.** We expect gross margins to grow from the mid-70% to the mid-80% with additional benefit from R&D and SG&A expenses that we expect to grow at a slower rate than sales. **(3) FLXN acquisition complements PCRX's existing non-opioid portfolio and enriches the pipeline for long-term value generation and growth.** FLXN's commercial product ZILRETTA in osteoarthritis (OA) knee pain and label expansion potential in shoulder OA, as well as pipeline assets FX201 and FX301 in OA and acute pain, are complementary to PCRX's long-term approach and pain management toolbox, in our view.

Potential catalysts: (1) Pre-announcement of February 2022 sales (March 2022); (2) interim from ph.IV PREPARE study of iovera with Exparel in TKA (2022); (3) Joint sNDA submission for new lower extremity nerve block in bunionectomy and TKA (4Q 2022); (4) ph.I data from FX-201/301 and path forward (2022).

Valuation

Our base case assumes, an 80% probability of success for Exparel with ~$1.6B out-year sales potential, a 50% probability of success for iovera with over $90M out-year sales potential, a 70% probability of success for Zilretta with ~$300M out-year sales potential, and an 80% probability of success for other products with over $4M out-year sales potential collectively. Our $83 price target is based on a blend of DCF (using a 12% discount rate and a 0.5% terminal growth rate) and probability-adjusted multiple (20x on 2026E adjusted EPS with a 12% discount) analyses. Our valuation assumptions are comparable to other biotech companies developing therapeutics at a similar stage. Our price target supports an Outperform rating.

Risks to rating and price target

Key potential downside risks to our price target and rating arise from: (1) pricing risk, which is a key concern that may impede adoption and greater utilization of the product; (2) regulatory/bundling risk from CMS bundled payments in orthopedic procedures; (3) competitive risk; (4) data risk from Ph IV read-outs, or pipeline products in development; and (5) deeper recessionary risk from COVID-19 impacting elective surgery volumes.

Sarepta Therapeutics, Inc. (NASDAQ: SRPT)

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Rating: Outperform

Closing Price: $76.61

Price Target: $145.00

Implied All-in Return: 89.3 %

Most recent company note: link

Investment summary

We believe the key value driver for shares going forward will be progress toward the multibillion-dollar opportunity we see for Sarepta's two most advanced muscular dystrophy gene therapy programs. Based on the robust expression, biomarker and safety data for both programs to date—along with highly encouraging functional gains—we believe SRPT could have the best-in-class therapy for both Duchenne and limb girdle muscular dystrophy. Underpinning the significant promise of its gene therapy pipeline are approved drugs (Exondys 51, Vyondys 53, and Amondys 45) addressing a subgroup of DMD patients, and a strong balance sheet bolstered by what we view as a highly validating ex-U.S. microdystrophin DMD gene therapy commercialization deal with Roche. Given Exondys's strong launch, Vyondys's recent approval, positive initial PPMO data, and our increasing optimism around microdystrophin and limb girdle muscular dystrophy gene therapy programs, we believe shares are currently undervalued.

Key positives: (1) potentially transformative clinical-stage gene therapy programs represent a substantial opportunity; (2) strong U.S. Exondys 51 launch, with quick uptake and high visibility for growth; and (3) regulatory success with Vyondys 53 accelerated approval.

Key potential catalysts: (1) Additional analysis from crossover cohort in Study 102 (1H22); (2) complete enrollment in Study 301 (mid-'22); (3) initiate pivotal study with LGMD2E gene therapy SRP-9003 in 2022.

Valuation

Our $145 price target blends DCF (using a 10.5% discount rate and a 3.0% terminal growth rate) and probability-adjusted multiples (30x on 2025E adjusted EPS discounted at 10.5%) analyses. Our price target supports an Outperform rating.

Risks to rating and price target

Risks: (1) clinical, manufacturing, or regulatory setbacks in DMD or LGMD gene therapy programs; (2) slower-than-anticipated growth or other commercial setbacks for Exondys 51, Vyondys 53, and Amondys 45; (3) failure to successfully develop and gain regulatory approval for follow-on exon-skipping drugs, including PPMOs; (4) poor performance in confirmatory study leading to market removal or increased patient discontinuations.

Investment Summaries – Healthcare Technology and Services

Avid Bioservices, Inc. (NASDAQ:CDMO)

Sean Dodge (Analyst)
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Rating: Outperform

Closing Price: $20.48

Price Target: $32.00

Implied All-in Return: 56.3 %

Most recent company note: link

Investment summary

Avid Bioservices (CDMO) is a pure-play contract development and manufacturing organization specializing in the production of drug substances used in biologics-based therapeutics. While Avid has been manufacturing biologics since 1993, the story has gotten a lot more exciting recently for several reasons. (1) Timing – since the restructuring to a pure-play CDMO in 2018, the company has focused on shifting to a service-driven culture, building a sales force to pursue business more proactively, and assembling a more manufacturing-focused management team. (2) Industry – Avid specializes in biologics – the fastest growing segment of drugs in development, which, along with accelerated demand for COVID-related treatments, has created what we view as a sustainable supply-demand imbalance for at least the next few years. (3) Runway – the company has lots of expansion potential within existing facilities, meaning there is considerable room for growth that should come on at high incremental margins which we believe can support both revenue growth >25% for the next three years and significant EBITDA margin expansion.

Potential catalysts: (1) Signing New Commercial Customers. As a standalone CDMO, Avid's goal is to partner with pharmaceutical companies early in the development process and support them through the clinical stages in hopes of winning business if/when approval for commercial production is reached. Signing any new commercial-scale contracts with new or existing customers will likely have a material impact on the business. **(2) Completion of Capacity Expansions.** Avid has two phases of capacity expansion underway; when complete, these will more than double Avid's existing revenue-generating capacity. The first phase is set to come online early CY22 and support an additional $50M of manufacturing revenue at scale. **(3) Commercialization of Former R&D Assets.** As part of its restructuring in 2018, Avid sold the majority of its R&D assets including two key antibody programs. While these do not appear to be materializing in the near-term, Avid is entitled to a potential $116M of earn-outs based on certain development and commercialization milestones.

Valuation

Given the nature of CDMO's business—optimizing the utilization of its manufacturing capacity—we believe the best way to value the company is using a discounted cash flow analysis. Our $32 price target supports our Outperform rating and is based on the following assumptions: (1) revenue growing at a 25%+ CAGR for at least the next 4 years supported by the investments CDMO is making in capacity expansions (including its recent entry into cell & gene therapy), then slows to the MSDs-HSDs thereafter; (2) EBITDA margins reach 31.5% at maturity; (3) a terminal trailing EBITDA multiple of 21x, which is >10x below where its peers currently trade given the relative risk; and (4) a WACC of 9.4%.

Risks to rating and price target

Risks to our rating and price target include significant customer concentration, a dynamic regulatory landscape, hazardous material handling, geographic isolation, and competition from other CDMOs and/or pharmaceutical companies insourcing production.

OptimizeRx Corp (NASDAQ: OPRX)

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Rating: Outperform

Closing Price: $45.29

Price Target: $100.00

Implied All-in Return: 120.8 %

Most recent company note: link

Investment summary

OPRX is a leading digital communications solutions platform helping life sciences companies to optimize the growing proportion of marketing spend being directed through digital channels. We expect revenue to grow at a 30%+ CAGR over the next 3+ years, driven by a combination of: (1) strong macro tailwinds—an increasing proportion of the $20B+ spent annually by pharma companies on S&M is being diverted to digital channels; (2) deepening integration of OPRX into its clients' commercial planning processes; (3) ongoing transition to more Enterprise-type engagements, which both acts as a multiplier on revenue and increases client "stickiness"; (4) cross-selling into its existing client base—adding both new brands and indications; and (5) signing new clients. Further, a majority of OPRX's revenue is driven by solutions that use a combination of algorithms and EHR integrations to intelligently deliver relevant content to docs at the point of care, meaning that they are very scalable. Consequently, we expect the incremental margins on revenue growth to be very high (i.e., 50%+), helping to drive EBITDA margins to 30%+ at maturity.

Potential catalysts: (1) Signing Additional Enterprise Clients. Signing enterprise deals is important for OPRX for several reasons: (1) It creates a higher value offering—converting OPRX's first client from a single solution to an enterprise deal increased annual revenue from ~$775K to ~$4M. (2) It is also a much stickier approach, as it consolidates vendors by replacing a number of point solutions. Lastly, (3) it further solidifies OPRX as a partner in the commercialization process rather than a tactical marketing vendor. Increasing the relative mix of these multi-product clients should have a sharp and lasting impact on the business. **(2) Adding New Client Brands and Drug Indications.** OPRX has a significant opportunity to add more branded drugs both inside and outside its client base. Pharmaceutical manufacturers have a different marketing team for each branded drug. Within that, each indication (FDA approved use case) for each drug can have a separate marketing campaign targeting different physicians. Therefore, OPRX has opportunities to win new business with new indications within an existing drug and significant opportunity to expand to other branded drugs manufactured by the parent company through internal referrals.

Valuation

Our $100 price target is based on a trading comparable analysis of OPRX vs. its HCIT and Technology peers. OPRX exhibits all of the "tech"-like attributes we look for in digital health companies: big/underpenetrated TAM, steep revenue growth trajectory, and a scalable model. Its Healthcare peers currently trade at multiples nearly half those of its Technology peers. OPRX shares currently trade at 9.5x our '22 revenue estimate, and our $100 price target is based on a 21x multiple—as the company's mix of the more recurring/sticky Enterprise deals continues to grow, we expect it to trade closer to the Tech group. Our valuation work and price target support our Outperform rating.

Risks to rating and price target

Risks to our rating and price target include the loss of provider network exclusivity, direct and indirect competition for pharmaceutical marketing dollars, significant customer concentration, and client brands losing exclusivity/facing competition from generics.

Surgery Partners, Inc. (NASDAQ: SGRY)

Ben Hendrix (Analyst)
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Rating: Outperform
Closing Price: $52.27
Price Target: $65.00
Implied All-in Return: 33.9%
Most recent company note: link

Investment summary

SGRY is one of the largest ASC platforms in the country, representing an attractive value proposition for the U.S. healthcare system, as the low-cost care delivery alternative that will likely become increasingly important for patients and payors.

Management has been implementing specific strategies to accelerate SS growth, with a focus on supporting and expanding services in surgical facilities in its existing markets.

These initiatives appear to be gaining traction, yielding improved SS volume growth, strong pricing improvements, and margin expansion.

The benefits from these efforts, along with focused recruitment in targeted high-acuity specialties such as musculoskeletal and cardiology procedures, helped to deliver solid growth through the pandemic. Management is confident in achieving sustainable, double-digit EBITDA growth annually over the long term.

Additionally, forthcoming Medicare rule changes would allow SGRY to perform additional high-acuity procedures in its ASCs, significantly expanding the addressable market, and through continued investments in OR capacity and physician recruitment, we believe the company is well positioned to capitalize on these opportunities, supporting the long-term earnings growth trajectory.

Valuation

Our $65 price target is based on an enterprise multiple of ~22x our FY22E adjusted EBITDA-MI and reflects higher share count following the November 2021 secondary stock offering. Our target multiple is consistent with historical ranges, and given that SGRY is a pure-play ASC operator, our multiple reflects a premium versus its closest public peer. Our price target supports our Outperform rating.

Risks to rating and price target

(1) Dependence on managed care and Medicare payment rates, including Medicare lab fees; (2) Integration risk; (3) Physician recruitment and retention; (4) Labor cost inflation; (5) Revenue concentration; (6) Balance sheet leverage; (7) Tax receivable agreement

Investment Summaries – Energy

Fluence Energy, Inc. (NYSE: FLNC)

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Rating: Outperform
Closing Price: $13.53
Price Target: $28.00
Implied All-in Return: 107.0%
Most recent company note: link

Investment summary

While a rising interest rate environment and supply chain disruptions have significantly dampened valuations in 2022, we maintain our view that Fluence can capture long-term value from a large addressable market. We believe Fluence's competitive advantage is its global sales and distribution channel through its founders AES and Siemens. We believe project delays will suppress margins in the short term but expect project backlog to remain strong. As we anticipate logistical issues to ease up towards the end of 2022, we expect ~50% revenue CAGR through 2025. US tax incentives for energy storage is still on the table and we believe it remains a catalyst for Fluence in 2022/2023.

Valuation

Our price target of $28 is based on a discounted cash flow model assuming 10% WACC and 5x terminal EBITDA multiple. We apply a two-stage growth model to EBIT: 25% annual growth in 2026-2030 and 7.5% annual growth in 2031-2040. This results in an enterprise value of $4.9B, equivalent to a 12x EV/EBITDA multiple on our 2025E EBITDA of $408M. We believe this target multiple reflects our view of a large and long-dated growth potential. Our price target supports an Outperform rating.

Risks to rating and price target

(1) Supply chain disruptions persist and pressure margins; (2) New entrants and longer-term threat of substitute from green hydrogen; (3) Sustained increases in power prices slows down clean energy transition; (4) Lower attach rates in services and digital solutions due to higher competition; (5) Inability to contract sufficient production capacity limits growth; (6) Long-dated valuation suffers from interest rate sensitivity.

Matador Resources Company (NYSE: MTDR)

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Rating: Outperform

Closing Price: $49.60

Price Target: $57.00

Implied All-in Return: 15.6%

Most recent company note: link

Investment summary

We believe MTDR shares will outperform peers over the next 12 months. Management has built a large Permian Basin position of 125,000 net acres. The position contains over a decade of identified drilling locations. Additionally, the company is advantaged with in-basin Permian gathering, transportation, and processing through a 51% ownership stake in San Mateo Midstream, LLC joint venture.

(1) MTDR is the operator on the majority of its core acreage development and the company has a track record of exceeding investors' operational and financial expectations and we believe that trend should continue. (2) Management and insider ownership is high relative to peers. The management team insider ownership of MTDR is nearly 6.5%, which is more than 3x its peers. (3) Current ESG efforts include reducing air emissions and water usage, increasing corporate diversity, BoD independence, and high insider ownership. (4) MTDR is differentiated from its SMid-cap peers by the high concentration in the respective core development areas, including the federal acreage in the Stateline area. (5) At our mid-cycle oil price scenario ($55/bbl, WTI), economic growth rates could average 5-10% over a several year period, above the SMid cap peer group. (6) MTDR ownership in San Mateo Midstream is accretive for the upstream business through its low-cost structure and access to key sales points. Third-party revenues provide another avenue for cash flow. San Mateo should generate FCF moving forward.

Valuation

Our $57/share price target is derived from a combination of evaluating forward EBITDA multiples, relative FCF levels, and our Net Asset Value (NAV). Our price target, NAV upside opportunity, and cash flow outlook support our Outperform rating. MTDR has a large core Permian position that contains more than a decade of drilling inventory and owns a controlling position in a value accretive midstream entity. Our target reflects: (1) A premium to our $40/share NAV, a larger premium to the SMid cap peer average due to strong relative operational execution, acreage quality, and the midstream advantage. Our NAV is a risked assessment of 3P reserves using the long-term RBC commodity price outlook of $55/bbl (WTI), $60/bbl (Brent), and $3.00/Mcf (HH); (2) A 3.5x multiple on our 2022E EBITDA estimate, a premium to the SMid peer average, which we think is warranted given the depth of its inventory, midstream ownership, and higher growth rates.

Risks to rating and price target

Well results and operational execution below expectations would have an adverse effect on the stock performance.

Regulatory changes on federal lands could adversely impact MTDR's development opportunities and economics.

Weaker-than-expected commodity prices could cause the stock to perform below our expectations and impede achievement of our price target objective.

Energy producers battled unprecedented global oil & gas market conditions amid the COVID-19 pandemic that caused a historical reduction in demand. The industry has aggressively cut capital programs, operating costs, and in some cases, suspended dividends. If demand-related issues persist, our expectations for commodity prices and corporate cash flows could be reduced, thus challenging our share price outlook.

Sunnova Energy International Inc. (NYSE: NOVA)

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Rating: Outperform

Closing Price: $20.15

Price Target: $40.00

Implied All-in Return: 98.5%

Most recent company note: link

Investment summary

NOVA is a leading provider of residential rooftop solar services in the United States. We estimate NOVA has ~4-5% market share of the US residential rooftop solar market, but a higher share of the market's growth. NOVA operates under the dealer model, whereby its dealers originate leads and complete the installation of solar systems. NOVA offers customers leases, PPAs and loans, which NOVA retains on its balance sheet. Rooftop solar penetration in the United States is ~4% according to Wood Mackenzie, providing a significant growth opportunity. The recent extension of the investment tax credit for rooftop solar panels should help drive growth over the next several years.

Valuation

We derive our price target of $40 for NOVA using a sum-of-the-parts analysis. We view NOVA's value having two components: (1) current net earning assets (which represents the value to equity holders already in NOVA's balance sheet); (2) equity value of future customers, which reflects what we believe is the value to equity holders from NOVA's future growth. We derive equity value of future customers using a discounted cash flow analysis, based on a 6% discount rate, 4% cost of debt, and 10% cost of equity. We forecast growth decelerates from 43% (in 2022) to 5% through 2035, and use a ~4% terminal growth rate. Our price target supports our Outperform rating.

Risks to rating and price target

(1) While the federal government has extended the commercial investment tax credit, potential changes in state regulations could impact the growth of rooftop solar. Specifically, changes to net metering policies could affect the value proposition of rooftop solar relative to traditional utilities given the potential lengthening of a homeowner's payback period as net metering allows homeowners with rooftop solar to sell back power into the grid (thus lowering the homeowner's electricity bill). (2) Rising interest rates increase the cost of debt and consequently the cost of capital, which in turn could drive returns lower. That said, historically utilities have passed on the cost of rising rates to consumers. If that holds true, then NOVA should be able to increase its rates while still maintaining a competitive rate vs utilities. (3) NOVA is dependent on debt and tax equity to finance its growth. If the cost of financing increases or financing is not available at optimal terms, then NOVA's returns could deteriorate. Specifically, NOVA has used low-cost tax equity structures to finance its business and inability to use these structures in the future could slow growth. (4) NOVA's growth potential could stall or returns could decline if its product suppliers were to encounter supply chain issues that either slowed production (shortage of solar modules or batteries) or increased costs. In addition, tariffs on solar modules and inverters have led to lower cost declines than in the past.

Investment Summaries – Financials

Goosehead Insurance Inc. (NASDAQ: GSHD)

Mark Dwelle (Analyst)
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Rating: Outperform

Closing Price: $86.98

Price Target: $140.00

Implied All-in Return: 61.0%

Most recent company note: link

Investment summary

Goosehead is an innovative player in the personal lines brokerage industry. Its fully integrated sales and service platform is a sizeable competitive advantage relative to other independent agents and captive agents and gives the company a cost and efficiency edge that is likely to prove sustainable for some time. Equally, its innovative Corporate/Franchise model enables the company to significantly leverage its technology edge and is a coiled economic spring for revenue and earnings growth. We see a long runway of growth ahead and expect that under normalized conditions the company can sustain revenue growth of +30% for the next three to five years with corresponding earnings growth from leverage and platform expansion. Our Outperform rating reflects its attractive high-cash-flow business model and the long-term growth characteristics of the business model.

Investment points: (1) Technology edge: The company's IT platform has three main advantages that competitors cannot easily match, in our view: an integrated sales and service platform, proprietary data, and advanced analytics to drive superior lead generation. **(2) Franchise model:** The company's franchise model allows growth with minimal investment. The company earns 20% of commissions on new and 50% on recurring business for providing technology and service support to its agents. **(3) High cash flow and recurring revenue visibility:** About 85–90% of customers renew and a service culture drives high retention. Homeowners insurance is a required purchase and premiums are usually escrowed, which improves retention even during difficult economic conditions. **(4) Direct-to-consumer:** While direct-to-consumer sales comprise only about 18% of personal lines sales, they are a growing proportion and represent a long-term headwind for all types of agents. The company's technology approach is designed to address this potential long-term challenge.

Valuation

Our price target of $140 equates to roughly 100x our 2023 operating EPS estimate and is reached via our DCF model. The key assumptions of our DCF include an 8.5% discount rate and a terminal P/E multiple of 23x. In the term of the DCF, we see a continued runway for growth as Goosehead expands operations and its market penetration. We see margins expanding as the company gains operating leverage. Our price target and implied return support our Outperform rating.

Risks to rating and price target

The insurance brokerage industry presents a range of unique business risks, many of which could impact our investment rating, the most foreseeable of which include the following: key man risk, information security risk, and regulatory risk in the various states in which the company operates. The company is also exposed to certain economic and recession risks, particularly related to the US housing market and any changes in competition or pricing of industry commissions. A more comprehensive list of potential risk exposures is included in the company's 10-K and other recent filings.

Kinsale Capital Group Inc (NASDAQ: KNSL)

Mark Dwelle (Analyst)
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Rating: Outperform

Closing Price: $209.76

Price Target: $225.00

Implied All-in Return: 7.5%

Most recent company note: link

Investment summary

Kinsale is the rare P&C insurer with the ability to achieve strong premium growth while at the same time delivering above-average underwriting margins. The company's technology platform is a key differentiator against all but its largest peers, which positions Kinsale to better serve its distribution partners and in turn drives its opportunity to profitably increase market share within focused customer segments while still maintaining a low expense ratio. Focusing on hard-to-place risks in the E&S market, Kinsale has a long runway available for future growth. We expect the company to continue to achieve strong premium growth near term while generating mid-80s (or better) combined ratios and steady reserving. Management's experience in building specialty insurance organizations is a unique feature that gives us confidence that Kinsale can execute its business strategy. Our Outperform rating is premised on four main points: **(1) A platform for growth:** We believe Kinsale can achieve a normalized double-digit organic growth rate through a continued focus on hard-to-place risk and a willingness to offer terms on risks requiring more extensive underwriting. **(2) Demonstrated underwriting skill:** Management has demonstrated the ability to underwrite profitably with combined ratios in the mid-80s (or better). We expect this will continue over the near term. **(3) Technology supporting a low expense ratio:** Kinsale's expense ratio is several points better than peers, reflecting lower acquisition costs and a technology-aided expense structure. We anticipate this advantage will persist as the company continues to expand its distribution. **(4) The economy and growth**: Kinsale's ability to drive strong premium growth will depend in part on the economy and how it impacts its small business customers. Near term, we see the economy as a tailwind.

Valuation

Our $225 price target is based on approximately 6.3x estimated full-year 2022 book value per share. While this multiple is above many specialty peers, we believe it is supported by a superior combined ratio performance and promising long-term growth potential. Our price target considers Kinsale's operating ROE, premium growth rate and above-average combined ratio, all of which are better than peers. We also consider the company's comparatively shorter operating history. Our price target is consistent with our Outperform rating.

Risks to rating and price target

The main risks to our rating would include industry-wide pricing deterioration, large or unusual catastrophe losses in Kinsale's property business, and adverse development in ongoing business interruption litigation surrounding COVID-19. Like most P&C companies, reserves are always a risk and subject to estimation error. Kinsale also has a significant equity portfolio, and could see book value fluctuate alongside broader equity markets.

Investment Summaries – Industrials

Kratos Defense & Security Solutions Inc (NASDAQ: KTOS)

Ken Herbert (Analyst)
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Rating: Outperform

Closing Price: $20.92

Price Target: $24.00

Implied All-in Return: 14.7%

Most recent company note: link

Investment summary

We believe KTOS is very well positioned to benefit from the increased focus on unmanned capabilities at the DoD. The company is active in several markets, but it is the Unmanned segment that is most important for investor sentiment, and we believe is the primary source of upside in 2022-2023E. We believe the company has a very strong organic growth outlook, with several opportunities for programs to become material to the potential upside. The company is focused on capturing its share of the emerging budget for high-performance, low-cost, unmanned systems. The company is facing a growing competitive threat from larger defense primes, but we are confident the company's low-cost and time-to-market advantage will continue to see support from the DoD.

We do not expect M&A to be a focus for the company. Management has indicated that bolt-on transactions are possible in select markets, but the focus will remain on organic growth. We believe the most important potential catalysts for the stock are contract awards and broader sentiment on the defense budget. KTOS faces investor concern on its 2022 growth outlook, but we expect the strong 4Q21 bookings and the eventual passage of the FY22 DoD budget to support confidence in the 2022 upside.

Valuation

Our $24 price target is based on a 27.5x multiple applied to our 2023 EBITDA estimate. Over the past five years the stock has traded at an average ~38x multiple on the NTM EBITDA basis. We believe the company is positioned to take advantage of increased demand for high-performance unmanned systems, and it has several potential contract awards in the next six to 12 months that could be potential catalysts. Our price target supports our Outperform rating.

Risks to rating and price target

Any of the following could impede the realization of our rating or price target: (1) Incremental delays to tactical drone or other development programs; (2) The successful execution of test flight programs or other development milestones; (3) Incremental pressure on overall defense spending, or spending for specific programs of importance to KTOS; (4) An extended continuing resolution (CR) associated with the beginning of the U.S. Government fiscal year 2022; (5) A shift in defense spending priorities away from important growth areas for KTOS, including unmanned systems, space, and hypersonics; (6) Greater-than-expected investment spending to support organic growth opportunities; (7) Additional COVID-related delays associated with defense program travel or testing, such as a potentially reduced activity level at aircraft flight test ranges; (8) The ability to hire the necessary staff, or to procure the necessary security clearances, to deliver on the expected production levels; (9) Broader investor pessimism on the outlook for defense stocks.

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