Vicor Technologies, Inc.

Update | USA | Diagnostics Apr-2011

Rating: Speculative BUY
Target Price: $1.38
Current Price: $0.44
UPSIDE: 213%

Price Chart

Stock information Reuters: VCRT.OB
Bloomberg: VCRT:US
Country: USA
Sector: Healthcare Diagnostics
M-Cap: $20.8 million
52 Weeks H/L: $ 0.35 - $ 0.88

VICOR TECHNOLOGIES, INC
Vicor is a development stage company which has developed a noninvasive diagnostic technology that measures heart rate variability to assess the risk of total mortality in patients with a number of life threatening conditions as well as the presence of autonomic nervous system dysfunction in diabetic patients. The company has received a 510(k) clearance from FDA to measure heartbeat rate variability and anticipates obtaining clearances for two more applications: as a diagnostic to identify congestive heart failure patients with a high risk of cardiac mortality (either from arrhythmic death or pump failure death) and to use its technology as a vital sign indicator to identify trauma patients requiring immediate life saving intervention (developed in collaboration with the U.S. Army). Studies for other applications are also underway.

Analyst: Vitalie Eremia, CFA

SUMMARY

Growing distribution network, good January sales

- New distribution agreements in China, Israel and Australia are probably the most important news from Vicor in the past few months. The company desperately needs to grow sales and establishing new channels is very important.
- As we mentioned earlier, Vicor had decent sales in January, which exceeded the entire previous quarter. However, Vicor needs to show that this performance is sustainable.
- Vicor has established a lease program during Q4-2010. This should help Vicor to reach more customers, while still receiving its revenues fully at the time of sale.
- The company has significantly increased its debt, but is likely to need more cash to push sales.
- We have revised our projections in the light of very slow 2010 performance. The company remains a Speculative Buy with good upside, but target price is lower at $1.38 per share.

Vicor: Key Financial Data

$ millions	2009	2010	2011e	2012e	2013e
Revenue	0.0	0.2	1.8	10.8	32.2
Operating income	-7.3	-6.5	-7.7	-6.5	-2.8
Operating margin	n/a	-3451.9%	-431.8%	-60.7%	-8.6%
Net Income	-6.6	-6.2	-12.4	-11.1	-7.1
Net margin	n/a	-3304.8%	-698.7%	-102.9%	-22.0%
EPS, $	-0.18	-0.14	-0.12	-0.10	-0.06

Source: OPUS

RECENT DEVELOPMENTS

Growing international distribution network

Australia

The company reports that its Chief Medical Officer Daniel N. Weiss, MD, FACC, addressed a meeting of The Royal Melbourne Hospital cardiologists. Mr. Weiss introduced the PD2i Analyzer™ to 30 of the hospital's cardiologists and also discussed the results of recent clinical trials involving the PD2i®. Vicor signed an agreement with Greatest Asset Limited to serve as its non-exclusive agent for the marketing and sale of the PD2i Analyzer™ in Australia.

Israel

Vicor has entered into an agreement with Hadar Training and Medical Services to serve as its exclusive agent for the marketing and sale of its PD2i Analyzer™, PD2i CA™ (Cardiac Analyzer) and PD2i VS ™ (Vital Sign) in Israel and Palestine. Prior to marketing of Vicor's equipment, Hadar will have to obtain the approval from the Israel Ministry of Health and any other required regulatory authorities for the marketing of Vicor's products.

China

Vicor reports that Guangzhou Jiyuan Biotech has become its exclusive distributor of the PD2i Analyzer™, PD2i CA (Cardiac Analyzer)™, and PD2i VS (Vital Sign) ™ in China, Hong Kong, and Macau. Guangzhou Jiyuan Biotech needs to obtain the approval from China's State Food and Drug Administration for the marketing of Vicor products.

...and the USA

In December, the company also announced that it had registered sales of its PD2i Analyzer™ in six new states across the USA.

Accelerating sales

January 2011 sales exceeded entire Q4-2010

Vicor reported $77 thousand in sales for January 2011 versus $69 thousand registered during Q4-2010 and $190 for the entire 2010. However, Vicor must demonstrate that it can sustain and grow sales and that it is not a one-off result.

Lease program for purchasers of PD2i Analyzer™

Additional purchase options for customers

Vicor has established a captive lease program with Coastal Leasing, Inc. to provide a financing option for purchasers of its PD2i Analyzer™.

New director of sports medicine

Focus on sports medicine

In February Vicor announced that it hired Steve A. Watts, MD, as director of sports medicine, a new part-time position. Dr. Watts will manage clinical trials to test the efficiency of Vicor's PD2i Analyzer™ to diagnose concussion and other sports-related conditions. Mr. Watts is a tenured associate professor in the UMMC Department of Orthopedic Surgery and Rehabilitation and the Department of Family Medicine. He also is Director for the Sports Medicine Fellowship Program, as well as University Sports Medicine staff physician at UMMC and team physician for sports teams of a number of colleges and schools. Dr. Watts is also a member of a number of medical societies serving diverse sports activities. He holds a Certification of Additional Qualification in Sports Medicine. Dr. Watts earned his MD at the University of Texas Southwestern Medical School. He holds a Texas Secondary Teacher's Certification in Biology and Chemistry from the University of Houston and a BS in Biology and Chemistry, cum laude, from the University of Houston.

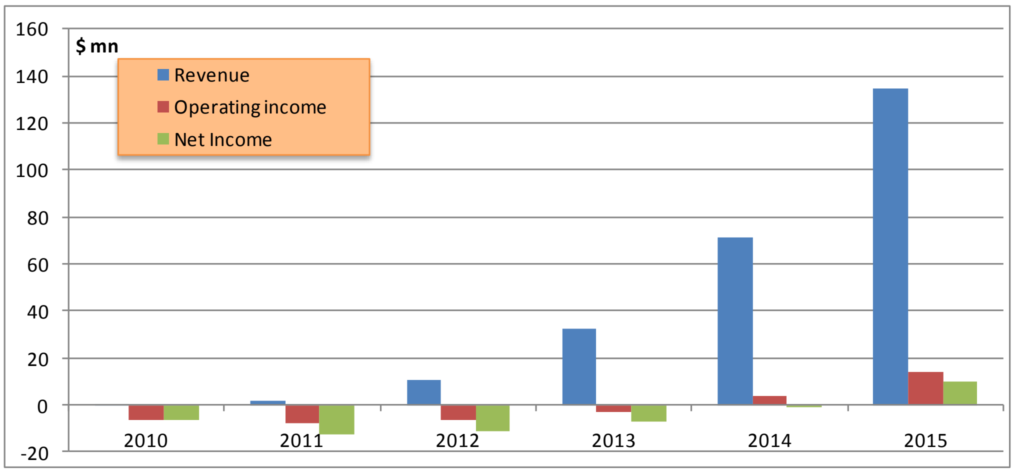
I. VALUATION

Although Vicor did not meet our expectations about revenue in 2010, its long-term outlook has not changed. We have adjusted our near-term forecasts, but longer term assumptions remain largely unchanged, although we have made some changes to these too. We do not expect the company to reach its maturity sales and operating profits until 2014, thus comparative multiples-based valuation cannot be done, as analyst consensus data for peers is generally available for 2011-2012 only. We thus have valued Vicor using the DCF approach, based on our projections of the company's sales and cash flows.

I.1. REVENUE FORECAST

Quick revenue growth expected

… but no profits until 2014



Source: analyst estimates.

Recurring revenues from test analysis will be the main source of income

We assumed that the growth rate of device sales will accelerate, and that Vicor will sell about 220 devices in 2011, growing to 4,000 units in 2015 (down from previous expectation of 5,000 as the company has failed to record any meaningful sales in 2010), at $6,500 per unit to total $26 million in device sales in 2015. We also assumed that each installed device will become increasingly used, from an average of 32 tests per device in 2011 to 300 in 2015. Thus, in 2015, we project an installed base of 9,078 devices, running a total of 2.7 million tests per year. At an average of $40 per test, this translates into $109 million in analysis revenues.

We also assumed that the gross margin will stabilize at 20%. We did not assume a higher gross margin because as soon as the company fully recovers its development costs for the PD2i platform, it will have to pay a 10% royalty on all PD2i-related revenues to the technology inventor. Again, our estimates are more conservative than Vicor's estimates of a 70% profit margin for analyzing diagnostic data (it is not clear what the "profit margin" refers to, but our estimates are definitely less optimistic).

Operating costs are expected to grow much more slowly than sales due to their semi-fixed nature. As such, we expect Vicor to reach an operating margin of 10.4% in 2015, with a net margin of 7.4%.

After 2015, we expect the revenue growth to slow down to 2% by 2021, as market reaches saturation.

I.2. DCF MODEL

Main assumptions underlying the DCF model are shown below:

WACC calculation	
Stock Price, $	0.44
Shares Outstanding, 000s	47,192.5
Market cap, $ 000s	20,764.7
Book Value of Net Debt, $ 000s	8,538.0
Enterprise value, $ 000s	29,302.7
Beta	1.00
Market premium	5.00%
Risk-free Rate	3.56%
Cost of Equity	8.6%
Long-term Equity Weight	70.9%
Cost of Debt	10.0%
Long-term Tax rate	38.0%
Tax Effected Cost of Debt	6.2%
Long-term Debt Weight	29.1%
WACC	7.9%
Terminal growth	2.0%
Forward diluted shares, 000s	120,000

Source: SEC filings, analyst estimates

We assumed the beta at 1, as betas available from public sources seem to be somewhat improbable: -0.29 reported by Yahoo! Finance and -0.38 by Reuters. We feel that the company's products will make it quite robust and resilient in difficult economic environments, warranting a relatively low beta, but given that the company still needs to break even, we don't think a beta less than 1 is justified.

We also assumed that the company will double its number of shares as it issues stock to raise additional funds to finance its growth. And we expect the company to begin paying income tax on its earnings in 2019.

$ millions	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	0.2	1.8	10.8	32.2	71.1	134.9	175.4	210.5	231.6	248.5	260.1	265.3
Revenue growth	n/a	839.6%	506.4%	199.3%	120.5%	89.9%	30.0%	20.0%	10.0%	7.3%	4.7%	2.0%
EBIT	-6.5	-7.7	-6.5	-2.8	3.9	14.0	18.2	21.8	24.0	25.8	27.0	27.5
EBIT margin	-3451.9%	-431.8%	-60.7%	-8.6%	5.5%	10.4%	10.4%	10.4%	10.4%	10.4%	10.4%	10.4%
EBIT*(1-tax)	-6.5	-7.7	-6.5	-2.8	3.9	14.0	18.2	21.8	24.0	16.0	16.7	17.1
(+) Dep & Amort	0.1	0.3	0.4	0.6	0.8	1.0	1.2	1.3	1.5	1.6	1.8	2.0
(+) Stock-based comp	0.7	0.7	0.8	0.9	0.9	1.0	1.2	1.4	1.4	1.4	1.4	1.3
(+) CapEx	-0.2	-0.3	-0.5	-0.7	-0.8	-1.0	-1.3	-1.6	-1.7	-1.8	-1.9	-2.0
(+) Decrease in non-ca	-0.3	-1.2	-2.2	-4.0	-5.8	-8.1	-5.1	-4.4	-2.7	-2.1	-1.5	-0.7
= Free Cash Flow (FC	-6.2	-8.2	-8.0	-5.9	-0.9	6.9	14.2	18.5	22.5	15.1	16.5	17.7
Terminal value												307.8
Discounted cash flov	**-6.2**	**-7.6**	**-6.9**	**-4.7**	**-0.7**	**4.7**	**9.0**	**10.9**	**12.3**	**7.6**	**7.8**	**7.7**
Discounted terminal												**133.8**

Source: analyst estimates

DCF valuation	$ millions
DCF stream	40.1
DC terminal value	133.8
Total DC Enterprise Value	173.8
(Less) Net Debt	8.5
Equity Value	165.3
Price target, $	**1.38**

The sensitivity of our valuation model to WACC and terminal growth rates is shown below:

Even with higher WACC and slower subsequent growth, there is upside potential

		WACC	
LT Growth ↓	**5.9%**	**7.9%**	**9.9%**
1.0%	1.97	1.21	0.80
2.0%	2.41	$\boxed{\textbf{1.38}}$	0.88
3.0%	3.17	1.62	0.99

III. RECENT FINANCIAL RESULTS

Despite beginning to sell its products, Vicor remains a start-up company, with all the financial characteristics of a startup: losses, high leverage, negative equity and high potential stock dilution.

III.1. INCOME STATEMENT

Sales are minimal

For Q4-2010, Vicor reported $67 thousand in revenues, which brought the full year 2010 sales to a total of $189 thousand. The gross margin was 35.8% and 30.7% during Q4-2010 and FY10 respectively. Q4-2010 sales were significantly better than in Q2-2010 and Q3-2010, when the company registered just $8 and $14 thousand in revenues. Recently, the company reported $77 thousand in revenue in January 2011 alone, which exceeds the revenue registered during entire Q4-2010. It remains to be seen if Vicor can sustain and growth its revenues.

Selected income statement indicators:

$'000	Q4-09	Q4-10	YoY change	FY09	FY10	YoY change
Revenues	0	67	n/m	0	189	n/m
Gross profit	0	24	n/m	0	58	n/m
Gross margin	*n/a*	*35.8%*	*n/a*	*n/a*	*30.7%*	*n/a*
Research and development	353	127	-64.0%	964	638	-33.8%
SG&A expenses	1,057	1,822	72.4%	3,705	5,944	60.4%
Interest expense	1,006	724	-28.0%	2,485	2,273	-8.5%
Operating loss	-2,457	-2,649	7.8%	-7,321	-8,797	20.2%
Net loss	1,124	-477	-142.4%	-6,622	-6,246	-5.7%
EPS	0.02	0.00	-100%	-0.18	-0.14	n/m

Source: company reports, analyst calculations.

Total operating expenses increased by 8.8% during Q4-2010 and amounted to $2.7 million, driven by a 72% increase in selling, general and administrative (SG&A) expenses which accounted for 68.2% of total operating expenses. For full 2010, total operating expenses increased by 21% year-on-year and amounted to $8.9 million, again represented mostly by SG&A expenses (67.1%). SG&A expenses increased by 60.4% during 2010 mostly due to an increase in headcount and sales and marketing efforts.

Interest expenses, which Vicor classifies as operating costs, accounted for 25.7% of total operating expenses during 2010 and decreased by 8.5% year-on-year due to reduction in debt issuance costs and conversion of debt into equity, partially offset by an increase in interest expenses related to higher debt levels.

Losses are large

Operating loss grew to $8.8 million, or by 20.2% year-on-year in 2010, while net loss contracted to $6.3 million, or by 5.7% year-on-year. The reduction in net loss is related to the 85% increase in gain from derivative financial instruments generated by the change in the company's common stock price and is thus neither cash-impacting, nor economically significant (as it is not related to Vicor's operations).

III.2. BALANCE SHEET

Balance sheet remains weak

80% of balance sheet assets are not related to operations!

The balance sheet remains weak with little cash, high debt and derivative liabilities and negative equity. The main asset on the company's balance sheet is deferred financing costs which amounted to $8 million at the end of 2010, comprised of unamortized derivative discount on its debt. The deferred financing costs increased sevenfold during Q4 due to increased debt.

Selected balance sheet items:

$'000	**30-Sep-10**	**31-Dec-10**
Cash	331	1,119
Other current assets	269	527
Total current assets	**600**	**1,646**
Intellectual property	201	192
Net property and equipment	106	155
Deferred charges	650	8,076
Other non-current assets	18	18
Total Assets	**1,575**	**10,087**
Accounts payable and accrued expenses	1,068	1,166
Current debt	660	360
Due to related parties	89	88
Total current liabilities	**1,832**	**1,614**
Long-term debt	2,226	8,277
Derivative financial instruments	5,469	7,692
Accrued dividends	834	932
Total long-term liabilities	**8,529**	**16,901**
Equity	**-8,786**	**-8,428**
Total liabilities and equity	**1,575**	**10,087**

Source: SEC filings.

More cash

Cash and cash equivalents more than tripled during the quarter, although their share of total assets declined to 11% from 21% as total assets increased more than sixfold due to the growth in deferred costs as mentioned above. Intellectual property and PPE together accounted for 3.4% of assets as of December 31, 2010 and increased by 13% in total value during the quarter.

A lot more derivative liabilities

Derivative financial instruments continue to dominate the company's balance sheet, amounting to $7.7 million at the end of 2010, comprised of conversion options embedded in 8% Subordinated Convertible Promissory Notes, 10% Convertible Promissory, and warrants to purchase common stock issued with preferred stock.

…and much more debt

Vicor has significantly increased its debt during the last quarter of 2010 – by more than threefold to $8.6 million. Most of it is long-term debt, mainly composed of 8% subordinated convertible notes and 10% convertible promissory notes. Current debt amounted to $360 thousand, or 4% of total debt.

Breakdown of debt:

$'000	**31-Dec-10**	**Interest**	**Maturity**
2004 notes	250	12%	month-to-month
Convertible Promissory note	110	12%	month-to-month
Total current debt	**360**		
8% Subordinated Convertible Promissory Notes	5,273	8%	Q4-2012
10% Convertible Promissory Notes	2,804	10%	Q3-2012
Bank loan, unsecured	200	3.45%	Q1-2012
Total debt	**8,637**		

Source: SEC filings.

Apparently some debt relates to derivatives

The increase in debt during the quarter significantly exceeds the cash flows from financing activities. Apparently, the 8% subordinated notes have derivative features attached to them that were recorded as debt instead of being part of the derivative liability item on the balance sheet.

III.3. CASH FLOWS

Vicor's cash flows consist mainly of cash outflows from operating activities; offset by inflows from financing activities (mainly issuance of debt), while investing activities remain minimal. During Q4-2010, the company raised $2.8 million from the sale of notes offset by $100 thousand in repayments.

Quarterly cash flow indicators:

$'000	FY09	FY10	Q4-09	Q4-10
CFO	-3,663	-5,618	-1,019	-1,848
CFI	-23	-178	1	-68
CFF	-4,048	6,371	497	2,704
Net Cash Flow	362	575	-521	788

Source: SEC filings.

III.4. STOCK DILUTION

Potential dilution is significant

Potential stock dilution remains at elevated levels. Most of the company's debt has conversion rights. As of December 31, 2010, the company had 46.8 million shares outstanding and approximately 57.3 million of shares potentially issuable in connection with convertible debt, options and warrants. However, all these instruments are out of the money at the market price of $0.44 as of April 6, 2011.

MEANING OF RATINGS

Buy

We believe the company is undervalued relative to its market and peers. We believe its risk reward ratio strongly advocates purchase of the stock relative to other stocks in the marketplace. Remember, with all equities there is always downside risk.

Speculative Buy

We believe that the long run prospects of the company are positive. We believe its risk reward ratio advocates purchase of the stock. We feel the investment risk is higher than our typical "buy" recommendation. In the short run, the stock may be subject to high volatility and continue to trade at a discount to its market.

Neutral

We will remain neutral pending certain developments.

Underperform

We believe that the company may be fairly valued based on its current status. Upside potential is limited relative to investment risk.

Sell

We believe that the company is significantly overvalued based on its current status. The future of the company's operations may be questionable and there is an extreme level of investment risk relative to reward.

SOME NOTABLE RISKS WITHIN THE MICROCAP MARKET

Stocks in the Microcap segment of the market have many risks that are not as prevalent in Large-cap, Blue Chips or even Small-cap stocks. Often it is these risks that cause Microcap stocks to trade at discounts to their peers. The most common of these risks is liquidity risk, which is typically caused by small trading floats and very low trading volume which can lead to large spreads and high volatility in stock price. In addition, Microcaps tend to have significant company specific risks that contribute to lower valuations.

Investors need to be aware of the higher probability of financial default and higher degree of financial distress inherent in the microcap segment of the market.

DISCLAIMER

Opinions, information or ratings contained in this report are suggested solely for information purposes by qualified professional analysts. The opinions expressed in this research report are analyst's personal views about the company. The information contained herein is based on sources which we believe to be reliable but is not guaranteed by us as being accurate and does not purport to be a complete statement or summary of the available data. Opus Group Financial, publisher, editor and their associates are not responsible for errors and omissions. Information on companies is provided sometime by the companies themselves, or is available from public sources or may be the opinion of the writer and Opus Group Financial makes no representations, warranties or guarantees as to the accuracy or completeness of the reported company. Any usage of the word ―recommendation,‖ if any is to be defined as a ―rating‖ only. The information may contains forward-looking information within the meaning of Section 27A of the Securities Act of 1993 and Section 21E of the Securities Exchange Act of 1934 including statements regarding expected continual growth of the company and the value of its securities. In accordance with the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 it is hereby noted that statements contained herein that look forward in time which include everything other than historical information, involve risk and uncertainties that may affect the company's actual results of operation. Factors that could cause actual results to differ include the size and growth of the market for the company's products, the company's ability to fund its capital requirements in the near term and in the long term, pricing pressures, unforeseen and/or unexpected circumstances in happenings, pricing pressures, etc. Investing in securities is speculative and carries risk. Past performance does not guarantee future results. Opus Group Financial or any of its affiliates may or not be registered investment advisors or registered with a FINRA member broker dealer. Opus Group Financial has been advised that the investments in researched companies are considered to be high risk and use of the information provided is at the investor's sole discretion. Be advised that the purchase of such high risk securities may result in the loss of some or all of the investment. Investors should not rely solely on the information presented and or the opinion of others. Factual statements made in research and evaluation reports are made as of the date stated and are subject to change without notice. Investing in private, small and micro-cap securities is highly speculative and carries an extremely high degree of risk. It is possible that an investor's entire investment may be lost or impaired due to the speculative nature of these companies. Opus Group Financial makes no recommendation that the securities of the companies researched and evaluated should be purchased, sold or held by individuals or entities that learn of the companies through Opus Group Financial. Opinions and recommendations contained in this report are submitted solely for advisory and information purposes and are not intended as an offering or a solicitation to buy or sell the securities. Readers are advised that this analysis report is issued solely for informational purposes. Neither the information presented nor any statement or expression of opinion, or any other matter herein, directly or indirectly constitutes a representation by the publisher nor a solicitation of the purchase or sale of any securities. The information used and statements of fact made have been obtained from sources considered reliable but neither guarantee nor representation is made as to the completeness or accuracy. No representation whatsoever is made by Opus Group Financial, its officers, associates or employees. Additional information on the company mentioned in this report is available upon request. It should be noted and made clear that this report should not be construed as advice designed to meet the particular investment needs of any investor. Such information and the opinions expressed are subject to change without notice. This report is not intended as an offering or a solicitation of an offer to buy or sell the securities mentioned or discussed. Opus Group Financial, it's officers or employees may at any given time buy, sell, or trade these securities during the term of the contract. They may from time to time have a position in the securities mentioned herein and may increase or decrease such positions without notice. The analysts are strictly prohibited from buying, selling, or trading these securities during the term of the contract. Any opinions expressed are subject to change without notice. Opus Group Financial encourages readers and investors to supplement the information in these reports with independent research and other professional advice. Professional, credentialed analysts are paid fully in advance for their initial reports by Opus Group Financial to eliminate a pecuniary interest and insure independence. Opus certifies that no part of the analysts' compensation was, is, or will be, directly or indirectly, related to the specific recommendation or views expressed by the analyst in the report. Analysts are under contract to Opus Group Financial to provide their reports solely for the benefit of the public. Opus Group Financial is under contract to be paid seventeen thousand five hundred dollars for initial research coverage and under agreement for monthly consulting and advisory services. The fees associated with this service are paid to Opus Group Financial and not directly to the analyst.