iSpecimen (ISPN): A Cool Idea With A Terrible Balance Sheet & Awful Loan Agreements

I try to research excellent companies solving complex problems trading at ridiculously cheap 3-5YR cash-flow estimates. This is not one of those write-ups.

I found iSpecimen (ISPN) after culling through a fresh batch of S-1 filings (something I do weekly).

ISPN caught my eye because its technology tries to solve a critical, *real* issue in the healthcare/life sciences space. I thought to myself, “Wow, this company looks like the *perfect* ARKK ETF addition.” What’s not to like?

Turns out, a lot. While the company’s technology is interesting (dare I say, promising), the balance sheet is so putrid and their bridge loan terms so egregious I wonder if the business will last 12 months post-IPO.

I contemplated throwing away the research and moving on to the next idea (which is what I *usually* do). But if there’s a utility in uncovering a potentially *great* idea, there *must be* some shade of value in unearthing an idea that *looks* promising but could destroy shareholder value.

The thesis: ISPN is trying to create an “Amazon-like” online marketplace for biospecimen distribution. The platform connects healthcare providers that want to sell biospecimens with researchers and institutions that need those specimens for life science research and studies. Initial results look promising. Revenue expanded from $3M to $5M over 9M September 2020.

The Problem: ISPN’s balance sheet is full of bridge notes, convertible notes, accrued interest, and A-B preferred stock issuances. The company cannot continue operations without external financing. This isn’t even considering the IPO. ISPN used bridge loans to pay for working capital to stay afloat. The $6M in bridge loans come with a *whopping* 30% interest rate. Moreover, $2M of the bridge loan comes from the founder’s *father*. You read that right. 30% interest rate on a $6M bridge loan for a company doing $5M in revenues. On top of that, the company continues to burn cash at a rate of ~$700K - $1M/quarter.

The Reality: Minority (common) shareholders get screwed investing in ISPN. Not only does the company have outstanding bridge loans with the company’s dad. They also have Series A, A-1, and B preferred stock. These of course come with accrued dividends totaling ~$4M (because that’s what you do when you burn $1M/month in cash). Not to be outdone, Preferred Stock shareholders receive dividends in the event of liquidation, dissolution, or winding up *before* common shareholders get a dime.

Knowing this, the question is simple: **Why would anyone want to own iSpecimen (ISPN) common stock?**

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ISPN Online Marketplace: An Overview

The company wants to create the largest online marketplace platform to connect sellers and buyers of live biospecimen materials. This platform would generate revenue for healthcare providers and hospitals while providing *a much easier* way to access vital biospecimens for research purposes.

The company solves a real problem. 400K researchers need biospecimens for research. Yet the current model makes it hard for them to find those specimens. >80% of researchers report limited research due to a *lack of access* to biospecimens. More specifically, the demand comes from three main customers:

- Biopharmaceutical
- Vitro Diagnostic (IVD)
- Government/Academic Institutions

Then there's the supply side, comprised of nine main providers:

- healthcare systems
- community hospitals
- clinics
- Private practice organizations
- commercial labs
- blood centers
- commercial biobanks
- Cadaveric donation centers

BENEFITS FOR RESEARCHERS

- Can reduce costs of specimen procurement
- Supports accelerated time to discovery
- Helps to reduce compliance and contracting risks

BENEFITS FOR HEALTHCARE ORGANIZATIONS

- Generates much-needed revenue
- Helps advance medical research
- Supports research mission and desires of philanthropic patients

REQUEST A QUOTE

These suppliers are located across 12 countries including the US, Europe and Asia. There's a clear profit incentive for these providers to sell on the iSpecimen platform. It provides them with an additional revenue source, something hospitals, and healthcare systems would love to have. Second, iSpecimen reduces search and compliance costs. ISPN matches providers with buyers in a compliance-approved manner without the cumbersome back-and-forth email exchanges between the two parties.

Currently, ISPN provides three types of biospecimens:

- Biofluids: whole blood, plasma, serum, urine, saliva, sputum, nasopharyngeal material, and cerebral spinal fluid
- Solid tissue: fresh, fixed, and cryopreserved tissue; and formalin-fixed paraffin-embedded blocks, slides, and curls
- Hematopoietic stem and immune cells

As of 09/30/2020, ISPN had 3,500+ external registered users representing 2,700+ unique organizations. During that time they've delivered over 130K specimens to support 1,700 unique research projects. They've also helped healthcare providers generate $7.5M+ in additional revenue.

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A Closer Look At The ISPN Marketplace

There are four aspects to the ISPN biospecimen platform (explanations from the S-1):

- Search

"The primary purpose of the Marketplace is to matchmaker between those with access to subjects, specimens, and data, and those with a need for them to power their research.

Researchers can instantly search across available medical records of large populations within iSpecimen's healthcare provider network"

- Workflow

"Our iSpecimen Marketplace technology enables suppliers to track and manage all of their specimen requests from feasibility assessment through the ordering and fulfillment process in a single web application, thereby streamlining their bioprocurement workflow.

Because the work that we do with our suppliers is often a secondary concern to their primary mission of providing patient care, we believe that seamlessly integrating into their workflow is critical to its use and ongoing success."

- Data

"De-identify, normalize, and harmonize our supplier network's data for usage in our iSpecimen Marketplace, ensuring the highest level of patient privacy and compliance with HIPAA and other applicable regulations that govern the research use of patient specimens and data. As of September 30, 2020, the iSpecimen Marketplace had ingested and harmonized data on more than 11 million patients, 58 million clinical specimens, one million banked specimens, 475 million laboratory test results, and 800.000 medical conditions."

- Adminstration & Reporting

"Compliance management includes manual and technology-based processes that allow iSpecimen to track and manage unique regulatory and legal requirements across customers and suppliers (such as consent requirements versus consents granted, required specimen and data uses versus allowable specimen and data uses, resale or distribution requirements versus resale or distribution rights) to make sure that customer requirements and supplier requirements match before transferring specimens and data."

In short, ISPN wants to create an Amazon-like platform for biospecimens. That's not my thinking. They say it on their website (see below):

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ISPECIMEN MARKETPLACE

The iSpecimen Marketplace™ is an Amazon™-like platform

I hate when companies compare themselves to other great businesses. I don't know what it is about saying "we're the Amazon of {insert your business here}" that curdles my stomach. But it does. In fact, I'd say they're not necessarily an "Amazon" platform. Rather a standard marketplace connecting buyers and sellers. What's the need to put yourself in Amazon's light?

So far the platform's worked.

ISPN has grown both sides of the marketplace since 2015. They've grown suppliers from 15 to 168 as of September 2020. And they've increased their demand-side customer base from 24 to 308 during the same time.

The top three suppliers accounted for 40% of the cost of revenue and the top two customers accounted for 35% of revenue generated.

Revenue Drivers: Sales Team + Average Sales Price

There are two levers that drive ISPN's sales growth:

- Size of the sales team
- Average sale price

In 2016 the company hired their first VP of Sales and did $1.4M with one salesperson. In 2017 they added two salespeople and doubled revenue to $3.1M. Finally, in Q4 2019 ISPN hired four more sales staff and created $9M in open order backlog.

Along with increased sales staff, the company's benefited from an increase in the average sales price (ASP). ISPN's generated a 110% 3YR CAGR on ASPs (see below):

Average Selling Price per Specimen Shipped (Unaudited)

	As of December 31,				CAGR	As of September 30,	
Average Selling Price	**2019**	**2018**	**2017**	**2016**	**2016-19**	**2020**	**2019**
Per Specimen Shipped	$329.18	$163.98	$95.46	$35.48	110.1%	$314.31	$324.73

Higher ASPs are due to an increased percentage of research-only specimens through the platform pipeline. Research-only specimens carry higher price tags than other specimens (specifically, remnant).

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Founder-Led & Predictable Income Statement

Another point for the bulls is that the company's led by its founder who owns 17% of the business. We love seeing insider ownership in any investment. The entire executive team owns 58% of the company. And we're not scared by the income statement. It's not unusual to see high revenue growth and expanding operating losses when analyzing young, growth companies.

So what has us scared for equity shareholders? The balance sheet and working capital requirements.

An Egregious Balance Sheet w/ Awful Debt & Preferred Terms

I want to spend the rest of the write-up discussing the balance sheet, as its one of the worst I've seen for common shareholders.

As of September 2020, ISPN had $957K in cash on the balance sheet with $1.57M in accounts receivable (mostly deferred revenue), and $26K in inventory. This gives us ~$3M in current assets. The company then assigns a $2.57M value on their internally developed software (which seems like a low bar to hurdle if you're a competitor trying to enter the space. In other words, all it takes is $2.6M to build what ISPN has?).

In total, ISPN sports ~$6M in total assets. I know, "But Brandon it's an asset-light business." Again, that's fine. But let's see what the liabilities section shows.

ISPN's liabilities show a company desperately trying to finance their operating cash burn any way they can. For example, they've ballooned accounts payable from $737K to $1.2M. This means they've deferred payments on those accounts to conserve cash. Of course, they'll eventually have to pay that. They've also increased accrued expenses by $200K and accrued interest by nearly $1.5M. In other words, they're not paying expenses right now to fund their operations in hopes they can turn it around in time to make up for the difference.

As such, they've needed external financing. And they've chosen two methods: convertible notes and bridge notes. ISPN has $5.5M in convertible notes, $2.3M in derivative liability, and $6.4M in bridge notes. This gets us a total of ~$14.2M in debt obligations. That's a bit intimidating when you only have $957K in cash on the books.

LIABILITIES, CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS' DEFICIT		
Current liabilities:		
Accounts payable	$ 1,212,058	$ 737,794
Accrued expenses	600,992	471,348
Accrued interest	3,119,654	1,745,515
Convertible notes payable, related parties, net of unamortized debt discount and debt issuance costs	5,489,728	5,350,278
Derivative liability for embedded conversion features	2,290,000	2,214,000
Bridge notes payable, net of debt issuance costs	4,588,504	3,586,326
Bridge notes payable, related parties	1,905,000	1,655,000
Note payable, current portion	473,239	—
Deferred revenue	581,912	—
Total current liabilities	20,261,087	15,760,261
Note payable, net of current portion	309,769	—
Total liabilities	20,570,856	15,760,261

But it gets worse. Let's break down the bridge notes in greater detail.

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The Most Outrageous Bridge Note Terms I've Seen

ISPN issued a $5.2M bridge note between 2018 and 2019. Here's the definition from the S-1 filing (emphasis mine):

> *"During 2019 and 2018, the Company issued Secured Promissory Notes (the "Bridge Notes") to new investors and existing stockholders in an amount of $5,250,000 to finance the Company's interim working capital needs.* ***Of this amount, $1,655,000 is held by related parties****. The Bridge Notes* ***bear interest at a rate of twenty-four percent (24%) per annum****, without compounding."*

That's not a typo. In our low-interest-rate world, this company received a 24% interest-bearing bridge loan. But it gets better. Since the company couldn't meet its first repayment deadline, the party extended its loan terms while raising the interest rate from 24% to a **whopping 30%.** See below (emphasis mine):

> *"In June 2020, the Bridge Notes were amended to further extend the maturity date through September 30, 2020. In January 2020, the Company issued additional Bridge Notes for proceeds of $1,000,000. On October 1, 2020, the Company amended the Bridge Notes to extend the maturity date to March 31, 2021, and to increase the interest rate from 24% to 30% after October 1, 2020."*

Notice the first quote that $1.655M of that bridge note is held by "related parties". This related party happens to be the founder's (Christopher Ianelli) father. What better way to show that you appreciate your dad by giving him a 30% interest rate note with first-lien on the entire business (see below)?

> *"The Bridge Notes are senior in right of payment and priority to any Convertible Debt and subordinated to any Senior Debt. The investors that hold the Bridge Notes are granted a first-lien security interest in substantially all assets of the Company ("Collateral")."*

At this point a curious investor would ask, "Well wait, does that mean the company is IPO'ing to pay off the founder's dad at 30% interest?" Bingo. Common minority shareholders will subsidize this *ludicrous* financing deal that benefits an immediate family member of the founder.

What does the common shareholder get in return for this act of philanthropy? **Nothing.** Have you forgotten about the preferred stockholders?

Preferred Shareholders Get Second Dibs

After Ianelli's dad is done filling his stomach with minority shareholders' capital, it's the preferred shareholders' turn to lick the bones clean. ISPN issued three types of preferred stock: Series A, A-1, and B.

The company issued 8M Series B, 561K Series A-1, and 2.61M Series A preferred stock. Preferred shareholders get all the perks of common equity-holders while *having collateral*.

For example, what's the first thing a cash-burning company with loads of 30% interest debt should do? If you said "pay accruing dividends to preferred shareholders" you're correct! ISPN has a total of ~$3.5M in accumulated dividends payable to its preferred shareholders.

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Where will this money come from? I'm assuming the common equity investors, of course. That is after daddy Ianelli gets paid. For those keeping score at home, here's the liquidation hierarchy:

1. Bridge notes (Papa Ianelli)
2. Series B shareholders (executives)
3. Series A-1 shareholders (executives)
4. Series A shareholders (executives)

There's a theme developing. Executives get paid handsomely in preferred dividends whether the company succeeds or fails. Heads they win, tails common stockholders lose (see below):

Name of beneficial owner	Common stock	exercisable within 60 days	shares beneficially owned	%	purchase additional shares	%	purchase additional shares	%
5% or more stockholders:								
Anna-Maria & Stephen Kellen Foundation(1)	1,091,187(2)	—	1,091,187	8.7%				
OBF Investments	1,388,784(3)	—	1,388,784	11.1%				
Named executive officers and directors:								
Andrew L. Ross	4,740,153(4)	—	4,740,153	37.9%				
Christopher Ianelli	1,903,933(5)	277,689	2,181,622	17.0%				
Jill Mullan	274,859(6)	482,758	757,617	5.8%				
Steven Gullans	—	—	—	—				
John L. Brooks III	—	—	—	—				
Margaret H. Lawrence	—	—	—	—				
All current directors and executive officers as a group (6 persons)	6,918,945	760,447	7,679,392	57.8%				

1) Mr. Kellen is the President of the Anna-Maria and Stephen Kellen Foundation, Inc. and therefore may be deemed to hold voting and dispositive power of the securities held by Anna-Maria and Stephen Kellen Foundation, Inc.

2) Consists of 991,988 shares of common stock issuable upon conversion of Series B preferred stock and 91,999 shares of common stock issuable upon exercise of warrants.

3) Consists of 1,388,784 shares of common stock issuable upon conversion of Series B preferred stock. Mr. Scholl is the President and Chief Executive Officer of OBF Investments, and therefore, may be deemed to hold voting and dispositive power of the securities held by OBF Investments.

4) Consists of 2,689,815 shares of common stock issuable upon conversion of Series A and Series B preferred stock and 30,055 shares of common stock issuable upon exercise of warrants.

5) Consists of 14,768 shares of common stock issuable upon conversion of Series A preferred stock.

6) Consists of 34,657 shares of common stock issuable upon conversion of Series A preferred stock.

With a $21M IPO, the company has *a lot of people to pay* before they can use that cash to invest in their "Amazon-like" marketplace that costs <$3M in software to make.

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How The Shorts Get Screwed

There's a couple of ways shorts get screwed with this company. First, ARKK overlooks the obvious governance and balance sheet risk and adds it to their genomics ETF. This would send a shockwave of buying pressure and propel the micro-cap company higher. I'm not sure how likely this is given the size of the IPO, but something to consider.

Second, ISPN could generate MASSIVE revenues which when coupled with IPO proceeds clean up their balance sheet in one swift motion. We'd see this through increased customer adoption (potentially by a major hospital/healthcare provider) coupled with increased ASP and a larger salesforce. But again this seems farfetched as the company has a lot of plates to feed before they can focus on the business. And all those initiatives cost money (that the company can't generate via operations).

Why Would Anyone Buy This?

I don't see why anyone would buy the common stock of this company. The preferreds? That's a different story with their juicy dividends. And unless you're an Ianelli next-of-kin you can't get a 30% note with the entire company as collateral.

Who's going to buy this stock? I'm afraid the company will use its healthcare/life sciences "marketplace" jargon to sell retail investors on the next-great-thing since Amazon's 1-day delivery.

Because let's face it. The technology sounds cool. You're creating a marketplace that fulfills a need and coagulates a highly fragmented supply base with sustained demand in high-growth end-markets.

The fact is the company doesn't have the balance sheet to properly invest in its own platform. In turn, I have zero faith in management's ability to effectively deploy capital. Why trust a management team that buys all the preferred with juicy dividends while paying off immediate family members with common IPO proceeds?

iSpecimen is hoping to dupe investors to pay-off irresponsible debt arrangements in a world when anyone can seemingly get a loan for <7% per annum. Common shareholders get nothing in exchange for the small chance the company grows fast enough to cover their current working capital obligations.

It's a terrible risk/reward bet as the company is likely a zero if any revenue growth falls through.

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