

4th October 2019

Making rain from cloud software & services

Successful investing boils down to 2 key things - 'buying low & selling high'. People often get the first right, but fail on the second due to a tendency to cling on to winning positions for far too long. Only later to twig that they would have been better served banking the profits, and recycling the proceeds into other more attractive areas.

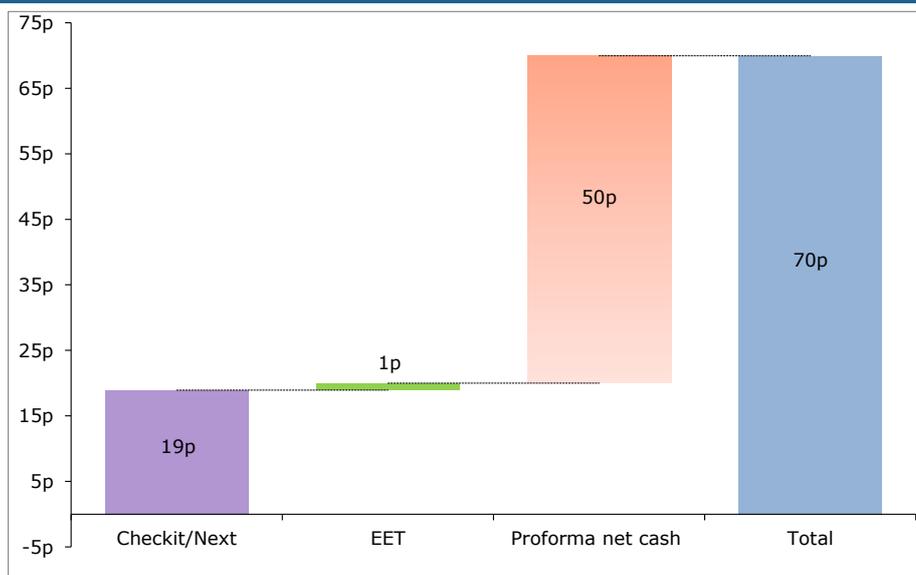
Not so Checkit (formerly Elektron Technology Plc). On 25th September the **group completed the disposal of its leading hermetically-sealed, fail-safe connector division Bulgin for £104.7m** (or 56.4p/share) to Equistone Partners, one of Europe's leading mid-market private equity houses. Representing FY20 EV/sales, EV/EBITDA, EV/EBIT and PE multiples of 3.3x, 9.8x, 10.2x and 12.9x respectively.

After deducting deal fees (£2.1m), director payments (£7.2m), retention bonuses (£0.6m), restructuring charges (£0.8m) and working capital adjustments (£0.6m), the **net receipts came in at a chunky £94m**. Hence leaving a **proforma £94m** (50p/share) **cash pile** (no debt). Elsewhere, the non-core EET (Eyecare) unit is also up for sale, and we suspect could chip in another £2m.

£81m to be returned to shareholders at 65p

The intention is to return the majority of these funds to shareholders in the form of a **2-for-3 £81m Tender Offer at 65p**. With the rest ear-marked for Checkit's rapidly expanding cloud based SaaS B2B solutions, with perhaps a little left over for bolt-on M&A. To us, **this strategic pivot towards software & services makes perfect sense**. Albeit in the short run the Bulgin disposal will be earnings dilutive, with our sum-of-the-parts valuation (see below) declining from 83p to 70p per diluted share.

Sum of the parts valuation (p/diluted share) – post Bulgin



Source: Equity Development

Company Data

EPIC	AIM: CKT
Price (last close)	54p
52 week Hi/Lo	56p/32p
Market cap	£100m
ED SOTP valuation	70p/share
Proforma net cash (pre tender offer)	£94m
Share count	186.1m
Avg. daily volume	500k

Share Price, p



Source: Share Cast

Description

Checkit (Est FY20 sales £11.6m: split £9.0m Checkit vs £2.6m EET) is aiming to become a global leader in real-time operations management software.

It operates a SaaS platform that digitises and vastly improves the running of routine tasks/workflows, particularly with regards to efficiency, quality, standardisation and regulatory compliance. In May'19, the group acquired Next Control Systems for £8.8m, which added scale to the IoT (Internet of Things) element of the product suite.

Next News: Tender offer

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Significant scope to repeat Bulgin’s incredible success

Moreover by exiting Bulgin at an favourable price, and re-deploying some of the funds into its proprietary technology, **we think this should lead to further lucrative returns**. Indeed the Board have done this before, with the shares trading at only 6.9p back in Sept’16 vs 55p today – representing **an 8-fold return**.

Sure past performance is no guarantee of future success. Yet equally, it’s a pretty strong indicator that the company has a firm grip of what works & what doesn’t. On top, **the Bulgin sale will enable far greater resource** (especially management time) **to be focused on Checkit** – ie to accelerate product innovation, marketing and international expansion. Alongside maximising the synergies from combining Checkit’s cutting edge software with Next’s temperature monitoring (retail, healthcare & life sciences) and data-rich Building Energy Management services.

Pivoting to software and services

With regards to quantum, it is hard to be too precise at this stage, yet we believe **the target is to** (at least) **double Next’s operating profit (£1.2m 2018) over the following 2 years**. A lot of which will be derived from self-help measures (re improved pricing, contracts, procurement, etc), with the remainder coming from organic growth. Although this will require some one-off restructuring & integration costs (c. £0.75m), coupled with extra R&D investment.

Cross fertilisation of ideas, cultures and best practise

Rationale for the Next Control System acquisition

- Scale
- Improve operational capability
- Diversify
- Cross-sell
- Broaden range
- Deepen domain knowledge
- Enhance consultancy



Source: Company

Further out, we believe Checkit’s **innovative SaaS solutions can be deployed across many other verticals**, with the potential to eventually become the *de facto* standard for

operations management. The immediate aim being to exploit this **1st mover advantage**, and **scale rapidly**.

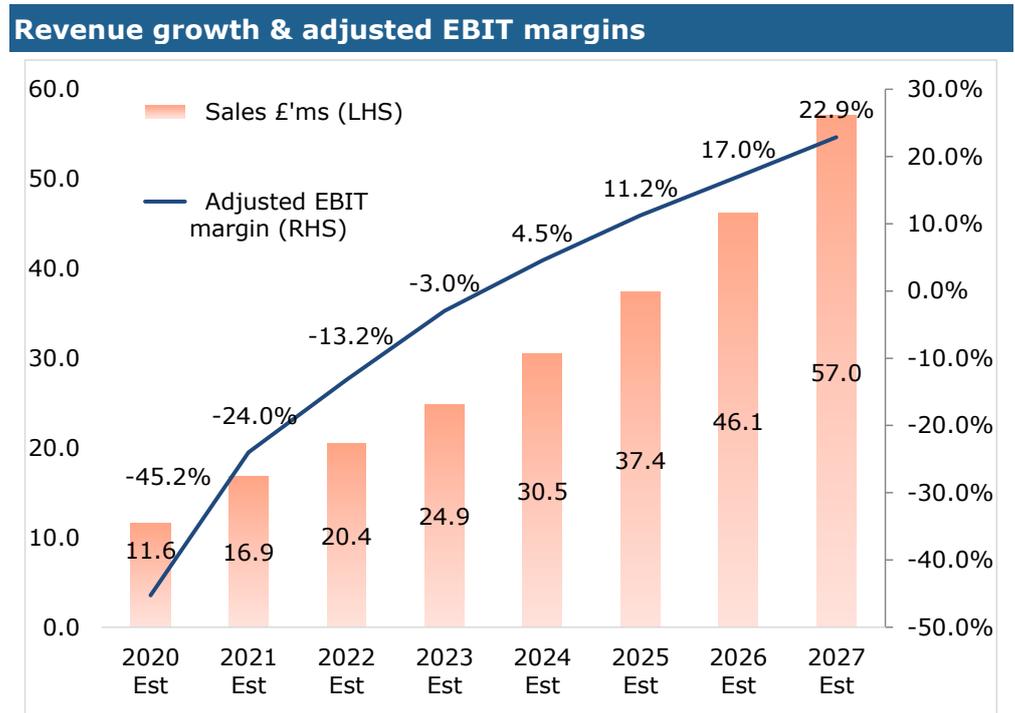
Checkit's Real-Time Operations Management System

Work Management Define, guide, enforce and audit user activities	IoT Continuously monitor and control business resources	Operational Insight Apply BI to the workplace as an aid to business improvement
		
People Android app (bring-your-own device)	Things Sensors and controllers, managed through the Cloud	Data Reporting; real-time dashboards; AI

Source: Company

Demonstrated track record of delivering value

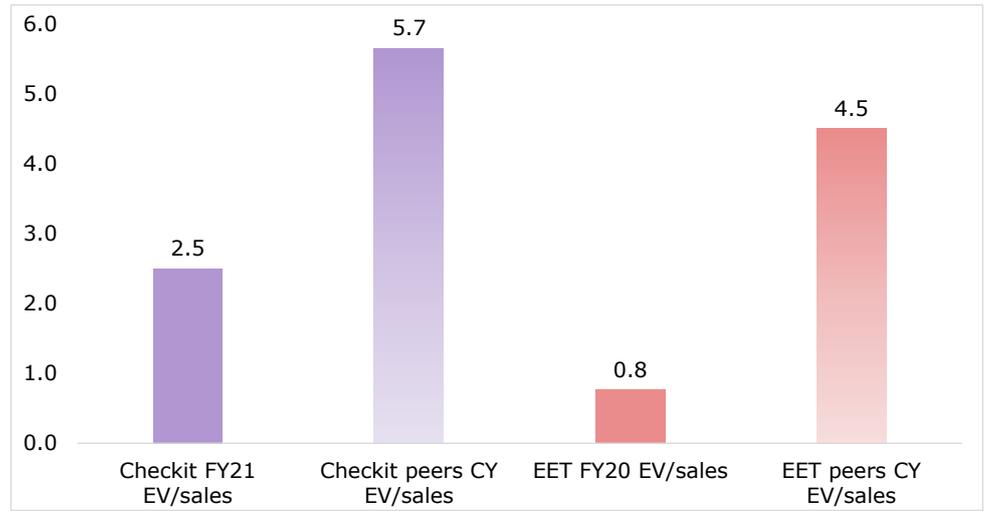
In terms of leadership, ex-CEO John Wilson has transferred with Bulgin to Equistone Partners, but is staying on as a non-exec director of Checkit. Keith Daley remains as Exec chairman and takes over Mr Wilson's previous day-to-day responsibilities, with CFO Andy Weatherstone continuing in his role.



Source: Equity Development. Excludes the amortisation of acquisition goodwill

Plus at 54p, there's appears to be a **material disconnect between Checkit's implied valuation and comparative industry metrics** (see below).

Valuation benchmarks vs peers

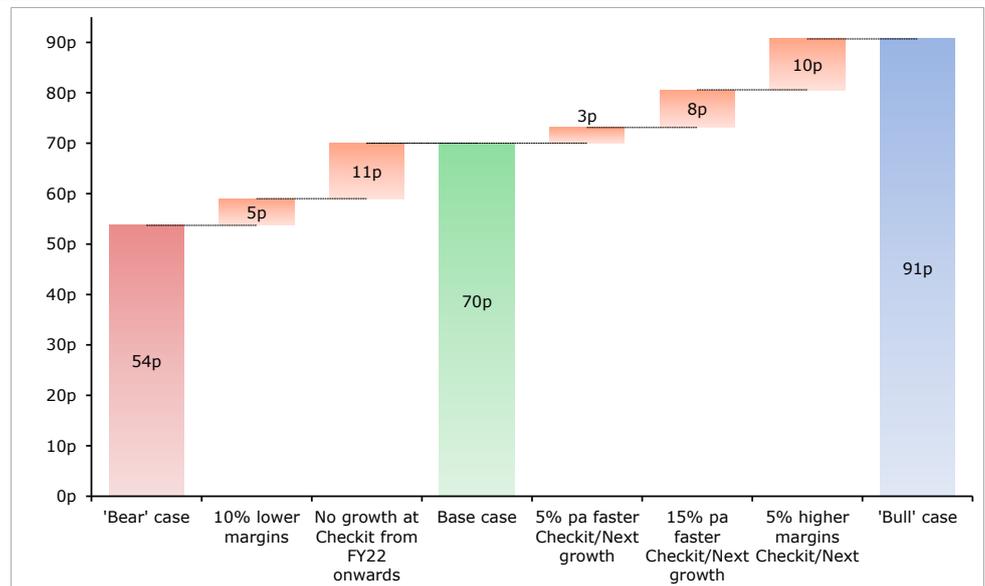


Source: Equity Development

Fortress like balance sheet, sporting £94m of net cash

In terms of risk, the organisation possesses a **rock solid balance sheet**, offering a **hefty margin of safety** and **minimal downside** for investors - as illustrated by our 'Bear' and 'Bull' scenarios (see below).

Sensitivity analysis (p/share)



Source: Equity Development

Exec Chairman Keith Daley commented "**The completion of the disposal of Bulgin business marks another milestone for the Group. We are now focused on Checkit's real-time operations management software.**

It has been an absolute pleasure to work with John over the past 11 years. During that time the Group has been transformed into an engine for the creation of shareholder value. The achievements are in no small way due to him." A circular and notice of general meeting in relation to the Tender Offer are expected to be issued shortly.

Finally, **the first day of trading in the new Checkit shares (AIM: CHK) commences today at 8am.**

Summary financial projections

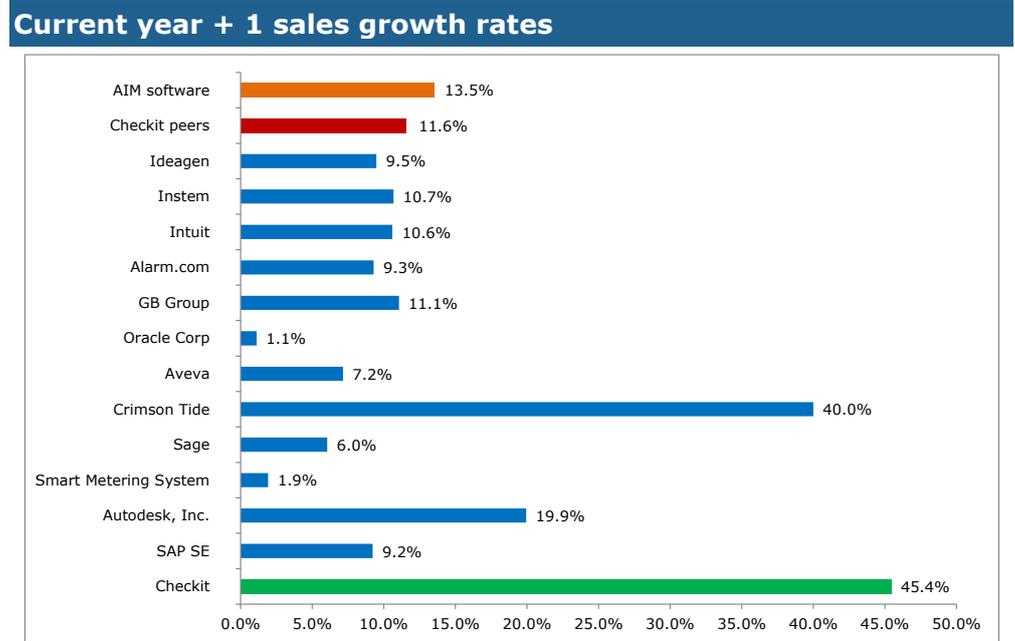
Checkit (January yearend)	2020 Est £ms	2021 Est £ms	2022 Est £ms	2023 Est £ms	2024 Est £ms	2025 Est £ms	2026 Est £ms	2027 Est £ms
Turnover	11.6	16.9	20.4	24.9	30.5	37.4	46.1	57.0
% growth	-65.6%	45.4%	21.1%	21.8%	22.4%	22.9%	23.3%	23.6%
Gross Profit	4.6	7.1	9.0	11.5	14.6	18.7	24.0	30.8
% margin	40.0%	42.0%	44.0%	46.0%	48.0%	50.0%	52.0%	54.0%
Operating expenses (ex DA)	-7.8	-9.3	-9.7	-10.2	-11.1	-12.2	-13.7	-15.1
Opex % sales	66.9%	55.1%	47.5%	40.9%	36.5%	32.6%	29.6%	26.5%
Adjusted EBITDA	-3.1	-2.2	-0.7	1.3	3.5	6.5	10.3	15.7
% EBITDA margin	-26.9%	-13.1%	-3.5%	5.1%	11.5%	17.4%	22.4%	27.5%
Depreciation & amortisation	-2.1	-1.8	-2.0	-2.0	-2.1	-2.3	-2.5	-2.7
Adjusted EBIT	-5.2	-4.0	-2.7	-0.7	1.4	4.2	7.9	13.0
% EBIT margin	-45.2%	-24.0%	-13.2%	-3.0%	4.5%	11.2%	17.0%	22.9%
Interest	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Adjusted Profit before Tax	-5.2	-4.0	-2.7	-0.7	1.4	4.2	7.9	13.0
Tax	0.0	0.0	0.0	0.0	-0.3	-0.8	-1.5	-2.5
Adjusted earnings	-5.2	-4.0	-2.7	-0.7	1.1	3.4	6.4	10.6
Adjusted EPS (p)	-2.8	-2.2	-1.4	-0.4	0.6	1.8	3.3	5.4
EPS growth rate	-230.1%	-23.2%	-33.7%	-72.8%	-251.2%	202.7%	86.1%	65.0%
Dividend (p)	0.0							
Yield	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Valuation benchmarks								
P/E ratio	-19.3	-25.1	-37.8	-139.3	92.1	30.4	16.4	9.9
EV/Sales	0.6	0.4	0.3	0.3	0.2	0.2	0.1	0.1
EV/EBITDA	-2.1	-2.9	-9.0	5.1	1.8	1.0	0.6	0.4
EV / EBITA	-1.2	-1.6	-2.4	-8.8	4.7	1.5	0.8	0.5
Adjusted tax rate	-19.0%	-19.0%	-19.0%	-19.0%	-19.0%	-19.0%	-19.0%	-19.0%
EBITDA drop through rates	44.9%	17.1%	42.0%	44.8%	40.0%	42.9%	44.1%	49.3%
Unlevered cashflow yield	-3.4%	-4.5%	-3.0%	-1.2%	0.5%	2.7%	5.5%	9.6%
PEG ratio	0.08	1.08	1.12	1.91	-0.37	0.15	0.19	0.15
Net cash/(debt)	92.0	87.5	84.5	83.2	83.7	86.4	92.0	101.6
Sharecount (Ks)	187.1	188.1	189.0	190.0	190.9	191.9	192.8	193.8
Shareprice (p)	54p							

Source: Equity Development estimates. Excludes the amortisation of acquisition goodwill

Key risks

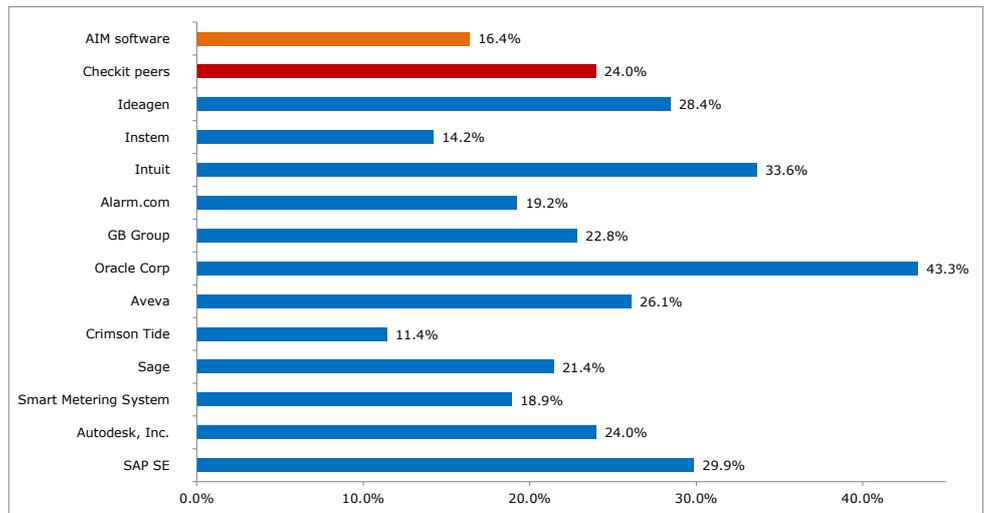
- Slowdown in global GDP which could impact CKT’s end-markets.
- Anticipated growth/profitability of Checkit may take longer than envisaged, cost more and/or not be fully realised.
- Successful integration of Next Control Systems, who have a high customer concentration relating to the John Lewis/Waitrose partnership.
- Foreign exchange fluctuations.
- Regulatory and tax changes.
- Competition may intensify as a function of new/existing players.
- Being relatively small, Checkit could get squeezed by larger rivals, partners and customers, particularly with regards to margins.
- Generic risks of retention/recruitment of key staff, etc.
- Potential future impact from BREXIT.
- As with many smallcap AIM stocks, daily trading volumes can occasionally decline, particularly during seasonally quieter periods and/or between newsflow.

Appendix - Valuation benchmarks & industry KPIs



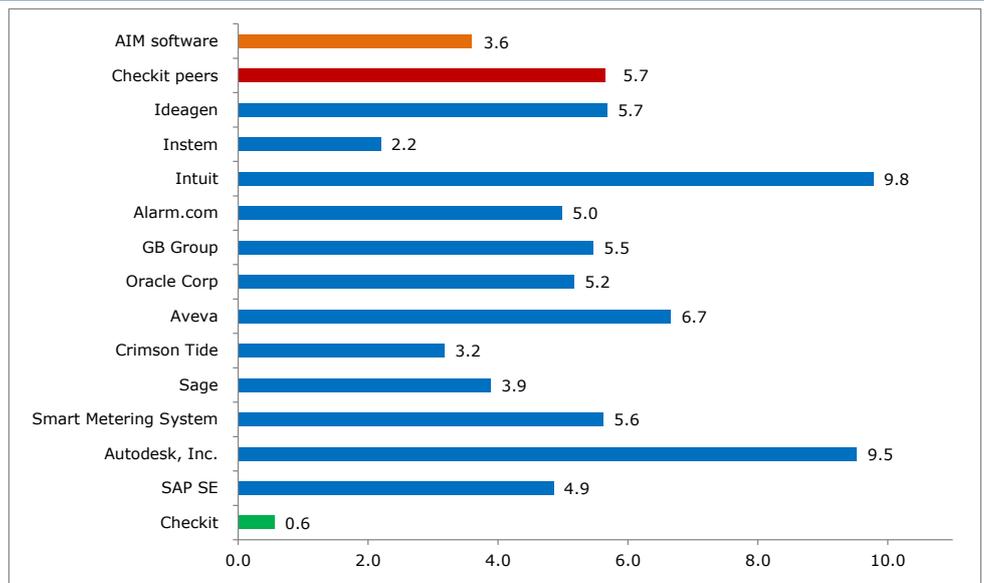
Source: Equity Development

Current year EBIT margins



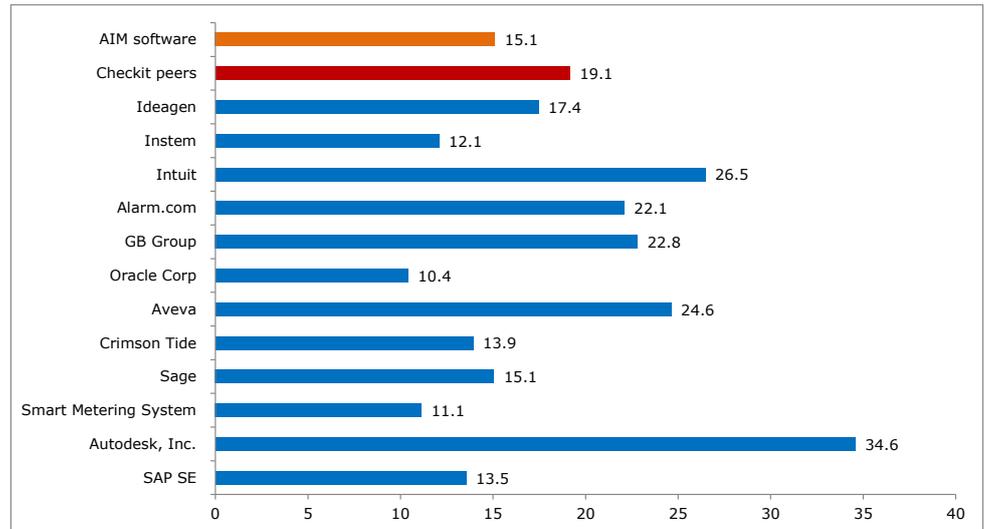
Source: Equity Development

Current year EV/sales



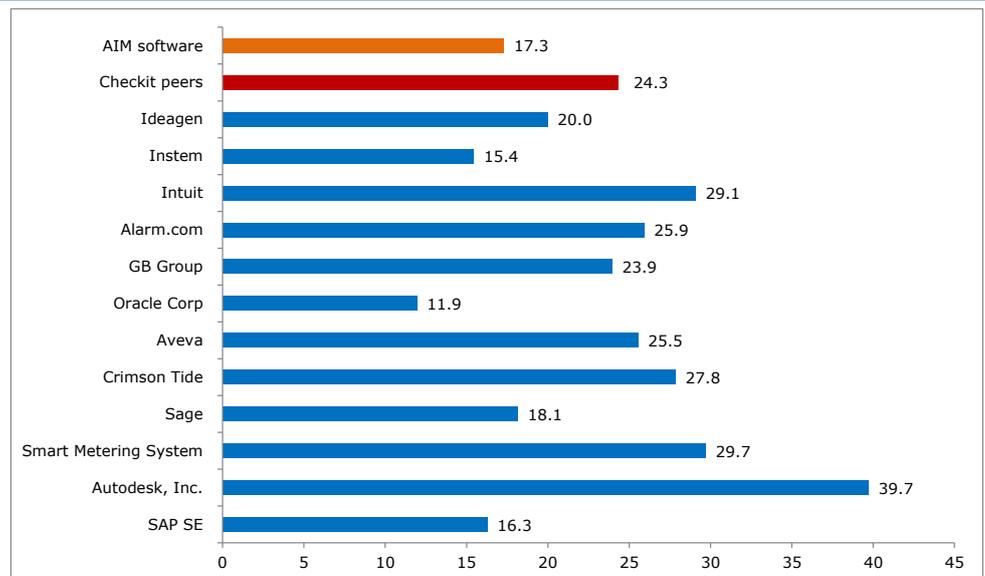
Source: Equity Development

Current year EV/EBITDA



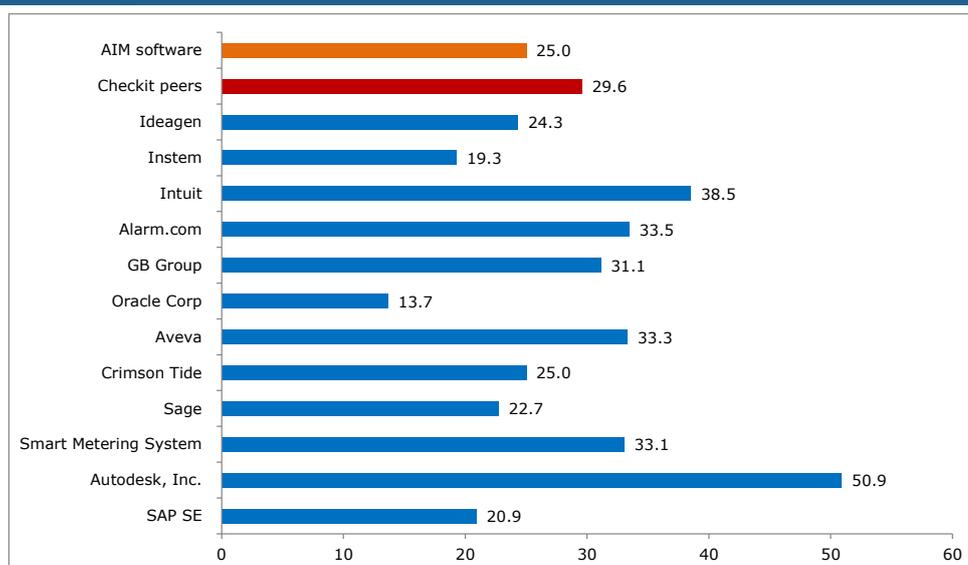
Source: Equity Development

Current year EV/EBIT



Source: Equity Development

Current year PER



Source: Equity Development

Market capitalisation of peers

	Shareprice	Mrk Cap (Millions)	CY net cash / (debt) Millions	Enterprise Value (Millions)
Checkit	54p	£100.5	£94.0	£6.5
SAP SE	€ 103	€ 123,085	-€ 9,329	€ 132,414
Autodesk, Inc.	\$140	\$30,800	-\$253	\$31,053
Smart Metering Syste	400p	£450.4	-£194.1	£644.5
Sage	650p	£7,052.5	-£475.0	£7,527.5
Crimson Tide	2.5p	£11.4	£0.3	£11.1
Aveva	£35.90	£5,790.7	£200.0	£5,590.7
Oracle Corp	\$53	\$185,500	-\$19,700	\$205,200
GB Group	520p	£1,003.6	-£50.0	£1,053.6
Alarm.com	\$47	\$2,344	\$90	\$2,254
Intuit	\$260	\$68,640	\$2,300	\$66,340
Intem	363p	£59.2	£3.6	£55.6
Ideagen	146	321.2	-8.5	329.7

Source: Equity Development



Investor Access

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