

Major medical imaging agreement, trading update

19 April 2023

Kromek Group has announced a major, seven-year agreement to supply its CZT-based detectors to a Tier 1 OEM manufacturer of medical imaging scanners. The client has a market-leading position across a range of healthcare technology markets. Although specific details are not yet available, we regard this as a 'breakthrough' development for the medical imaging arm of Kromek's business which underlines the significance of its leadership in CZT-based detector technology.

Trading update: Q3 revenue +50%YoY

Kromek has also issued a Trading Update which underpins our FY23 outlook. The Group reports that Q3 revenue rose +50%YoY (ED FY23 estimate is +49%YoY) with a gross profit margin expected in the high 40% range (ED FY23 estimate is 47.0%). The Group reports being 'broadly cash neutral' in Q3, continuing into Q4, which we interpret as an easing of supply chain issues and improved, or normalised, conversion of orders to shipment.

Medical imaging: Tier 1 dominance

The medical imaging market is broadly divided between CT- (computed tomography) and SPECT-based (single photon emission CT) products and dominated by four Tier 1 suppliers - Philips Medical Systems Inc., Siemens Healthineers GmbH, Canon Medical Systems Corp., and GE Healthcare. Tier 2 providers include Spectrum Dynamics, United Imaging, Analogic, Fuji Film Medical Systems, Mars, Mediso, NeuroLogica and Samsung, where there is emphasis on specialisation and service provision. The difference in scale is striking, with a **Tier 1 having an estimated market share of between 15% and 30%**, and a Tier 2 player estimated to have a single digit percentage market share.

Medical imaging: additional Tier 2 agreement

Kromek has also announced an agreement to collaborate with the Tier 2 medical imaging specialist **Analogic Corporation** (<https://www.analogic.com>) in the application of CZT-based detection technology to next-generation photon counting CT (PCCT) imaging - for both medical imaging and security applications. Photon counting-based systems offer increased image clarity and reduced radiation (X-ray) dosage as each photon 'impact' is recorded rather than in 'batches' and has applications in critical illness areas such as the early diagnosis of breast cancer or heart disease. **This further reinforces Kromek's status in the development of CZT-based detection systems.**

Valuation thoughts

We are reminded that, after Canon acquired Redlen Technologies Inc. in 2021 to secure its source of CZT technology, and Siemens having in-house capabilities, **Kromek is also the only independent source of CZT-based detection systems.** The Redlen acquisition indicated an estimated valuation of US\$290m (£173m)¹ i.e. a multiple-of-revenue range of 21x to 33x.

Whilst the trading update underpins our FY23-24 outlook, we note that the Tier 1 medical imaging collaboration involves a short initial joint development phase before moving into full commercialisation. Until more details are available on both the Tier 1 and Analogic agreements – product and market scale and focus - we maintain our near-term outlook.

Whilst awaiting further details of the agreements we also retain our Fair Value at 26p/share.

¹ www.bctechnology.com/news/2021/10/12

Company Data

EPIC	KMK.L
Price (last close)	6.5p
52 weeks Hi/Lo	14.4p / 5.0p
Market cap	£28.1m
ED Fair Value / share	26p

Share Price, p



Source: LSE

Description

Kromek is a detection and advanced imaging specialist operating globally in the fields of advanced imaging and hazard detection (CBRN: chemical, biological, radiation and nuclear). Within the advanced imaging segment, medical imaging, including BMD (bone mineral density), CT (computed tomography) and SPECT (single photon emission computed tomography), is particularly important, utilising Kromek's cadmium zinc telluride (CZT) materials technology.

Other key markets in advanced imaging include security screening and industrial imaging. Principally focused on radiation detection, CBRN also includes development of biohazard threat detection, including the presence of COVID-19.

Mike Jeremy (Analyst)

0207 065 2690
mike.jeremy@equitydevelopment.co.uk

Andy Edmond

0207 065 2691
andy@equitydevelopment.co.uk

Case study: Redlen Technologies Inc. read-across

The Tier 1 announcement serves as a reminder that Kromek is the only independent developer and producer of CZT-based detection systems; albeit not confined to medical imaging solutions. There is a precedent for the evaluation of this technology and status in the relatively recent acquisition of Redlen Technologies Inc., which offers a read-across the potential value and strategic positioning of Kromek in the context of medical imaging. On 29 September 2021 Canon Inc. increased its 15% holding in Redlen to full ownership, for an estimated CD\$341m (US\$270m), (see: www.bctechnology.com/news/2021/10/12).

This indicates a valuation (for 100%) of CD\$392m or US\$290m (£173m) at current exchange rates. Estimates of Redlen's revenue at the time of acquisition range of between CD\$12.0m (US\$8.9m, £5.3m) and CD\$19.0m (US\$14.1m, £8.4m), **indicative of a multiple of revenue range of 20.6x to 32.7x** (average of 26.7x).

The implied read-across valuation for Kromek, shown below, based on a 'Redlen valuation' for the diagnostic imaging segment and a US market-based revenue multiple for the CBRN segment, is between £291m and £340m, the majority of which (85%-87%) is derived from the metrics of the Redlen acquisition, i.e. the importance of CZT-based technology in the next generation of diagnostic imaging development.

Redlen Technologies acquisition valuation: read-across for KMK

Valuation range	Low	High
Kromek MI segment FY24E (£m)	9.9	9.9
Redlen multiple assumed	25.0x	30.0x
Kromek MI segment valuation (£m)	247.2	296.7
Kromek CBRN segment FY23E (£m)	9.1	9.1
US scientific instruments sector multiple	4.8x	4.8x
CBRN segment valuation (£m)	43.5	43.5
Sum-of-parts total (£m)	290.8	340.2
Per share (p)	67.3	78.8

Sources: US Scientific & Technical Instruments revenue valuation:

https://csimarket.com/Industry/Industry_Valuation.php?ind=1009.

Forecasts

At this stage our immediate financial outlook for Kromek to FY24 remains unchanged:

Kromek's outlook

Yr to 30 Apr (£m)	2020	2021	2022	2023E	2024E
Revenue	13.12	10.35	12.06	18.00	21.00
EBITDA (adj)	(1.93)	(1.69)	(1.16)	(2.28)	0.91
Pre-Tax Profit (adj)	(5.80)	(6.28)	(6.03)	(8.06)	(5.17)
EPS (adj, p)	(1.16)	(1.48)	(1.11)	(1.59)	(0.90)
Net debt / (cash)	(3.84)	(7.40)	1.38	7.81	11.05

Source: Company data. Equity Development estimates.

FULL FINANCIALS

Profit & Loss FY21 – FY24E							
Year-end Apr 30, £m		FY21	FY22	H1 23	H2 23E	FY23E	FY24E
Advanced Imaging			4.60	3.38	4.52	7.91	9.89
CBRN			5.40	3.16	4.57	7.73	9.14
R&D Projects			2.06	0.25	2.12	2.37	1.97
Revenue		10.35	12.06	6.79	11.22	18.00	21.00
Gross		5.01	5.64	2.74	5.72	8.46	9.93
	<i>Margin</i>	<i>48.4%</i>	<i>46.8%</i>	<i>40.4%</i>	<i>51.0%</i>	<i>47.0%</i>	<i>47.3%</i>
COGS		(5.35)	(6.42)	(4.05)	(5.50)	(9.54)	(11.07)
Other income		0.38	1.41	0.00	0.00	0.00	0.00
Distribution		(0.29)	(0.55)	(0.32)	(0.27)	(0.59)	(0.64)
Admin		(10.94)	(12.21)	(7.63)	(7.57)	(15.20)	(13.85)
Sum Op-ex		(10.84)	(11.35)	(7.95)	(7.84)	(15.79)	(14.48)
Exceptional items		0.05	0.13	0.00	0.00	0.00	0.00
EBIT Reported		(5.79)	(5.58)	(5.21)	(2.12)	(7.33)	(4.55)
EBIT Adjusted		(5.73)	(5.48)	(5.09)	(2.00)	(7.09)	(4.31)
Amortisation		(2.36)	(2.57)	(1.47)	(1.43)	(2.89)	(3.20)
Depreciation		(1.69)	(1.75)	(0.96)	(0.95)	(1.92)	(2.03)
EBITDA Reported		(1.74)	(1.26)	(2.79)	0.26	(2.52)	0.67
EBITDA Adjusted		(1.69)	(1.16)	(2.67)	0.38	(2.28)	0.91
Financial income		0.00	0.03	0.00	0.00	0.00	0.00
Financial expense		(0.55)	(0.58)	(0.46)	(0.51)	(0.97)	(0.86)
PBT Reported		(6.33)	(6.13)	(5.67)	(2.63)	(8.30)	(5.41)
PBT Adjusted		(6.28)	(6.03)	(5.55)	(2.51)	(8.06)	(5.17)
Tax		0.98	1.21	0.60	0.60	1.20	1.30
PAT Reported		(5.35)	(4.92)	(5.07)	(2.03)	(7.10)	(4.11)
PAT Adjusted		(5.30)	(4.81)	(4.95)	(1.91)	(6.86)	(3.87)
Basic wtd. av. shares		358.9	431.9	431.9	431.9	431.9	431.9
Diluted wtd. av. shares		359.3	432.2	432.2	451.1	451.1	451.1
EPS Reported Basic (p)		(1.5)	(1.1)	(1.2)	(0.5)	(1.6)	(1.0)
EPS Adjusted Basic (p)		(1.5)	(1.1)	(1.1)	(0.4)	(1.6)	(0.9)

Source: Company data. Equity Development estimates. Diluted basis EPS not reported.

Balance sheet FY21 – FY24E

Year-end Apr 30, £m	FY21	FY22	H1 23	H2 23E	FY23E	FY24E
Goodwill net	1.28	1.28	1.28	1.28	1.28	1.28
Intangible assets	24.14	28.38	30.54	30.54	30.54	31.81
PPE net	11.20	10.94	10.80	9.76	9.76	8.34
RoU net	4.08	3.87	4.26	3.46	3.46	3.01
Fixed Assets	40.70	44.47	46.87	45.03	45.03	44.43
Inventories	6.20	10.50	10.87	8.14	8.14	7.02
Trade receivables	6.64	6.43	6.69	7.40	7.40	8.05
Tax assets	1.02	0.94	0.35	1.20	1.20	1.30
Cash, Equivalents	15.60	5.08	0.96	1.45	1.45	1.37
Current Assets	29.46	22.96	18.86	18.19	18.19	17.74
Total Assets	70.16	67.42	65.74	63.22	63.22	62.17
Trade payables	(6.17)	(7.86)	(5.99)	(7.87)	(7.87)	(8.63)
Borrowings	(5.39)	(5.72)	(5.69)	(8.53)	(8.53)	(0.69)
Leases	(0.40)	(0.38)	(0.41)	(0.41)	(0.41)	(0.41)
Current Liabilities	(11.96)	(13.95)	(12.09)	(16.81)	(16.81)	(9.74)
Total Assets less Current Liabilities	58.20	53.48	53.64	46.41	46.41	52.43
Deferred income	(1.07)	(1.13)	(1.07)	(0.80)	(0.80)	(0.40)
Leases	(4.26)	(4.16)	(4.51)	(3.46)	(3.46)	(2.76)
Borrowings	(2.82)	(0.75)	(3.57)	(0.73)	(0.73)	(11.73)
Long-term liabilities	(8.14)	(6.04)	(9.14)	(4.99)	(4.99)	(14.89)
Total liabilities	(20.10)	(19.99)	(21.23)	(21.80)	(21.80)	(24.62)
Net Assets	50.06	47.44	44.50	41.42	41.42	37.55
Share Capital	4.32	4.32	4.32	4.32	4.32	4.32
Share Premium	72.94	72.94	72.94	72.94	72.94	72.94
Capital redemption reserve	21.85	21.85	21.85	21.85	21.85	21.85
Translation reserve	0.00	2.06	4.08	3.15	3.15	4.69
Accumulated losses	(49.06)	(53.74)	(58.69)	(60.84)	(60.84)	(66.25)
Equity	50.06	47.44	44.50	41.42	41.42	37.55
Net debt / (cash)	(7.40)	1.38	8.30	7.81	7.81	11.05

Source: Company data. Equity Development estimates.

Cashflow FY21 – FY24E

Year-end Apr 30, £m	FY21	FY22	H1 23	H2 23E	FY23E	FY24E
Net profit/loss	(5.35)	(4.92)	(5.07)	(2.03)	(7.10)	(4.11)
Finance (net)	0.55	0.55	0.46	0.51	0.97	0.86
Tax	(0.98)	(1.21)	(0.60)	(0.60)	(1.20)	(1.30)
Amortisation	2.36	2.57	1.47	1.43	2.89	3.20
Depreciation	1.69	1.75	0.96	0.95	1.92	2.03
Share-based payment	0.14	0.24	0.12	0.12	0.24	0.24
Other non-cash	0.08	(1.44)	0.00	0.00	0.00	0.00
Operating Cash Flow	(1.52)	(2.47)	(2.67)	0.38	(2.28)	0.91
Working capital						
(Increase)/Decrease inventories	0.21	(4.30)	(0.36)	2.73	2.37	1.12
(Increase)/Decrease in receivables	1.57	0.22	(0.26)	(0.71)	(0.97)	(0.66)
Increase/(Decrease) in payables	(2.57)	1.74	(1.93)	1.61	(0.32)	0.36
Change working capital	(0.79)	(2.35)	(2.56)	3.63	1.08	0.82
Cash from operations	(2.31)	(4.81)	(5.22)	4.02	(1.21)	1.74
Tax (paid)/received	1.01	1.28	1.20	0.00	1.20	1.20
Net cash from operations	(1.31)	(3.53)	(4.03)	4.02	(0.01)	2.94
Investing activities						
Investments	0.00	0.00	0.00	0.00	0.00	0.00
Interest	0.00	0.03	0.00	0.00	0.00	0.00
PPE	(0.45)	(0.65)	(0.19)	(0.06)	(0.25)	(0.10)
Other intangibles	0.00	0.00	(0.04)	(0.02)	(0.06)	(0.06)
ROU	(0.16)	(0.18)	(0.04)	(0.02)	(0.06)	(0.06)
Capitalised R&D	(5.46)	(5.62)	(2.58)	(2.42)	(5.00)	(4.40)
Net cash used in investing	(6.07)	(6.42)	(2.85)	(2.52)	(5.37)	(4.62)
Net OpFCF	(7.38)	(9.95)	(6.87)	1.49	(5.38)	(1.68)
Financing activities						
Shares (net)	12.22	0.00	0.00	0.00	0.00	0.00
Borrowings short-term	0.00	0.00	0.50	2.84	3.34	0.00
Borrowings short-term repaid	0.00	0.00	(0.52)	0.00	(0.52)	(7.84)
Borrowings long-term	3.22	0.76	3.34	(2.84)	0.50	11.00
Borrowings long-term repaid	(0.60)	(1.34)	(0.52)	0.00	(0.52)	0.00
Leases	(0.40)	(0.65)	(0.35)	(0.35)	(0.70)	(0.70)
Interest	(0.31)	(0.34)	(0.33)	(0.64)	(0.97)	(0.86)
Net cash from financing	14.13	(1.57)	2.12	(1.00)	1.12	1.60
Net change in cash	6.75	(11.51)	(4.75)	0.50	(4.26)	(0.08)
Cash at start of year	9.44	15.60	5.08	0.96	5.08	1.45
Forex	(0.59)	0.99	0.63	0.00	0.63	0.00
Cash at period-end	15.60	5.08	0.96	1.45	1.45	1.37
Net debt / (cash)	(7.40)	1.38	8.30	7.81	7.81	11.05

Source: Company data. Equity Development estimates.



Contacts

Andy Edmond

Direct: 020 7065 2691

Tel: 020 7065 2690

andy@equitydevelopment.co.uk

Hannah Crowe

Direct: 0207 065 2692

Tel: 0207 065 2690

hannah@equitydevelopment.co.uk

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More information is available on our website www.equitydevelopment.co.uk

Equity Development, 2nd Floor, Park House, 16-18 Finsbury Circus, London, EC2M 7EB

Contact: info@equitydevelopment.co.uk | 020 7065 2690