

## COVID-19 impacts short-term outlook

Hospital expenditure should logically rise during pandemics, right? Yes, but not always straight away. Indeed, total US healthcare spend actually fell 18% annualised in Q1'20, as operating theatres were converted into ICUs and non-critical procedures postponed to free up resource for COVID-19 patients. It's a similar picture worldwide, and why J&J recently said that its medical device division was experiencing contract delays. The important takeaway being that **these orders are not lost**, and **should come back in future quarters** – probably post any 2<sup>nd</sup> infection wave in the Autumn.

Consequently it was no great surprise either to hear today that part of Kromek's scheduled deliveries for H2'20 have also been pushed to the right - exacerbated by some near-term supply chain issues (eg sub-contractors, site access). Meaning all told, despite trading well up to February, FY20 revenues are now expected to come in at £14.5m (£18.5m ED Est, £14.5m LY). Delivering a breakeven adjusted EBITDA (£2.0m ED, £0.5m LY), with April closing net cash of £5.0m (£9.2m ED, £7.9m LY) & gross funds of £10.0m.

### Summary financials

£'000s	Act 2019	Act H1'20	Est H2'20	Est 2020
<b>Turnover</b>	<b>14,517</b>	<b>5,333</b>	<b>9,167</b>	<b>14,500</b>
LFL % growth	22.6%	44.7%	-15.4%	-0.1%
<b>Gross Profit</b>	<b>8,309</b>	<b>3,093</b>	<b>5,317</b>	<b>8,410</b>
% Margin	57.2%	58.0%	58.0%	58.0%
Overheads (ex SBPs)	-6,335	-3,704	-4,706	-8,410
<b>Adjusted EBITDA (pre SBPs)</b>	<b>1,974</b>	<b>-611</b>	<b>611</b>	<b>0</b>
Share based payments	-195	-100	-120	-220
<b>Adjusted EBITDA (post SBPs)</b>	<b>1,779</b>	<b>-711</b>	<b>491</b>	<b>-220</b>
Depreciation & Amortisation	-2,685	-1,631	-1,616	-3,673
<b>Adjusted EBIT Margin</b>	<b>-906</b>	<b>-2,342</b>	<b>-1,125</b>	<b>-3,893</b>
	-6.2%	-43.9%	-12.3%	-26.8%
Net interest	-364	-311	-389	-700
Adjusted PBT	-1,270	-2,653	-578	-4,593
<b>Net cash / (debt)</b>	<b>16,420</b>	<b>7,674</b>	<b>5,000</b>	<b>5,000</b>
Sharecount	275,073	344,642	344,642	344,642

Source: Equity Development

## Affects should only be transitory though

That said we think this liquidity, augmented by £3m of annualised cost savings (eg rent concessions, restructuring, cutting discretionary spend), should provide a sufficient financial ballast for the group to weather this temporary soft patch.

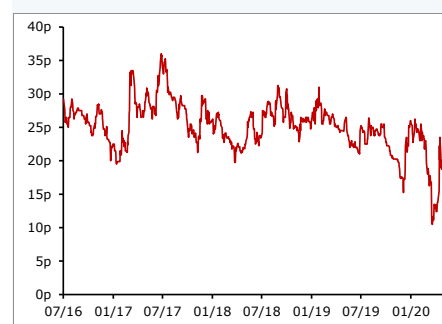
Moreover big picture, **where there is disruption, there is also opportunity**. Not least in helping the world fight this highly contagious & terrible disease.

1st May 2020

### Company Data

EPIC	<b>AIM:KMK</b>
Price (last close)	20.0p
52 week Hi/Lo	28p/11p
Market cap	£68.9m
Share count	344.6m
Net cash Apr'20	£5.0m
Daily volume	300k
ED valuation / share	Withdrawn

### Share Price, p



Source: Share Cast

### Description

Kromek is a radiation detection company operating globally in three high-value markets – Medical Imaging (eg BMD, SPECT), Nuclear Detection (D3S), Security Screening (Airport baggage/bottles), primarily using cadmium zinc telluride (CZT) crystals. Headquartered in Sedgefield (UK), Kromek has c.116 employees, of which approx. 95 are in R&D, with a 3 further sites in California, Pittsburgh and Germany. The firm has filed/registered >280 patents.

We estimate that as at 27/06/19 the orderbook stood at >\$90m - defined as orders, normal repeat business and preferred supplier positions.

**Next news:** Prelims June 2020

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## Two substantial coronavirus opportunities....

Here Kromek announced a fortnight ago that it would soon be manufacturing ventilators (see below) under license from Metran Co. Ltd. Japan's leading such OEM, who competes against the likes of Drägerwerk AG, GE, Fisher & Paykel and Inspiration Healthcare.

### Firstly building ICU-grade ventilators... and

As you're probably aware these devices are in short supply globally, with the NHS requiring 18,000 vs the 10,900 odd currently on hand. And where the company is planning to produce at least 2,000 units by end July 2020.

#### Metran's emergency ventilator



Source: Equity Development.

### Secondly detecting airborne COVID-19

But that's not all. On 10<sup>th</sup> December 2018, Kromek was awarded a \$2.0m contract by DARPA (research arm of US Dept. of Defense) to develop a ground-breaking vehicle-mounted biological-threat detector. The project is well advanced, with the primary end-point being to rapidly identify (say within 1 hour) any airborne pathogen, which may be used say as germ-warfare.

Interestingly we understand the same **1<sup>st</sup>-of-its-kind science can also accurately & consistently recognise COVID-19**, which could have substantial benefits for many non military applications, such as city/shopping centres, sports arenas, theme parks, government buildings (schools), hospitals, commercial properties (offices), airplanes, cruise-ships and so forth.

Finally due to the near-term uncertainty, **the Board has withdrawn its FY21 guidance** - and likewise we have retracted our forecasts & valuation until there is greater clarity. At 20p, the shares trade on a 4.4x EV/sales multiple, which appears good value for risk tolerant investors. Particularly for an IPR-rich business, sporting disruptive technology and addressing high growth multi-billion dollar markets. Time to be patient.

## Summary financial projections

<b>Kromek</b> (April year end)	<b>2014 Act</b> <b>£'000s</b>	<b>2015 Act</b> <b>£'000s</b>	<b>2016 Act</b> <b>£'000s</b>	<b>2017 Act</b> <b>£'000s</b>	<b>2018 Act</b> <b>£'000s</b>	<b>2019 Act</b> <b>£'000s</b>	<b>2020 Est</b> <b>£'000s</b>
Product	4,746	3,726	5,432	6,671	9,611	12,060	
Other	1,226	4,375	2,910	2,297	2,234	2,457	
<b>Turnover</b>	<b>5,972</b>	<b>8,101</b>	<b>8,342</b>	<b>8,968</b>	<b>11,845</b>	<b>14,517</b>	<b>14,500</b>
% growth	121.9%	35.6%	3.0%	7.5%	32.1%	22.6%	-0.1%
<b>Gross margin</b>	<b>3,871</b>	<b>5,626</b>	<b>4,429</b>	<b>5,117</b>	<b>6,684</b>	<b>8,309</b>	<b>8,410</b>
% Margin	64.8%	69.4%	53.1%	57.1%	56.4%	57.2%	58.0%
<b>Adjusted EBITDA (pre SBP)</b>	<b>-3,007</b>	<b>-1,557</b>	<b>-2,376</b>	<b>-1,461</b>	<b>482</b>	<b>1,974</b>	<b>0</b>
% Margin	-50.4%	-19.2%	-28.5%	-16.3%	4.1%	13.6%	0.0%
Depreciation	-737	-673	-709	-762	-785	-879	-1,460
Amortisation of capitalised R&D	-560	-711	-828	-1,417	-1,907	-1,806	-2,213
Share based payments	-125	-181	-166	-99	-131	-195	-220
<b>Adjusted EBIT (post SBP)</b>	<b>-4,429</b>	<b>-3,122</b>	<b>-4,079</b>	<b>-3,754</b>	<b>-2,341</b>	<b>-906</b>	<b>-3,893</b>
% Margin	-74.2%	-38.5%	-48.9%	-41.9%	-19.8%	-6.2%	-26.8%
Underlying Interest charge	-515	-71	-83	-40	-192	-364	-700
<b>Adj. Profit before Tax (post SBPs)</b>	<b>-4,944</b>	<b>-3,135</b>	<b>-4,162</b>	<b>-3,794</b>	<b>-2,533</b>	<b>-1,270</b>	<b>-4,593</b>
<b>Adj. Basic EPS (p)</b>	<b>-8.0</b>	<b>-2.9</b>	<b>-2.9</b>	<b>-1.8</b>	<b>-0.4</b>	<b>-0.1</b>	<b>-1.1</b>
EPS growth rate			-1.3%	40.0%	76.0%	75.8%	-969.7%
<b>Valuation benchmarks</b>							
P/E ratio							
EV/Sales	10.7	7.9	7.7	7.1	5.4	4.4	4.4
EV/EBITDA (pre SBPs)						32.4	
EV/EBIT							
Effective tax rate				0.0%	0.0%	0.0%	0.0%
PEG ratio							0.0
% EBITDA drop-through rate					67.5%	55.8%	11611.8%
Dividend yield					0.0%	0.0%	0.0%
<b>Net cash/(debt)</b> - includes £1.25m of long term money market deposits	<b>6,563</b>	<b>151</b>	<b>3,857</b>	<b>17,343</b>	<b>7,738</b>	<b>16,420</b>	<b>5,000</b>
Reported sharecount	61,871	107,818	141,337	174,573	260,162	275,073	344,642
Sharecount diluted	66,951	114,042	147,586	178,137	262,768	277,655	346,215
<b>Shareprice (p)</b>	<b>20.0</b>						

Source: Equity Development.

## Key risks

- Although Kromek is presently commercialising its leading technology, there is no absolute certainty that anticipated revenues or growth can be achieved. Plus the adoption of new break-through science can take longer and cost more than originally thought
- Orders tend to be lumpy in nature, and therefore by their nature difficult to forecast.
- The company is executing on many fronts, and therefore it is important there is sufficient management resource to facilitate the growth.

- Scaling up production and aftermarket support to satisfy substantially higher volumes could cause teething problems.
- Protection of intellectual property, especially from patent challenges.
- Competitive pressures – yet given Kromek's leading position in CZT, then this looks a less immediate threat.
- Customer concentration (largest client generated sales of £4.1m in FY19), and regulatory changes which may impact the introduction of CZT based products.
- Foreign exchange fluctuations and unwind of the working capital position (£19.4m as at Oct'19), particularly relating to a large Asian OEM.
- The firm is loss making. In the event more funding is required (albeit unlikely given strong net cash position), then it is not certain that future capital would be available at commercial rates.



## Investor Access

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