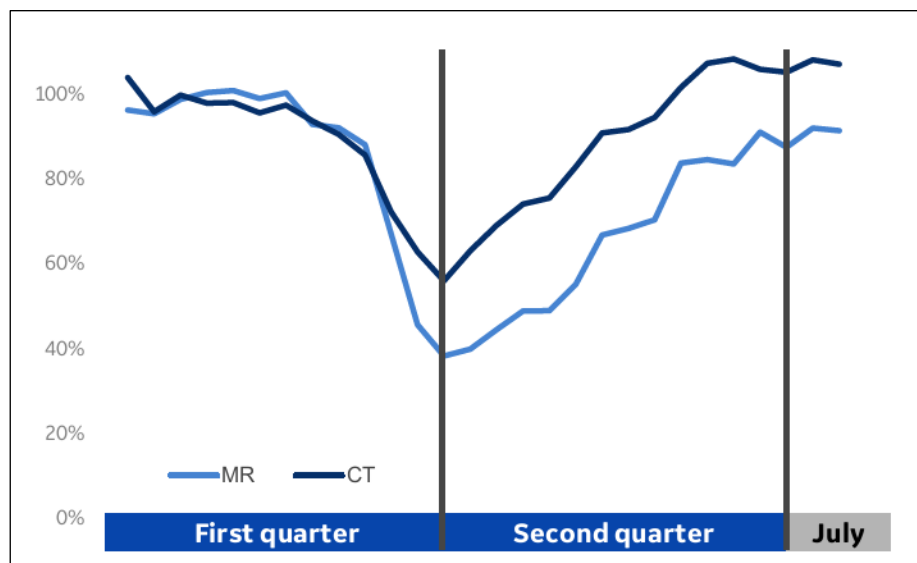


Through the eye of the Covid storm

'What doesn't kill you makes you stronger'. Ditto for radiation detection expert Kromek, which was hit by a 'perfect storm' in the Spring, after the pandemic forced hospitals to postpone operations, borders to close and governments to impose national lockdowns.

In turn, hitting the firm's 3 core markets, namely Medical Imaging (SPECT, BMD), 'dirty bomb' detection (D3S) & Airport Screening (baggage scanners).

Number of medical image scans performed globally vs Q4'19



Source: GE Healthcare

Never let a crisis go to waste

Nonetheless client activity (re RFPs) has recently started to improve, with **Medical Imaging coming back first** (Europe & US), **followed by Nuclear Security** (government contracts), and **lastly Airport Screening**, which is on a slightly longer timeline reflecting continued modest passenger traffic.

What's more, the Board has not wasted the downturn, & implemented a series of **self-help measures that have stabilised the business**. Not least **temporarily shutting down CZT production** (back live now), furloughing staff (almost all returned), cutting costs/capex and crucially **renegotiating its banking covenants** with HSBC. Such that going forward **the group believes it has sufficient liquidity** – ie £9.4m as at April 2020, including £3.8m of net cash vs £16.4m LY - **to fund itself until at least March 2022**.

Future proofing the business

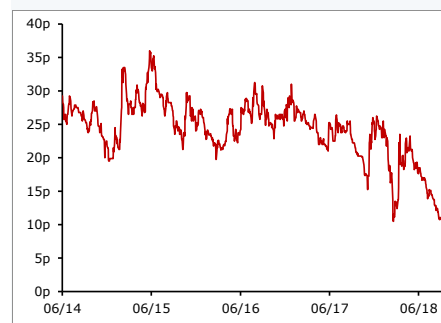
The **balance sheet too has been 'future proofed'** by writing down £13.1m of trade debtors and L/T WIP (known as 'Amounts Recoverable On Contract', or AROC) – related to **[we guess]** a Chinese healthcare client (re in country visits). A sensible decision in our view, since it removes an unnecessary 'albatross' that had been hanging around the company's neck for some time.

7th October 2020

Company Data

EPIC	AIM:KMK
Price	8.0p
52 week Hi/Lo	27p/8p
Market cap	£27.6m
Share count	344.6m
Net cash Apr'20	£3.8m
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ED valuation / share	Withdrawn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.139 employees, of which approx. 116 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 30th Apr'20 the orderbook stood at \$90m - defined as orders, normal repeat business and preferred supplier positions.

Next news: AGM

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Moreover, potentially providing cashflow upside if any future shipments are paid for upfront by this East Asian customer (accounted for as an exceptional gain).

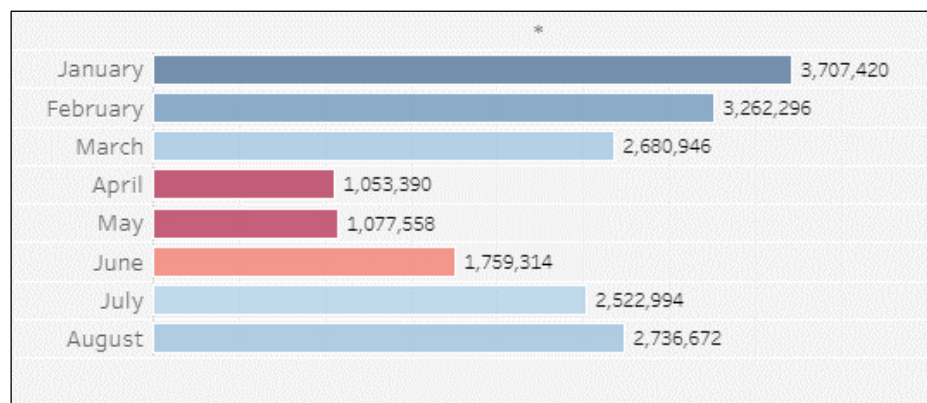
So where does that leave us?

Well, after surviving not only the sink, but also the whole kitchen being thrown at it, we think Kromek has demonstrated remarkable **resilience** during an extremely challenging period – and today is probably **leaner & fitter operationally** than it's ever been.

Plus, the **fundamentals remain intact**, as evidenced by [we understand] **only a handful contracts being cancelled** - leaving the **backlog** (including commercial call-offs & development agreements) **still at near record levels** (ED est \$90m), even after entirely removing the AROC agreement.

Sure Kromek is not entirely out of the woods, since there's likely to be another tough year ahead, until international air-travel & city-centre footfall fully recovers (see below). Yet equally the Board has managed to steady the ship and position it for calmer waters ahead.

Global scheduled passenger flights (excl cargo) in 2020



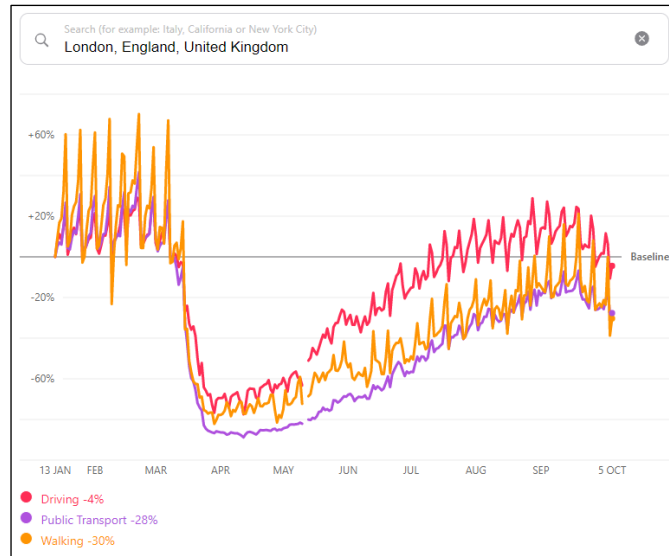
Source: International Civil Aviation Organization

Demonstrated resilience & fortitude

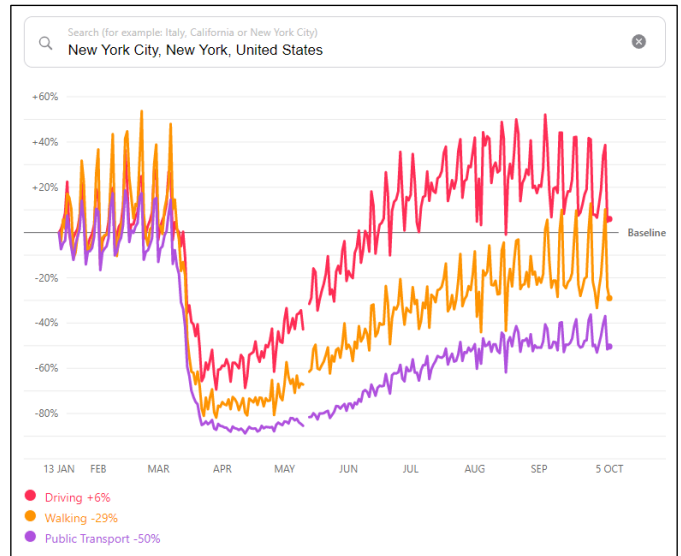
For FY21 though, investors shouldn't expect results to shoot the lights out. Here we envisage a weak H1, followed by a gradual return to more normal activity levels by Apr'21.

Albeit come FY22, **improved operational gearing should materially drive profits higher**, as a larger chunk of incremental revenues drop straight to the bottom line.

Population movements are gradually recovering in major international cities



Source: Apple



Source: Apple

Fine, but what about today's numbers?

Well although mostly covering pre-Covid, FY20 was nevertheless impacted by the coronavirus as site/hospital access was restricted - & further suffered from the one-off £13.1m debtor/AROC impairment.

All told, reporting **turnover down -9.6% LFL to £13.1m** (vs £14.5m LY), **gross margins** of 47.3% (57.2%) & **EBITDA** (pre SBPs) at **-£0.4m** (£2.0m).

H1 vs H2 breakdown

£'000s	Act 2019	Act H1'20	Act H2'20	Act 2020
Product sales	12,060	4,382	5,932	10,314
R&D development contracts	2,457	951	1,855	2,806
Turnover	14,517	5,333	7,787	13,120
LFL % growth	22.6%	44.7%	-28.1%	-9.6%
Gross Profit	8,309	3,093	4,516	6,208
% Margin	57.2%	58.0%	58.0%	47.3%
Overheads (ex SBPs)	-6,335	-3,704	-4,346	-6,649
Adjusted EBITDA (pre SBPs)	1,974	-611	170	-441
Share based payments	-195	-100	-125	-225
Adjusted EBITDA (post SBPs)	1,779	-711	45	-666
Depreciation & Amortisation	-2,685	-1,631	-1,341	-3,327
Adjusted EBIT	-906	-2,342	-1,296	-3,993
Margin	-6.2%	-43.9%	-16.6%	-30.4%
Net interest	-364	-311	-233	-544
Adjusted PBT	-1,270	-2,653	-784	-4,537
Net cash / (debt)	16,420	7,674	3,838	3,838
Sharecount (Ks)	275,073	344,642	344,644	344,644

Source : Equity Development

Sales came in lower than May's guidance, mainly because of changes in sales recognition & contract accounting policies, which were implemented as a part of the annual audit.

Elsewhere **net cash closed the period at £3.8m** (vs £16.4m LY), including £7.0m of capex (CZT expansion), £3.2m inventory build (re CV19 supply chain disruption) & £0.7m higher debtors (invoice timing), partly offset by R&D tax credits and movements in capital creditors. Capitalised R&D rose 92% to £5.3m (£2.7m LY) vs associated amortisation of £2.1m.

So does Kromek need to raise any more money?

Not anytime soon considering its banking covenants with HSBC have just been renegotiated to "*ensure the Group can continue to rely on the £5m RCF*". Moreover, post y/e another £1.4m of funds has been secured with the lender, & £0.8m received from the US PPP scheme.

Further out any possible equity injection would depend on KMK's cashflow generation, internal requirements, investment opportunities and crucially how quickly things can get back to normal. In fact, based on the assumption demand picks up in H2, the **Board is "cautiously optimistic"**, and reckon there should be no need for fresh capital (re going concern statement).

Ok, but what's the status of the 2,000 ventilators?

Here, the group struck a landmark deal in April with Japan's Metran Co. Ltd to manufacture 2,000 adult/child ventilators under license. An agreement to supply some of these devices has already been signed with a European customer, but the shipment is presently awaiting regulatory clearances before being built.

Elsewhere the company continues to develop the world's first "biothreat" detector, which is being funded 100% by DARPA (part of the US DoD).

Ground-breaking biothreat detector

Once finished, using state-of-the-art RNA/DNA sequencing, the solution should be able to **continuously monitor & collect airborne microbes** (eg Covid19), which are condensed into single droplets of water. These samples are then genetically coded, with results available in <60 minutes. Not only detailing exactly what families of viruses & bacteria are present, but also which specific strain or mutation.

This is really is ground-breaking stuff, that could potentially revolutionise how mankind deals with any deadly pathogen. Especially in high footfall locations such as airports, hospitals, city/shopping centres, sports arenas, theme parks, government buildings, schools, offices, airplanes, cruise-ships and so forth.

Don't get me wrong, Kromek's smaller civilian version is not yet ready for deployment in an urban setting. But should be over the next year or so after being trialled by DARPA.

Indicative timeline for new revolutionary Biothreat detector

2018 – \$2m award at start DARPA programme to develop a proof-of-concept device for a vehicle-mounted biological-threat identifier

2020 – post period, \$5.2m award to develop mobile wide-area bio-surveillance system capable of detecting airborne pathogens to protect against bio-terrorism

Current status and next milestones

Undertaking field trials with pre-production prototype collecting airborne samples from urban and rural locations

2021 Jan-May – various UK pilots with beta systems

2021 Jan – field test scheduled with beta model in London

2021 May – delivery of multiple units for pilot deployment in US

Source: Company

“Cautiously optimistic for FY21”

Putting all this together & considering the current uncertainty, **management have temporarily suspended guidance**. Meaning our forecasts and valuation too remain under review.

However bigger picture, remember most of **the delayed hospital ‘elective procedures’ have not been cancelled**, they are simply deferred for a later date. At some point these patient backlogs will need to be eliminated, requiring new imaging equipment that Kromek’s patented CZT technology should be able to support.

CEO Arnab Basu adding: “*The **disruption in Q4’20 has carried through into the first 4 months of FY21**. Normal business patterns are returning and some customers are beginning to resume orders with detector production and shipments being scheduled. **Two customers who had postponed their contracts have now issued instructions to recommence work**. Additionally, the Group is experiencing increasing visibility from its customers, including from Kromek’s largest customer in the medical imaging segment, who has provided it with visibility on their plans for FY21.*”

Demand for D3S family of products continues to increase and there is renewed procurement activities in the US, Asia and Europe after a period of slowdown over the past 6 months. As a result, the **Board is cautiously optimistic for the year ahead** and will provide updates to the market as the outlook becomes clearer moving forward.”

*With substantial long-term market drivers and significantly expanded production capacity in place, **Kromek is well positioned to deliver on demand from around the world for next-generation radiation detection technologies.***”

Summary financials

Kromek (April year end)	2014 Act £'000s	2015 Act £'000s	2016 Act £'000s	2017 Act £'000s	2018 Act £'000s	2019 Act £'000s	2020 Act £'000s
Product	4,746	3,726	5,432	6,671	9,611	12,060	10,314
Other	1,226	4,375	2,910	2,297	2,234	2,457	2,806
Turnover	5,972	8,101	8,342	8,968	11,845	14,517	13,120
% growth	121.9%	35.6%	3.0%	7.5%	32.1%	22.6%	-9.6%
Gross margin	3,871	5,626	4,429	5,117	6,684	8,309	6,208
% Margin	64.8%	69.4%	53.1%	57.1%	56.4%	57.2%	47.3%
Adjusted EBITDA (pre SBP)	-3,007	-1,557	-2,376	-1,461	482	1,974	-441
% Margin	-50.4%	-19.2%	-28.5%	-16.3%	4.1%	13.6%	-3.4%
Depreciation	-737	-673	-709	-762	-785	-879	-1,185
Amortisation of capitalised R&D	-560	-711	-828	-1,417	-1,907	-1,806	-2,142
Share based payments	-125	-181	-166	-99	-131	-195	-225
Adjusted EBIT (post SBP)	-4,429	-3,122	-4,079	-3,754	-2,341	-906	-3,993
% Margin	-74.2%	-38.5%	-48.9%	-41.9%	-19.8%	-6.2%	-30.4%
Underlying Interest charge	-515	-71	-83	-40	-192	-364	-544
Adj. Profit before Tax (post SBPs)	-4,944	-3,135	-4,162	-3,794	-2,533	-1,270	-4,537
Adj. Basic EPS (p)	-8.0	-2.9	-2.9	-1.8	-0.4	-0.1	-0.8
EPS growth rate			-1.3%	40.0%	76.0%	75.8%	-670.5%
Valuation benchmarks							
P/E ratio							
EV/Sales	4.0	2.9	2.8	2.6	2.0	1.6	1.8
EV/EBITDA (pre SBPs)						12.0	
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%	172.9%
Dividend yield					0.0%	0.0%	0.0%
Net cash/(debt) - pre IFRS16	6,563	151	3,857	17,343	7,738	16,420	3,838
Reported sharecount	61,871	107,818	141,337	174,573	260,162	275,073	344,644
Sharecount diluted	66,951	114,042	147,586	178,137	262,768	277,655	345,729
Shareprice (p)	8.0						

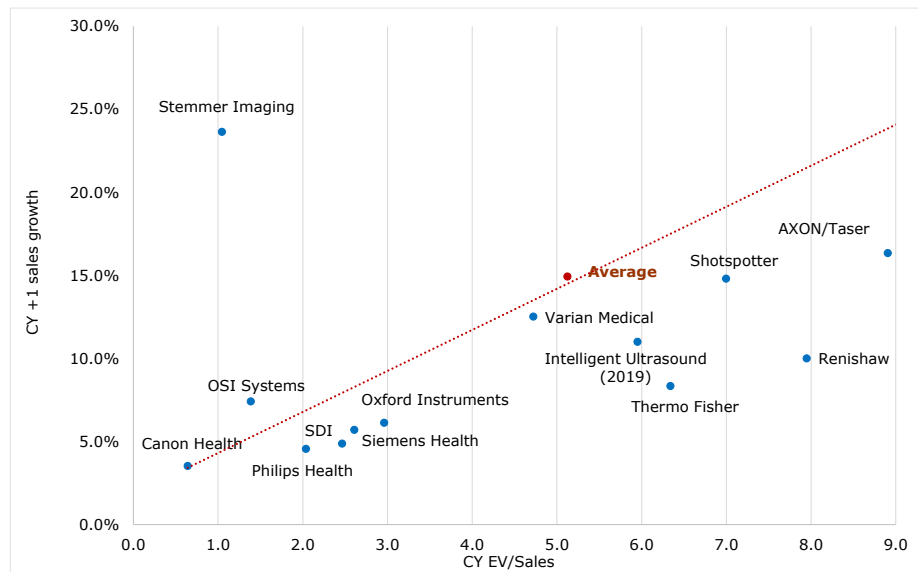
Source: Equity Development, Company Sharecount in Ks

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.
- Covid19 related effects endure longer than expected, thus impacting Kromek's major image scanning markets.
- 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, particularly relating to a large Asian OEM.
- The firm is loss making. In the event more funding is required, then it is not certain that future capital would be available at commercial rates.

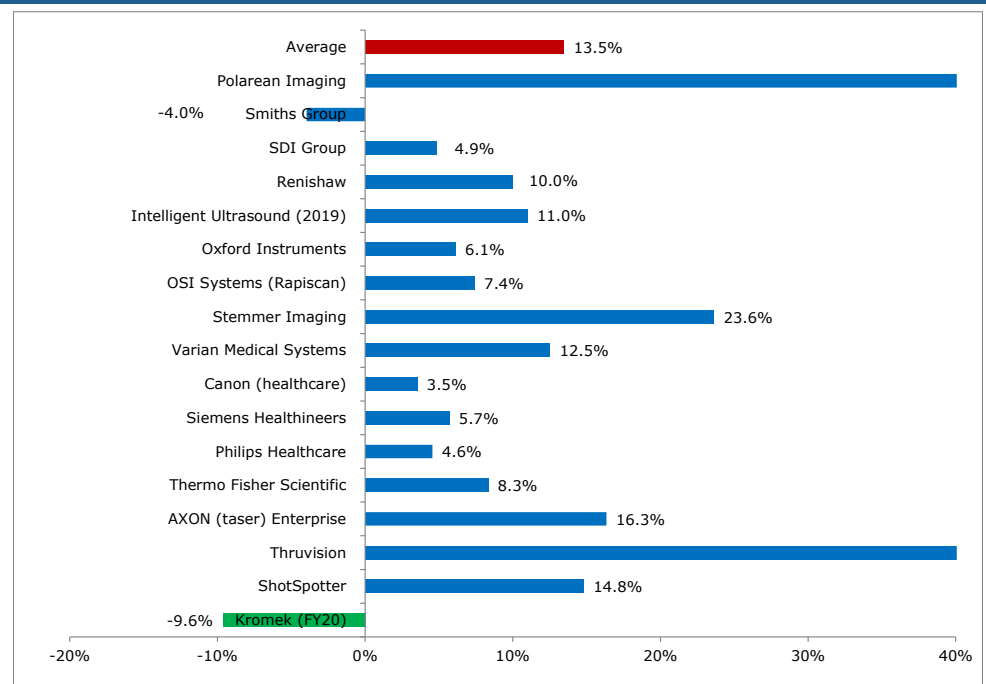
Appendix - Valuation benchmarks & industry KPIs

CY EV/sales multiple vs CY+1 revenue growth



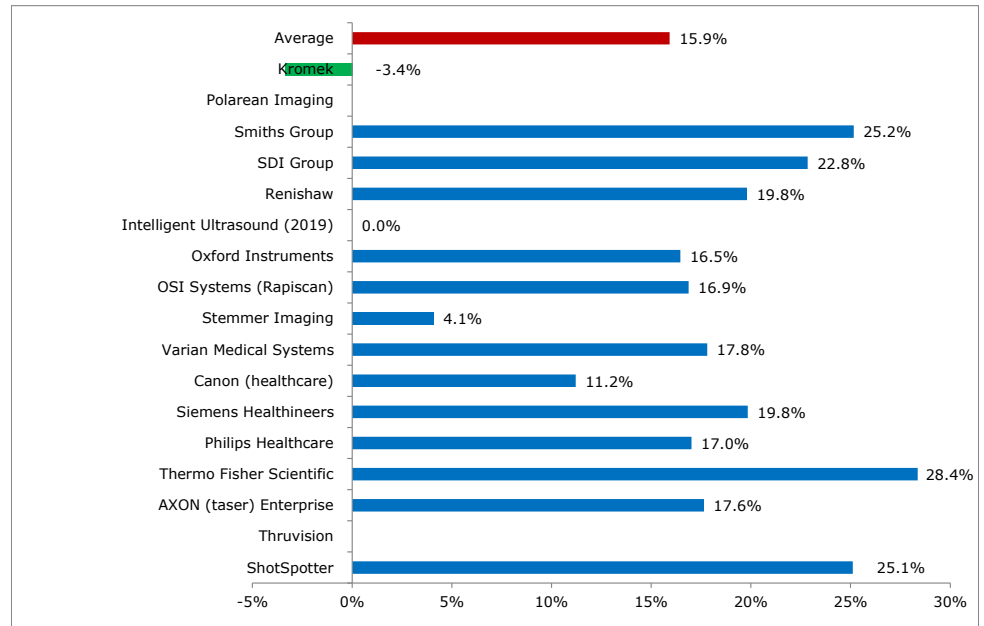
Source: Equity Development

Current year + 1 sales growth rates



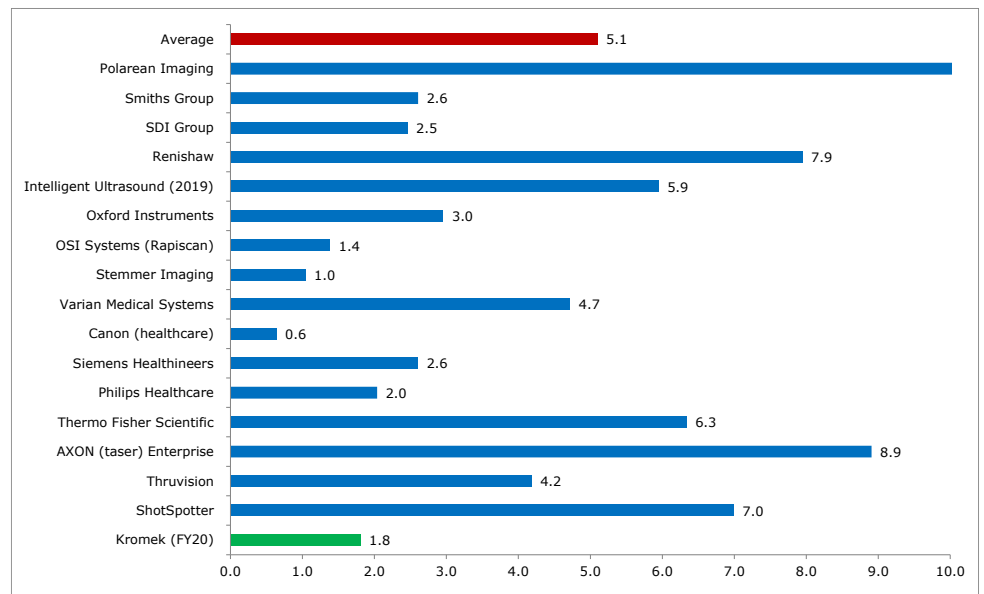
Source: Equity Development. Kromek FY20 figs

Current year EBITDA margins



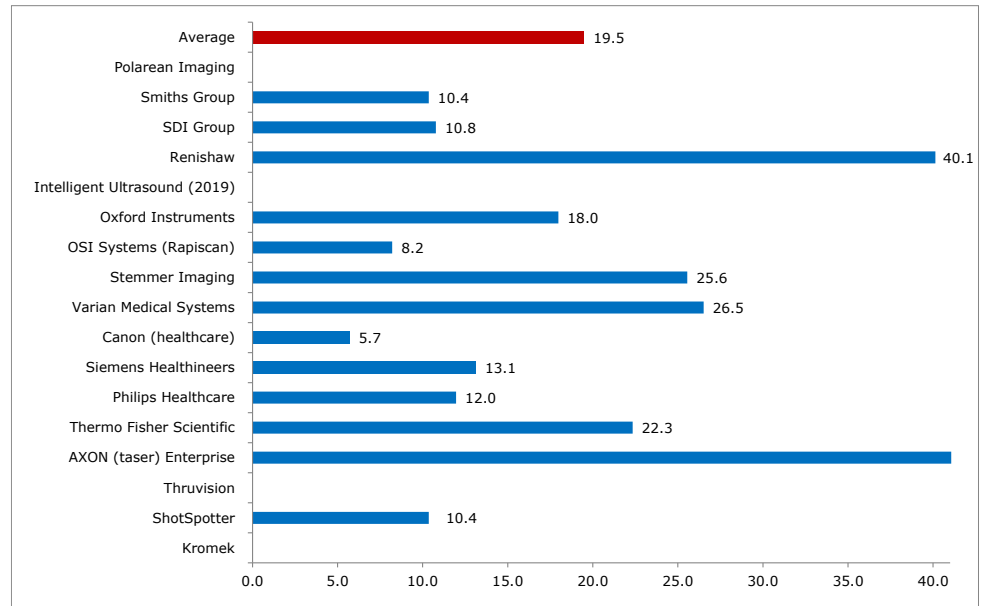
Source: Equity Development. Kromek FY20 figs

Current year EV/sales



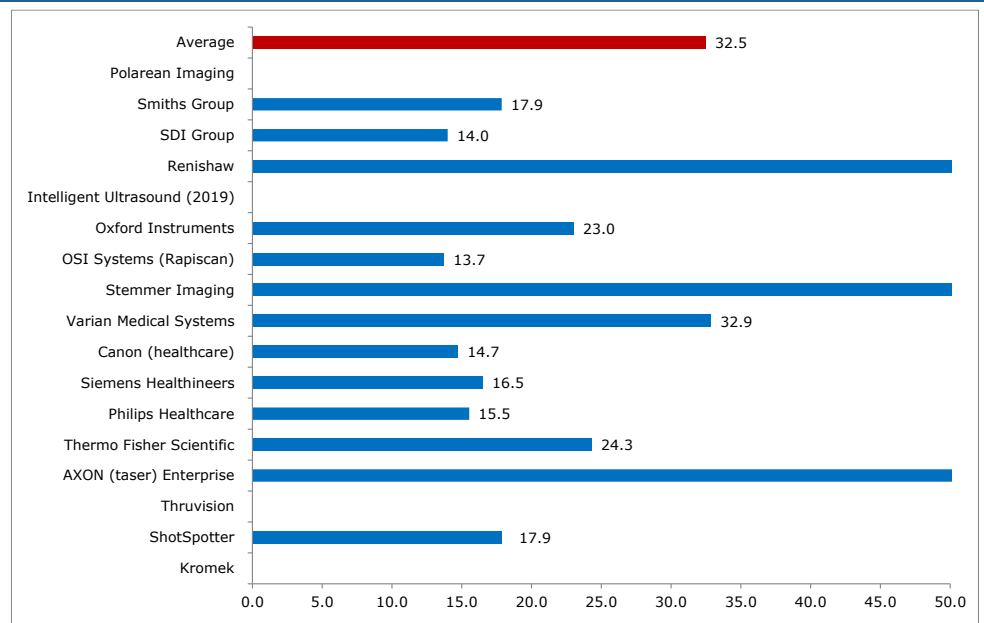
Source: Equity Development. Kromek FY20 figs

Current year EV/EBITDA



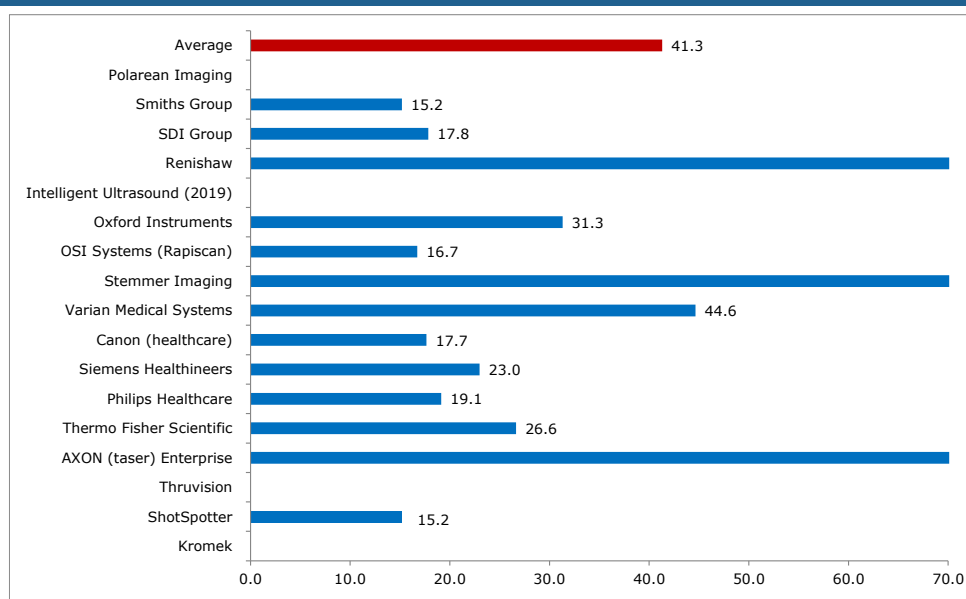
Source: Equity Development

Current year EV/EBIT



Source: Equity Development

Current year PER



Source: Equity Development

Market capitalisation of sector

	Shareprice	Mrk Cap (Millions)	CY net cash / (debt) Millions	Enterprise Value (Millions)
ShotSpotter	\$30.0	\$342	\$30	\$312
Thruvision	£27.0	£39.3	£5.8	£33.5
AXON (taser) Enterprise	\$93.0	\$5,906	\$455	\$5,451
Thermo Fisher Scientific	\$430.0	\$171,570	-\$13,312	\$184,882
Philips Healthcare	€ 40.00	€ 35,800	-€ 4,425	€ 40,225
Siemens Healthineers	€ 37.00	€ 37,000	-€ 996	€ 37,996
Canon (healthcare)	¥1,750	¥1,872,500	-¥206,599	¥2,079,099
Varian Medical Systems	\$171	\$15,561	\$741	\$14,820
Stemmer Imaging	€ 20.00	€ 130.00	€ 15.00	€ 115.00
OSI Systems (Rapiscan)	\$78.0	\$1,404	-\$148	\$1,552
Oxford Instruments	\$1,650.0	\$947	\$77	\$870
Intelligent Ultrasound (2019)	16.0p	£43.1	£8.0	£35.1
Renishaw	£57.00	£4,150	£96	£4,054
SDI Group	£0.66	£64	-£1	£66
Smiths Group	£13.90	\$5,560	-\$1,083	\$6,643
Polarean Imaging	\$0.45	\$72.9	\$9.9	\$63.0
Kromek (FY20)	8.0p	£27.6	£3.8	£23.7

Source: Equity Development



Investor Access

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