Kromek Group plc

Oversubscribed £13m fund raise to drive growth

2nd March 2021

Despite the pandemic, **smart investors continue to back world beating technology**. So it is with Kromek, who yesterday confirmed that it had **raised £13m gross at 15p/share** from existing and new shareholders. The proceeds being earmarked to further develop the **new ground-breaking biothreat/Covid airborne detector** (see below), alongside **optimising its CZT medical/nuclear imaging & D3S 'dirty bomb' commercialisation strategy**. Whilst equally bolstering the balance sheet.

100s of possible uses for Kromek's airborne Covid/Biothreat detectors

Source: Kromek

Enormous opportunity in airborne pathogen detection…

In particular, there are four key reasons why we're excited about the Covid/Biothreat detectors:

1) **Firstly this is a large and untapped global market**, which could be worth more than £500m pa.

2) **Significant aftermarket opportunities**. Next these 'early warning systems' should be able to generate high margin, recurring revenues. Say from either daily sampling, ongoing support, remote diagnostics and/or 'mining' the vast amounts of 'networked data'. The latter enabling governments to monitor, respond & analyse (using DNA sequencing) new coronavirus variants &/or other infectious diseases in near real-time.

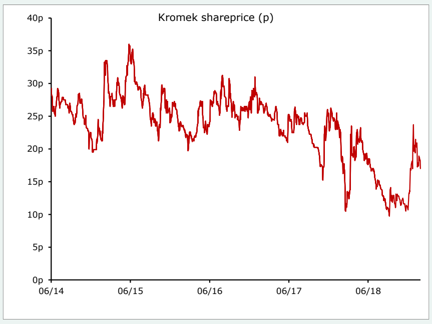
3) **Demand led growth**. Plus rather than being simply an expense, once installed the equipment could become a valuable USP &/or revenue generator for clients. Helping them (eg airlines, in/outdoor stadia, nightclubs, etc) differentiate their activities to both drive sales &/or reduce insurance premiums by providing an extra layer of end-user protection.

4) **Substantial barriers to entry**. Lastly this '1st of its kind' technology is not easy to copy, given the vast amount of scientific & engineering expertise built-in over the past 2+ years, since beginning the DARPA (US Dept of Defence) funded development project in Dec'18. Providing Kromek with a major time-advantage vs possible new entrants.

Company Data

EPIC	AIM:KMK
Price (previous close)	17p
52 weeks Hi/Lo	27p/8p
Market cap	£73.4m
Share count	431.9m
Est net cash April 2021	£8.0m
ED valuation	24p/share
Average daily volume	2m

Share Price, p



Source: Yahoo

Description

Kromek is a radiation detection company operating globally in 4 high-value markets – Medical Imaging (eg BMD, SPECT), Nuclear Detection (D3S), Security Screening (Airport baggage/bottles) & Bio-threat surveillance - 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 2 further sites in California & Pittsburgh. The firm has filed/registered >280 patents.

Next news: Pre close update May 2021

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…that could ultimately lift the valuation by 69p/share

So looking ahead, what should investors expect? Well we understand field trials will be in motion soon, with full commercial launch slated for sometime in FY22, once the supply chain has been established. Probably involving 3rd party contract manufacturers to assemble the kit, as opposed to in-house factory resource.

Not surprisingly, this it will take a little time, and not all the airborne pathogen market would be captured by one a single player. However, assuming Kromek can ultimately acquire say a 20% share, then this would translate into an approx. £100m pa opportunity, generating c.25% drop through rates. Which using 3x sales &/or 12x EBIT multiples – **might lift the market cap by £300m** (or 69p/share) vs £73.4m today.

Moreover in light of the product's **outstanding performance** (re 'sensitivity & specificity' rates), then the **last piece in the jigsaw is execution**. And with a recently refreshed & refocused management team, we think **the firm's 'irresistible tech-force'** has now passed **Covid's 'immovable object'**.

None of this potential upside has been included in our re-instated forecasts or 24p/share valuation either. Where FY21 turnover & adjusted EBITDA (pre SBPs) of £10m & -£1.9m respectively has been pencilled in, climbing to £15m & -£0.1m for FY22 (see below). Augmented by an estimated **£8m of net funds as at Apr'21** (split cash +£15.6m, debt £7.6m), excluding the possibility of receiving some of last year's £13m in written off Asian debt (AROC).

Summary H1 vs Est H2'21 forecasts

£'000s	Act H1'20	Act H1'21	Act H2'20	Est H2'21	Act FY20	Est FY21
Turnover	**5,333**	**4,576**	**7,787**	**5,424**	**13,120**	**10,000**
LFL % growth	*44.7%*	*-14.2%*	*-28.1%*	*-30.3%*	*-9.6%*	*-23.8%*
Gross Profit	**3,093**	**2,493**	**4,516**	**2,820**	**6,208**	**5,313**
% Margin	*58.0%*	*54.5%*	*58.0%*	*52.0%*	*47.3%*	*53.1%*
Overheads (ex SBPs)	-3,704	-3,366	-4,346	-3,847	-6,649	-7,213
Adjusted EBITDA (pre SBPs)	**-611**	**-873**	**170**	**-1,027**	**-441**	**-1,900**
Share based payments	-100	-120	-125	-130	-225	-250
Adjusted EBITDA (post SBPs)	**-711**	**-993**	**45**	**-1,157**	**-666**	**-2,150**
Depreciation & Amortisation	-1,631	-2,100	-1,341	-2,000	-3,327	-4,100
Adjusted EBIT	**-2,342**	**-3,093**	**-1,296**	**-3,157**	**-3,993**	**-6,250**
Margin	*-43.9%*	*-67.6%*	*-16.6%*	*-58.2%*	*-30.4%*	*-62.5%*
Net interest	-311	-306	-233	-244	-544	-550
Adjusted PBT	-2,653	-3,399	-784	-1,271	-4,537	-6,800
Net cash / (debt)	**7,674**	**-1,772**	**3,838**	**8,000**	**3,838**	**8,000**
Sharecount (Ks)	344,642	344,751	344,644	431,852	344,644	431,852

Source: Equity Development

Secured $750,000 worth of new orders

But that's not all. After a 'relatively fallow' period in terms of order flow (re medical imaging, airports, border control and public gatherings) due to the coronavirus, the sluice gates are now gently reopening. Driven by customer catchup of deferred projects, pent up demand and greater C-suite optimism. In the UK alone, the NHS needs to tackle a **4.5m patient backlog**, who are on waiting lists for elective procedures, scans & associated diagnostics.

Airports and other border crossings too are expecting considerably more travellers this year, as vaccination programs are rolled out and social distancing restrictions lifted. Indeed yesterday, the company reported $750,000 of new contract wins from existing customers – one SPECT and the other in Nuclear Security. **Further underpinning our conservative projections**.

CEO Arnab Basu adding: "*These latest orders reflect the beginning of the* ***return to normal business activities as our customers increasingly resume commercial activity***.

These repeat orders, in our core commercial markets of medical imaging and nuclear security, reflect the value of our technology to our customers in these areas. In addition, with $375,000 due to be delivered this financial year, ***they provide us with greater visibility over our full year forecasts****. We look forward to delivering these orders and to continuing to expand our pipeline."*

Large healthcare OEM is ramping deliveries

Elsewhere, we understand Kromek's biggest SPECT OEM ($58m order signed Jan'19) is increasing deliveries of CZT detectors, which on its own could eventually become a £7m+ / year revenue generator.

Meanwhile the D3S family of dirty bomb detectors is attracting significant interest too from the UK, US, Europe and Asia. Here, **the UK government is planning to spend £329m over the next 4 years from Apr'21 to improve its nuclear detection capability**. Most of the budget is being allocated for border and inland security (city & critical infrastructure) – from which Kromek, as a British supplier post Brexit, is likely to receive its fair share.

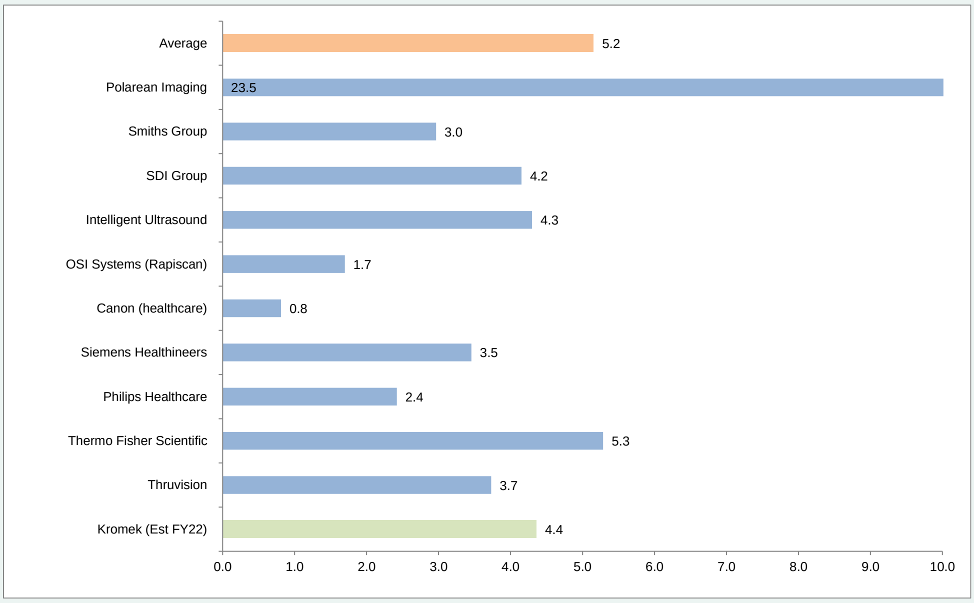
Fine, but how much is this all going to cost? Well the good news is that overheads remain tightly controlled, and likewise there should be sufficient CZT production capacity to meet all demand within its core business for the foreseeable future.

Stock appears undervalued in absolute & relative terms

Finally, the stock at 17p trades at a 10% discount to 'IPR' rich tech peers – on 4.4x FY22 EV/sales vs 5.2x for the sector (see below), yet is set to grow materially faster over the next few years. Plus, thanks to the increasing momentum, we reckon this gap will close in due course. Or if not, Kromek might even attract one or more opportunistic buyers at current down-trodden levels.

Similarly with regards to smallcaps in general - assuming vaccinations continue to be rolled out and new variants are successfully addressed (eg airborne Covid detector) - then this should foster synchronised global growth and a continued investor 'risk on' bias. A view supported by recent commodity price inflation, semiconductor shortages and rising bond yields.

Current year EV/turnover multiples vs peers



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.
- 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 £2.2m in FY20), and regulatory changes which may impact the introduction of CZT based products.
- Foreign exchange fluctuations.
- 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.

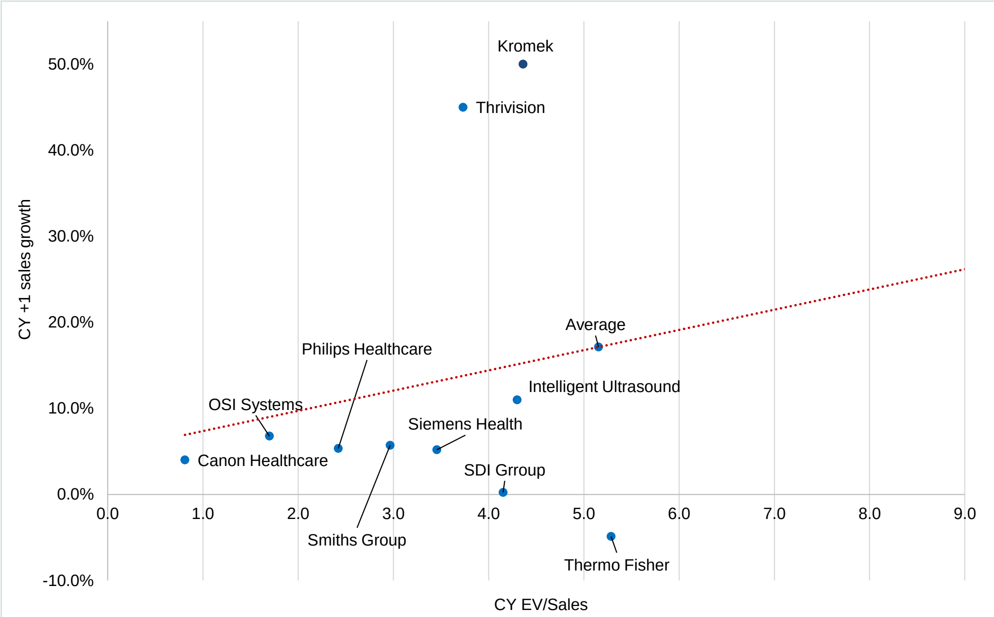
Summary financials (£'000s)

Kromek (April year end)	2018 Act £'000s	2019 Act £'000s	2020 Act £'000s	2021 Est £'000s	2022 Est £'000s
Product	9,611	12,060	10,314		
Other	2,234	2,457	2,806		
Turnover	**11,845**	**14,517**	**13,120**	**10,000**	**15,000**
% growth	*32.1%*	*22.6%*	*-9.6%*	*-23.8%*	*50.0%*
Gross margin	**6,684**	**8,309**	**6,208**	**5,313**	**7,800**
% Margin	*56.4%*	*57.2%*	*47.3%*	*53.1%*	*52.0%*
Adjusted EBITDA (pre SBP)	**482**	**1,974**	**-441**	**-1,900**	**-100**
% Margin	*4.1%*	*13.6%*	*-3.4%*	*-19.0%*	*-0.7%*
Depreciation	-785	-879	-1,185	-1,600	-1,400
Amortisation of capitalised R&D	-1,907	-1,806	-2,142	-2,500	-3,125
Share based payments	-131	-195	-225	-250	-275
Adjusted EBIT (post SBP)	**-2,341**	**-906**	**-3,993**	**-6,250**	**-4,900**
% Margin	*-19.8%*	*-6.2%*	*-30.4%*	*-62.5%*	*-32.7%*
Underlying Interest charge	-192	-364	-544	-550	-575
Adj. Profit before Tax (post SBPs)	**-2,533**	**-1,270**	**-4,537**	**-6,800**	**-5,475**
Adj. Basic EPS (p)	**-0.4**	**-0.1**	**-0.8**	**-1.4**	**-1.3**
EPS growth rate	*76.0%*	*75.8%*	*-670.5%*	*75.3%*	*-9.2%*
Valuation benchmarks					
P/E ratio					
EV/Sales	*5.5*	*4.5*	*5.0*	*6.5*	*4.4*
EV/EBITDA (pre SBPs)		*33.1*		*-34.4*	*-654.1*
EV/EBIT					
Effective tax rate	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*
PEG ratio			*0.0*	*0.0*	*0.0*
% EBITDA drop-through rate	*67.5%*	*55.8%*	*172.9%*	*46.7%*	*36.0%*
Dividend yield	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*
Net cash/(debt) - pre IFRS16	**7,738**	**16,420**	**3,838**	**8,000**	**3,000**
Reported sharecount	260,162	275,073	344,644	431,852	434,011
Sharecount diluted	262,768	277,655	345,729	432,937	435,096
Shareprice (p)	**17.0**				

Source: Equity Development

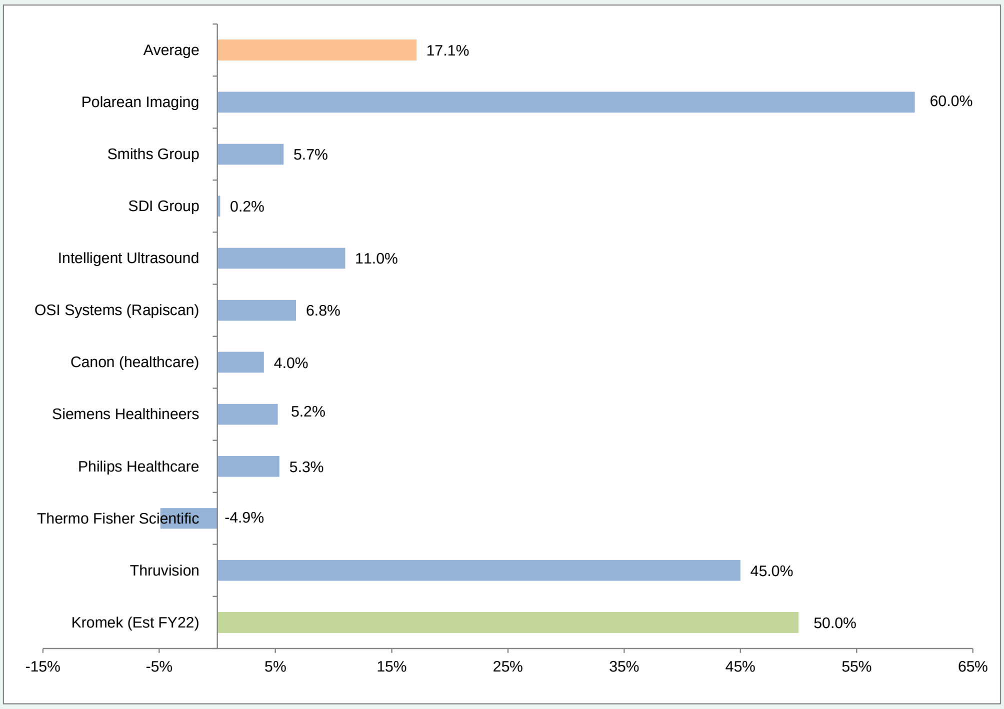
Appendices - sector valuation metrics and KPIs

Current year EV/sales vs CY+1 growth rates



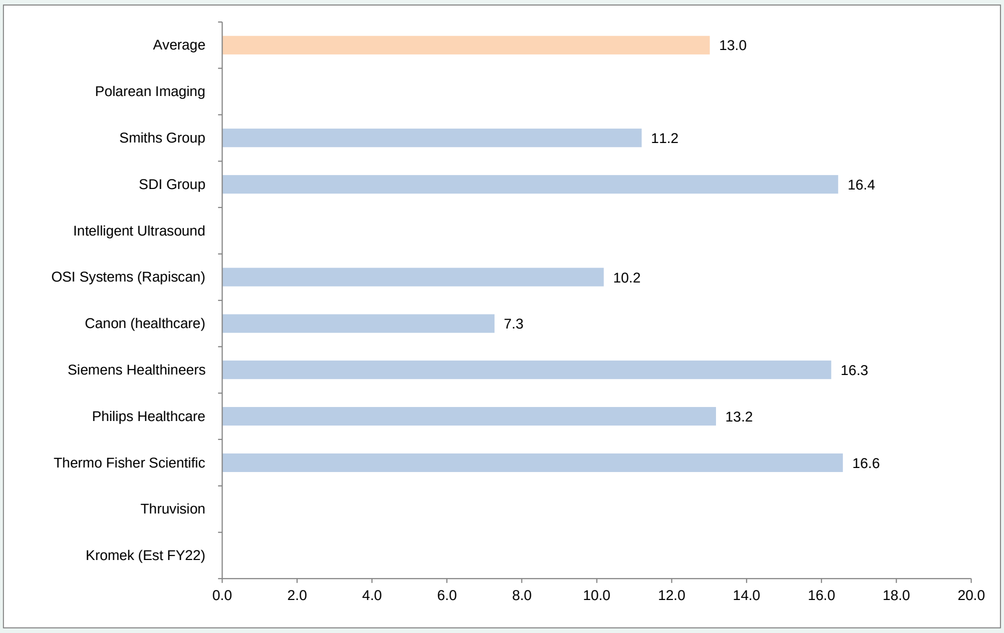
Source: Equity Development.

CY + 1 sales growth



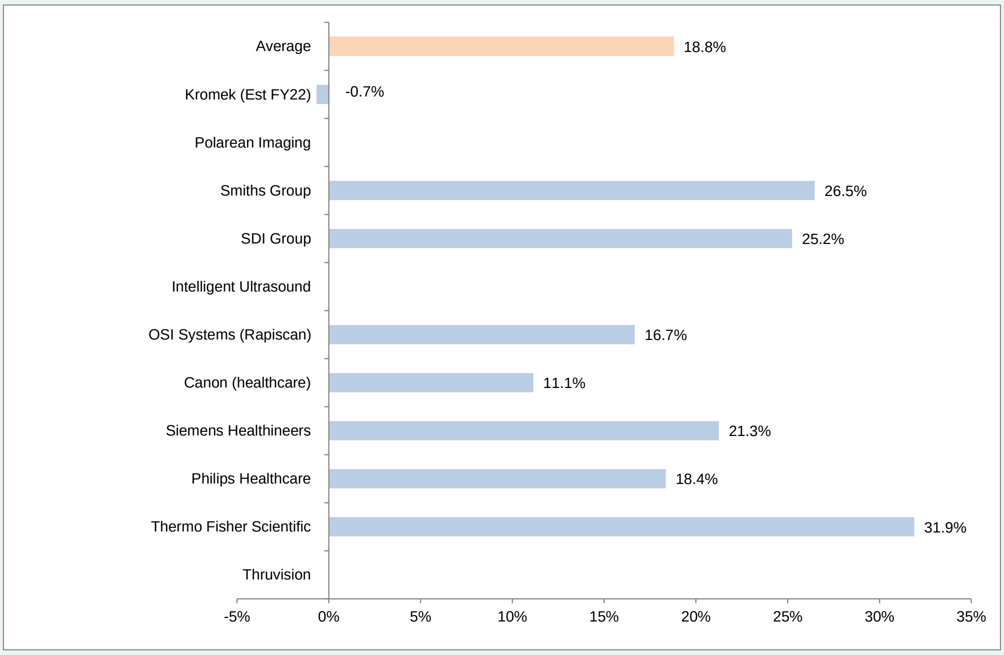
Source: Equity Development

Current Year (CY) EV / EBITDA vs peers



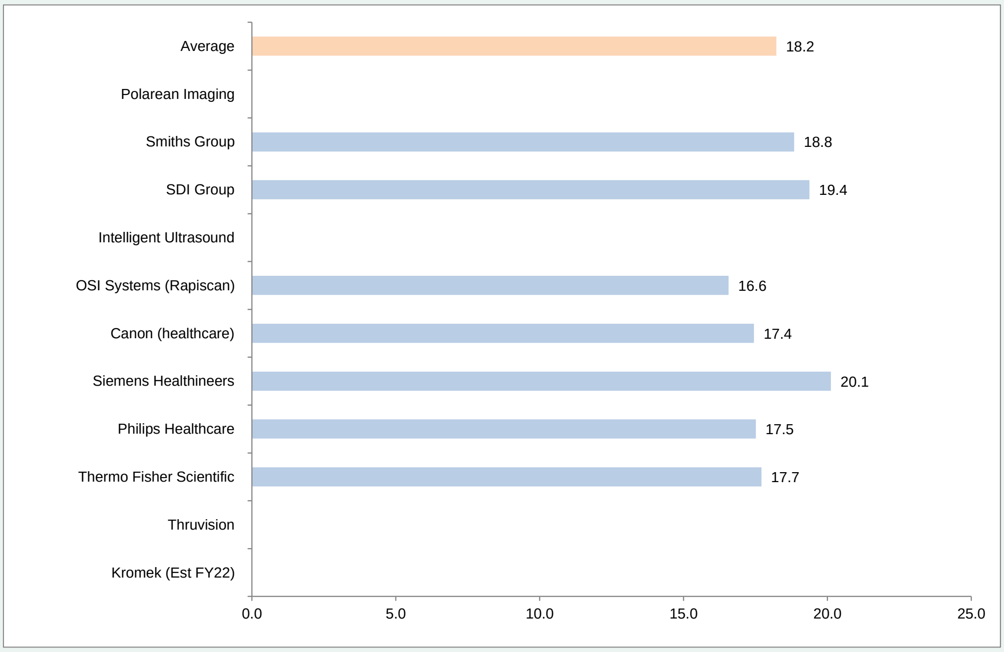
Source: Equity Development

CY EBITDA margins (%) vs peers



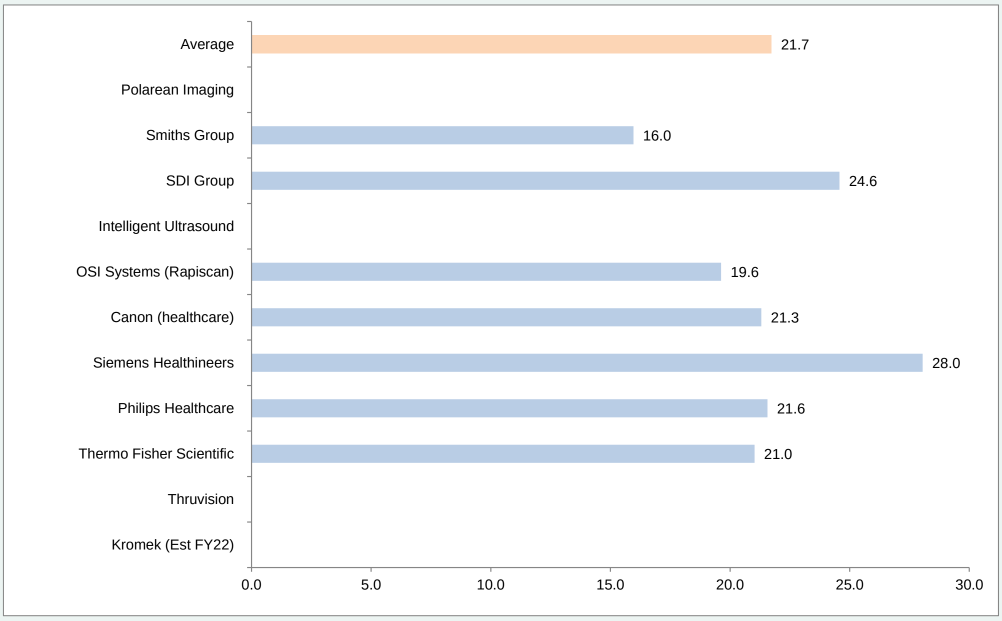
Source: Equity Development.

Current Year (CY) EV / EBIT vs peers



Source: Equity Development

Current Year (CY) PERs vs peers



Source: Equity Development

Market capitalisation of peers

	Shareprice	Mrk Cap (Millions)	CY net cash / (debt) Millions	Enterprise Value (Millions)
Thruvision	£24.5	£35.6	£5.8	£29.8
Thermo Fisher Scientific	$456.0	$181,488	-$4,447	$185,935
Philips Healthcare	€ 45.50	€ 40,950	-€ 4,600	€ 45,550
Siemens Healthineers	€ 46.00	€ 49,450	-€ 1,600	€ 51,050
Canon (healthcare)	¥2,295	¥2,409,750	-¥207,305	¥2,617,055
OSI Systems (Rapiscan)	$95.0	$1,710	-$195	$1,905
Intelligent Ultrasound	13.5p	£36.4	£8.0	£28.4
SDI Group	£1.72	£169	-£6	£174
Smiths Group	£15.10	$6,025	-$1,099	$7,124
Polarean Imaging	70.0p	£113.4	£9.9	£103.5
Kromek (Est FY22)	17.0p	£73.4	£8.0	£65.4

Source: Equity Development

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