Elektron Technology plc

12th June 2019

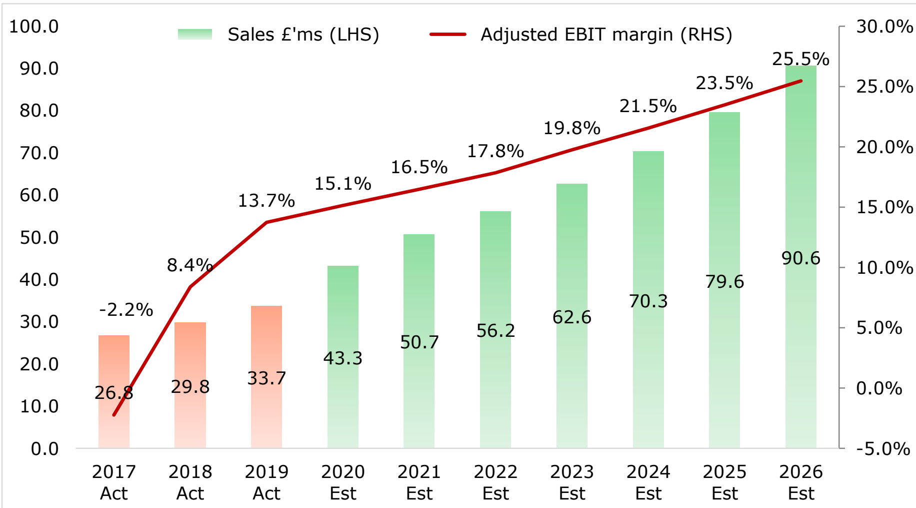
Turbo-charged growth at a modest price

"*If it ain't broke, don't fix it*" is synonymous with corporate life. However 'laurel resting' is not in Elektron's lexicon, even after producing a 10-fold rise in the stock price over the past 5 years. No instead, **the firm's DNA is based on 'continuous improvement'** and **maximising shareholder returns**, as characterised by **this morning's bumper results** and **encouraging outlook**.

Impressive numbers with more to come

FY19 **turnover jumped 13.1% to £33.7m** (all organic vs £29.8m LY), whilst **EBITDA** and **EBITA climbed 33%** and **77% to £6.8m** (£5.1m) and **£4.6m** (£2.6m) respectively – further bolstered by the devaluation of the Tunisian Dinar (+3.6% margin boost) and favourable operating leverage. Similarly, **underlying EPS came in at 2.1p** (+103%), with **net cash closing Jan'19 at £10.1m**, or 94% higher than 12 months' earlier (£5.2m) - despite investing £2.8m in R&D (8.3% sales), of which £1.5m was capitalised (vs £1.8m amortisation), and incurring start-up costs related to Checkit's US rollout on the West Coast.

Revenue growth & adjusted EBIT margins



Source: Equity Development

Industry 4.0 is boosting Bulgin growth

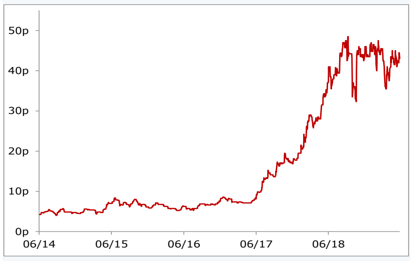
Divisionally, Bulgin revenues rose +10% to £30.1m, Checkit doubled to £1.0m and EET leapt 30% to £2.6m, with regional standouts in the UK (£12.3m +15%), EMEA (£9.7m + 20%) and Americas (£9.4m +9%).

The top line increase was primarily thanks to **robust demand at Bulgin for smart components** (eg agriculture, automotive, energy, industrial and marine), broadening distribution (eg Arrow Electronics) and new product launches. Complemented too, by **higher ARR at Checkit** (£0.9m, annualised recurring revenues) as more clients adopted the technology, together with expanded European distribution for EET's MPSII macular degeneration detector and greater orderflow for the Henson glaucoma screener.

Company Data

EPIC	**AIM: EKT**
Price (last close)	45p
52 week Hi/Lo	49p/31p
Market cap	£84m
ED SOTP valuation	83p/share
Net cash (est. Jan'20)	£3.2m
Avg. daily volume	170k

Share Price, p



Source: Share Cast

Description

Elektron (Est FY20 sales £43.3m) is a specialist product OEM and B2B operational service provider. It operates 3 separate divisions (see below), yet bound together by a single centre of engineering excellence located in Cambridge.

1) **Bulgin** (est. FY20 sales £31.8m) designs and manufactures premium, fail-safe, hermetically sealed (ie air/water tight) circular connectors and electronic components for harsh environments.

2) **Checkit/Next** (£8.7m) is a real-time SaaS platform that digitises and vastly improves the management of routine tasks. Likewise in May'19 Next was added for £8.8m, enabling EKT to further monitor, control and optimise business processes.

3) **EET** (£2.8m) develops field vision (Glaucoma) and macular degeneration screeners for the ophthalmic industry.

Next News: AGM at end of July 2019

Paul Hill (Analyst)

0207 065 2690

paul.hill@equitydevelopment.co.uk

But this is just the start

Going forward though, we think the '**best is yet to come'**. Here Bulgin is focused on further enhancing profitability, differentiation and LFL growth (c. 2x global GDP), as it **transitions from being a manufacturer of components into a leading provider of engineered solutions**.

Better still, the majority of sales (>60%) are 'designed-in' to specific applications, creating a **formidable 'moat' and attractive retention rates**. Which augmented by new product launches (8 planned for FY20) and continued channel development (>92,000 end-users), helps underpin the division's **resilience across the economic cycle**.

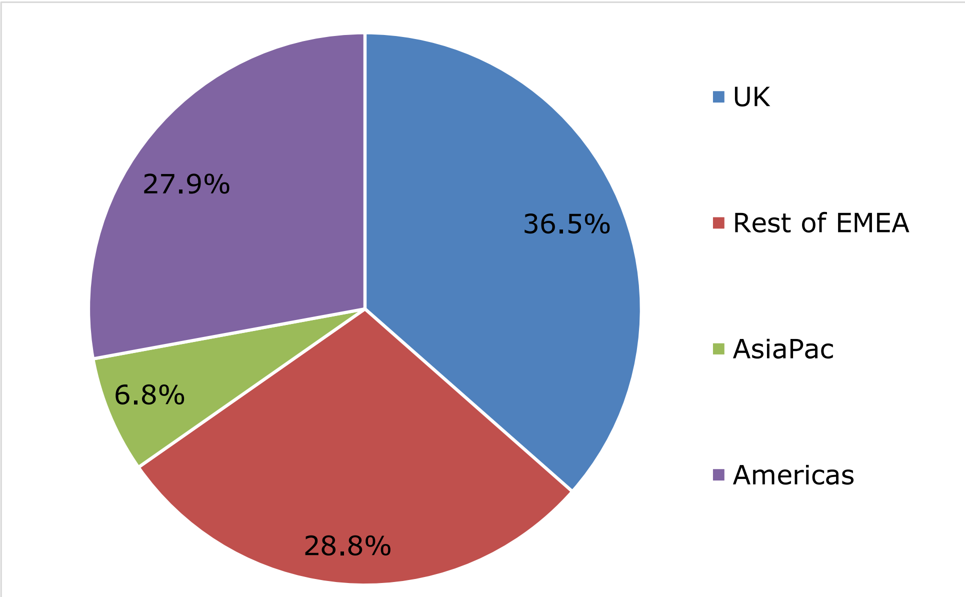
Substantial synergies combining Checkit with Next

Elsewhere, **Checkit is rapidly expanding its domain expertise and geographical footprint** - ie outside of its UK food-service heartland, which experienced some softness in Q1'20 due to High Street competition, restaurant closures, etc. Equally though, Q1 revenues still advanced 49% LFL, alongside positive customer receptions in America, where it is running several multi-site trials.

Also after only 1 month, **the integration of Next Control Systems with Checkit is progressing to plan**. Indeed the £8.8m acquisition takes Checkit beyond remote monitoring into control systems, with the added bonus of cross selling into the leisure, hospitality, healthcare and retail verticals.

Lastly, although classed as non-core and awaiting disposal, we think that **EET is showing genuine promise too**, generating a £0.1m profit in FY19 on revenues 30% higher (£2.6m).

Balanced geographical split (FY19 turnover £33.7m)



Source: Equity Development

Current trading in line with expectations

Overall **Q1'20 group trading** (ie Feb-April) **has continued to be strong with turnover up 17% to £8.9m** (LY £7.6m), driven by robust demand at Bulgin (+20%), which also benefited from some distributor stocking. EET on the other hand, fell 11% LFL reflecting tough comparatives.

For the rest of the year, Bulgin's expansion is set to moderate, although still anticipated to **report record H1 figures**. As such we have nudged up our FY20 revenue forecast, but maintain EBIT at £10.3m (margin 32.4%) due to the "*cautious macro conditions*".

With regards to quantifying the Next & Checkit synergies, it is hard to be precise at this stage, yet we believe **management are targeting to (at least) double NCS' operating profit** (£1.2m 2018) **over the next 2-3 years**. A lot of which will be derived from self-help measures (re improved pricing, contract management, procurement, etc), with the remainder coming from scale advantages. Additionally, there will be some one-off integration costs (c. £400k-£500k) coupled with extra technology investment.

On track to lift EPS by 70% over next 2 years

Adjusted EPS forecasts

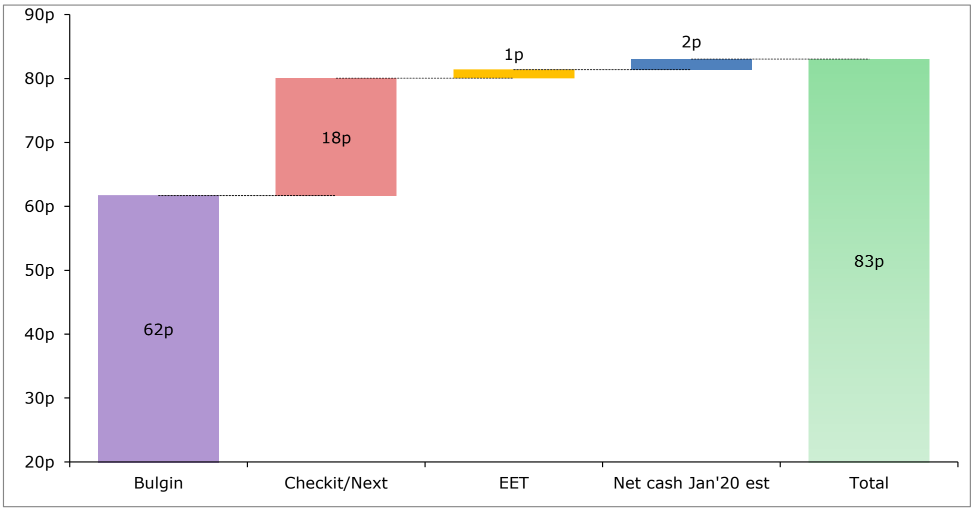
Source: Equity Development

So what about the valuation?

Well in light of the global uncertainties, we've prudently decided to hold our **'de-risked' FY20 adjusted EBIT** (£6.6m, margin 15.1%) **and EPS (2.7p) estimates intact** (see above) – rising to £8.4m (margin 16.5%) & 3.5p respectively in FY21. Nonetheless recognising there may be scope to upgrade as the year progresses – ie in the absence of any macro induced setbacks and/or other adverse factors.

Likewise our sum-of-the-parts (SOTP) **valuation** (see below) **remains unchanged at 83p/share**, but we are encouraged by **the improved risk profile**.

Sum of the parts valuation (pence/share)



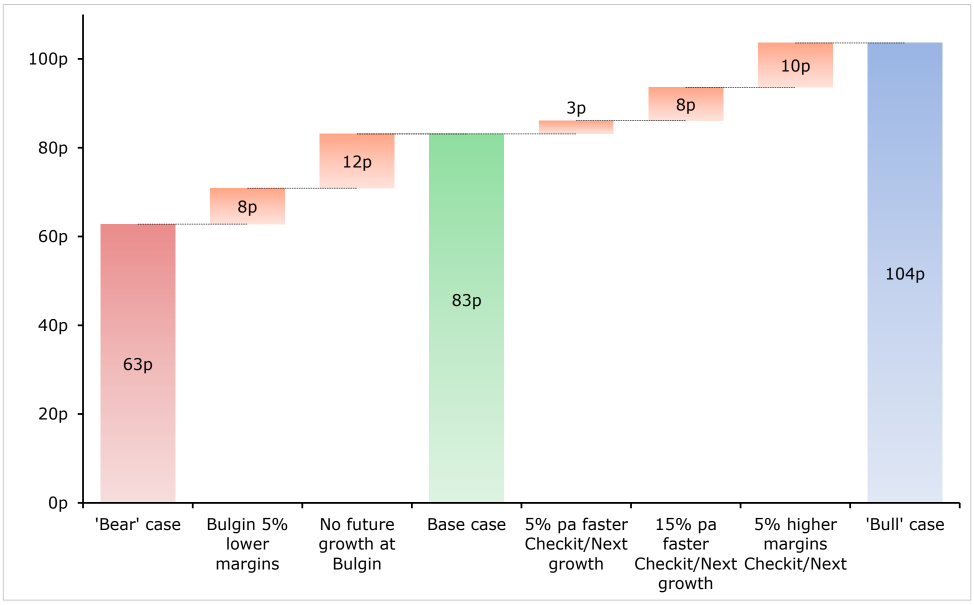
Source: Equity Development

Significant upside potential

In fact, we think there is a **healthy margin of safety** and **minimal downside** for risk tolerant investors - echoing Elektron's **double digit growth** & **rising profit margins**, as illustrated in the below 'Bear' and 'Bull' case scenarios of 63p and 104p per share.

Moreover, Checkit's **innovative SaaS solutions are applicable across many different sectors**, and have the potential to eventually become the industry's *de facto* standard. The immediate aim being to exploit this **1st mover advantage**, and **rapidly scale the enlarged division**.

Sensitivity analysis (p/share)

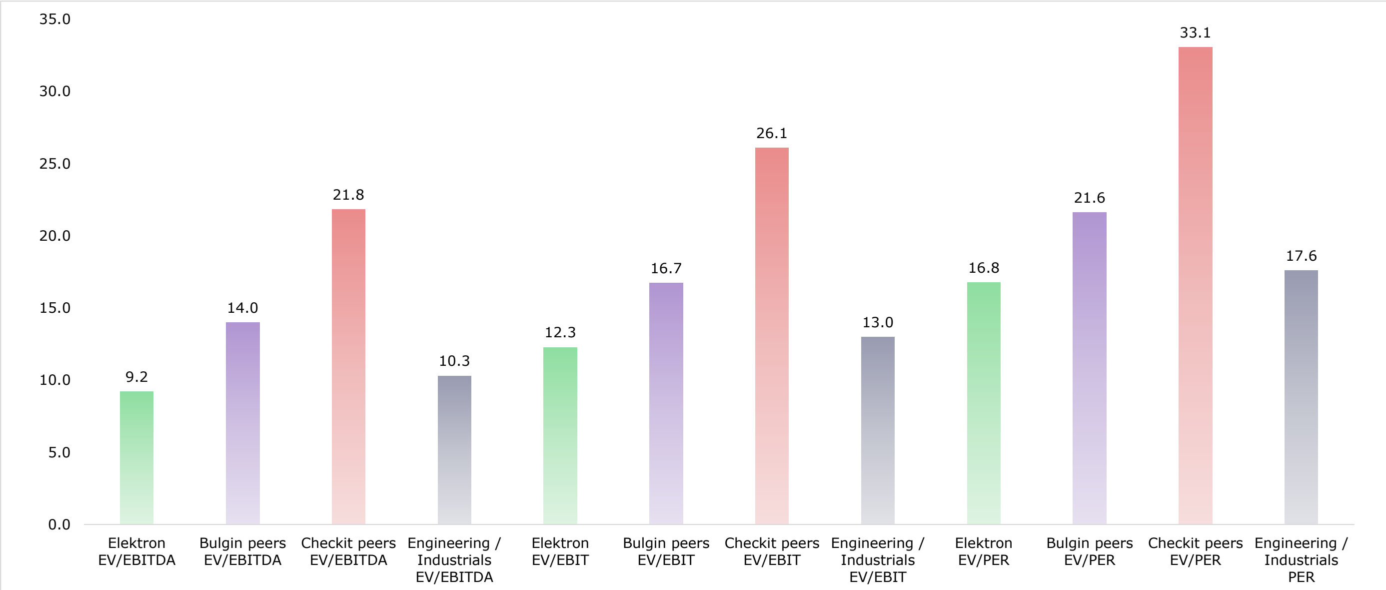


Source: Equity Development

Undervalued in both relative & absolute terms

Lastly, **the stock at 45p trades at an unwarranted discount to peers** (see below) in respect of most financial benchmarks.

Valuation benchmarks vs peers

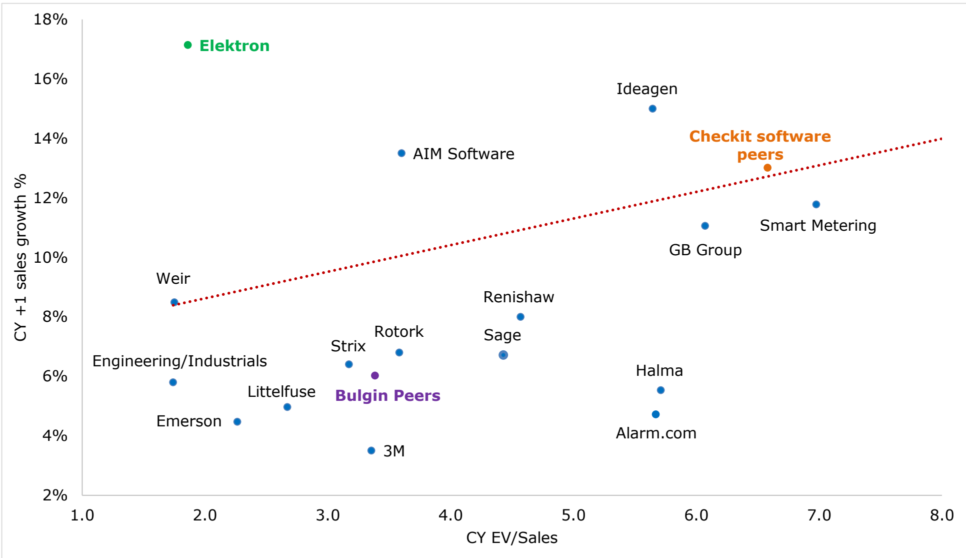


Source: Equity Development

Possible upwards re-rating as growth accelerates

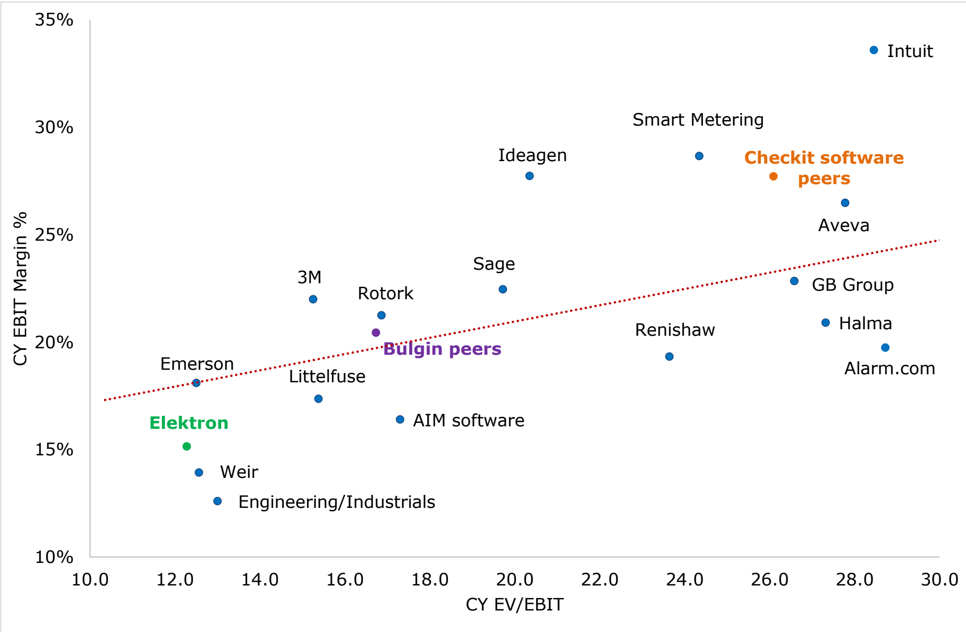
Sure, narrowing this gap will probably take time, but once the 'bell rings' that LFLs are accelerating and margins improving, then we suspect the stock could move sharply higher (see below).

Current year EV/sales multiples vs CY+1 revenue growth



Source: Equity Development.

Current year EV/EBIT multiples vs EBIT margins



Source: Equity Development.

Fine, but what could derail the outlook?

Apart from the usual concerns of a global recession, Brexit, trade tensions (US vs China/EU), tougher competition, etc – **we see little on the horizon for shareholders to be unduly worried about**.

Admittedly a protracted trade war between America and China could disturb the economic calculus, yet we reckon both sides will eventually reach a rational compromise, since they have too much to lose. Besides, Bulgin manufactures most of its products in Tunisia anyway, so it might even become a net beneficiary in the short term.

Investors: *'Our Friends Elektron'*

CEO John Wilson commenting: *"**The Group's trading performance in FY19 was exceptional** and we have made strong operational and financial progress during the year. **Bulgin delivered record profitability, Checkit sales accelerated to plan and EET returned to profitability**. We look to the future with optimism."*

Executive Chairman Keith Daley adding: "*__The recent acquisition of Next Control Systems significantly enhances the market opportunity for Checkit__. Next adds new capabilities, services and brings immediate scale to the business. We look forward to realising the many opportunities offered by the combination of Checkit and Next."*

Summary financial projections

Elektron Technology (January yearend)	2017 Act £ms	2018 Act £ms	2019 Act £ms	2020 Est £ms	2021 Est £ms	2022 Est £ms	2023 Est £ms	2024 Est £ms	2025 Est £ms	2026 Est £ms
Bulgin	24.1	27.3	30.1	31.8	33.4	35.1	36.8	38.7	40.6	42.6
Checkit/Next	0.3	0.5	1.0	8.7	14.3	17.8	22.3	27.9	34.8	43.5
EET	2.4	2.0	2.6	2.8	3.0	3.3	3.5	3.8	4.1	4.5
Turnover	**26.8**	**29.8**	**33.7**	**43.3**	**50.7**	**56.2**	**62.6**	**70.3**	**79.6**	**90.6**
Bulgin		*13.3%*	*10.3%*	*5.6%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*
Checkit/Next		*66.7%*	*100.0%*	*766.9%*	*64.6%*	*25.0%*	*25.0%*	*25.0%*	*25.0%*	*25.0%*
EET		*-16.7%*	*30.0%*	*8.0%*	*8.0%*	*8.0%*	*8.0%*	*8.0%*	*8.0%*	*8.0%*
% growth		*11.2%*	*13.1%*	*28.4%*	*17.1%*	*10.8%*	*11.5%*	*12.3%*	*13.1%*	*13.9%*
Gross Profit	**11.2**	**14.8**	**16.7**	**22.5**	**26.7**	**30.1**	**34.0**	**38.7**	**44.3**	**51.2**
% margin	41.8%	49.7%	49.6%	52.0%	52.8%	53.5%	54.3%	55.0%	55.8%	56.5%
Bulgin	4.3	7.9	9.4	10.7	11.3	11.8	12.4	13.0	13.7	14.4
Checkit/Next	-2.8	-2.7	-2.8	-2.3	-1.0	0.2	2.0	4.3	7.3	11.1
EET	-0.2	-0.1	0.2	0.3	0.4	0.4	0.5	0.6	0.7	0.8
Adjusted EBITDA	**1.3**	**5.1**	**6.8**	**8.7**	**10.6**	**12.5**	**15.0**	**17.9**	**21.7**	**26.3**
Bulgin	*17.8%*	*28.9%*	*31.2%*	*33.7%*	*33.7%*	*33.7%*	*33.7%*	*33.7%*	*33.7%*	*33.7%*
Checkit/Next	*-933.3%*	*-540.0%*	*-280.0%*	*-26.3%*	*-6.8%*	*1.1%*	*9.2%*	*15.4%*	*20.9%*	*25.5%*
EET	*-8.3%*	*-5.0%*	*7.7%*	*10.4%*	*11.9%*	*13.2%*	*14.5%*	*15.6%*	*16.7%*	*17.7%*
% EBITDA margin	***4.9%***	***17.1%***	***20.2%***	***20.2%***	***21.0%***	***22.2%***	***23.9%***	***25.5%***	***27.2%***	***29.0%***
Bulgin	3.3	7.2	9.0	10.3	10.8	11.4	11.9	12.5	13.1	13.8
Checkit/Next	-3.5	-4.4	-4.5	-3.9	-2.7	-1.6	0.1	2.2	5.1	8.7
EET	-0.4	-0.3	0.1	0.2	0.2	0.3	0.3	0.4	0.5	0.6
Adjusted EBIT	**-0.6**	**2.5**	**4.6**	**6.6**	**8.4**	**10.0**	**12.4**	**15.2**	**18.7**	**23.1**
Bulgin	*13.7%*	*26.4%*	*30.0%*	*32.4%*	*32.4%*	*32.4%*	*32.4%*	*32.4%*	*32.4%*	*32.4%*
Checkit/Next	*-1166.7%*	*-880.0%*	*-450.0%*	*-45.0%*	*-18.7%*	*-9.0%*	*0.5%*	*8.0%*	*14.5%*	*20.0%*
EET	*-16.7%*	*-15.0%*	*3.8%*	*5.4%*	*6.9%*	*8.2%*	*9.5%*	*10.6%*	*11.7%*	*12.7%*
% EBIT margin	***-2.2%***	***8.4%***	***13.7%***	***15.1%***	***16.5%***	***17.8%***	***19.8%***	***21.5%***	***23.5%***	***25.5%***
Adjusted Profit before Tax	**-0.6**	**2.6**	**4.6**	**6.4**	**8.4**	**10.0**	**12.4**	**15.2**	**18.7**	**23.1**
Adjusted EPS (p)	**-0.1**	**1.0**	**2.1**	**2.7**	**3.5**	**4.2**	**5.1**	**6.3**	**7.7**	**9.5**
EPS growth rate			*103.3%*	*30.4%*	*30.9%*	*19.3%*	*22.8%*	*21.9%*	*22.6%*	*22.9%*
Dividend (p)	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***
Yield	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*
Valuation benchmarks										
P/E ratio	*-774.9*	*44.5*	*21.9*	*16.8*	*12.8*	*10.7*	*8.7*	*7.2*	*5.8*	*4.8*
EV/Sales	*3.0*	*2.7*	*2.4*	*1.9*	*1.6*	*1.4*	*1.3*	*1.1*	*1.0*	*0.9*
EV/EBITDA	*61.9*	*15.8*	*11.8*	*9.2*	*7.6*	*6.5*	*5.4*	*4.5*	*3.7*	*3.1*
EV / EBITA	*-134.2*	*32.2*	*17.4*	*12.3*	*9.6*	*8.0*	*6.5*	*5.3*	*4.3*	*3.5*
Adjusted tax rate	*-83.3%*	*-30.8%*	*-17.3%*	*-21.0%*	*-21.0%*	*-21.0%*	*-21.0%*	*-21.0%*	*-21.0%*	*-21.0%*
EBITDA drop through rates		*126.7%*	*43.6%*	*20.2%*	*25.7%*	*33.1%*	*38.8%*	*38.5%*	*40.4%*	*41.6%*
Unlevered cashflow yield				*4.5%*	*6.2%*	*7.8%*	*9.7%*	*11.8%*	*14.6%*	*18.0%*
PEG ratio			*0.21*	*0.55*	*0.42*	*0.56*	*0.38*	*0.33*	*0.26*	*0.21*
Net cash/(debt)	**2.5**	**5.2**	**10.1**	**3.2**	**8.5**	**15.0**	**23.1**	**33.1**	**45.3**	**60.4**
Sharecount (Ks)	172.2	177.9	186.2	187.1	188.1	189.0	190.0	190.9	191.9	192.8
Shareprice (p)	**45.0**									

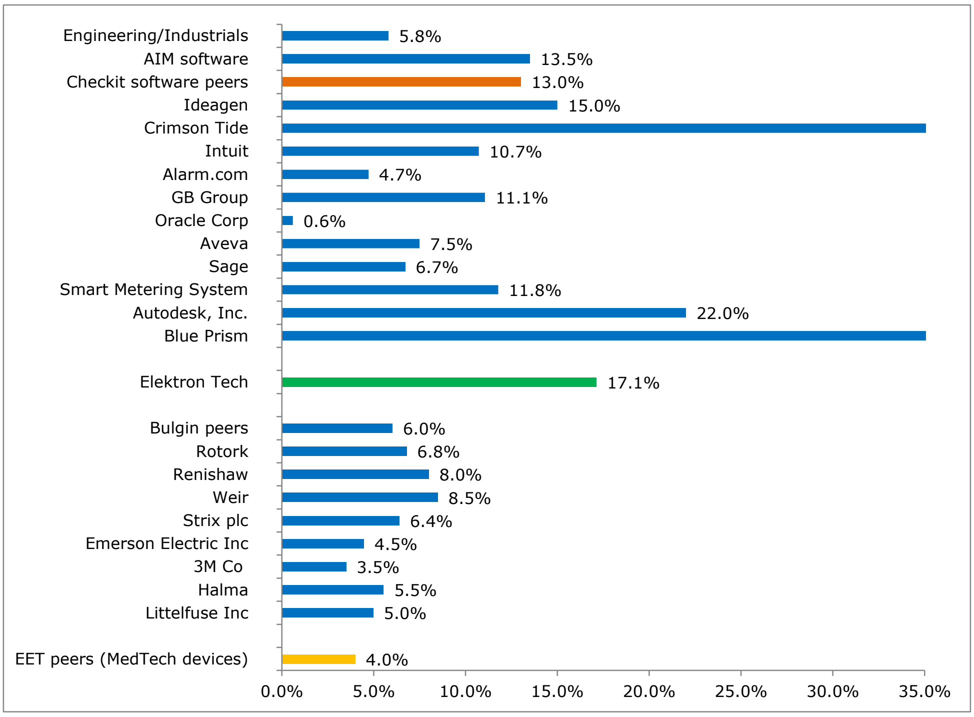
Source: Equity Development estimates, Company historic data. Note: Expense reclassification of £400k from Bulgin to Checkit from FY20 onwards

Key risks

- Slowdown in global GDP which could impact EKT’s end-markets. In particular Bulgin is early-cycle with revenues amplified by distributor de/restocking.
- Forward visibility at EET and Bulgin tends to be only 8 and 12 weeks’ respectively.
- Anticipated growth/profitability (eg Checkit/EET) 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. However this is primarily a translation risk with 64% of Elektron's FY18 turnover being generated outside the UK.
- Regulatory and tax changes. Competition may intensify as a function of new/existing players.
- Being relatively small, Elektron 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 and/or US-China/EU trade tariffs/sanctions
- As with many smallcap AIM stocks, daily trading volumes can occasionally decline, particularly during seasonally quieter periods and/or between newsflow.

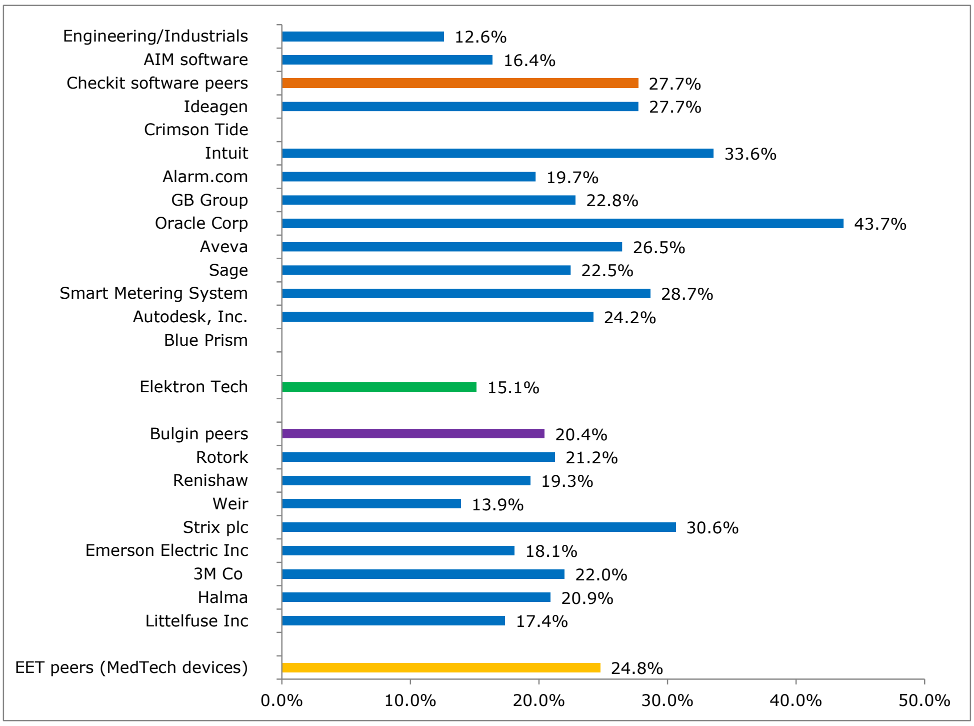
Appendix - Valuation benchmarks & industry KPIs

Current year + 1 sales growth rates



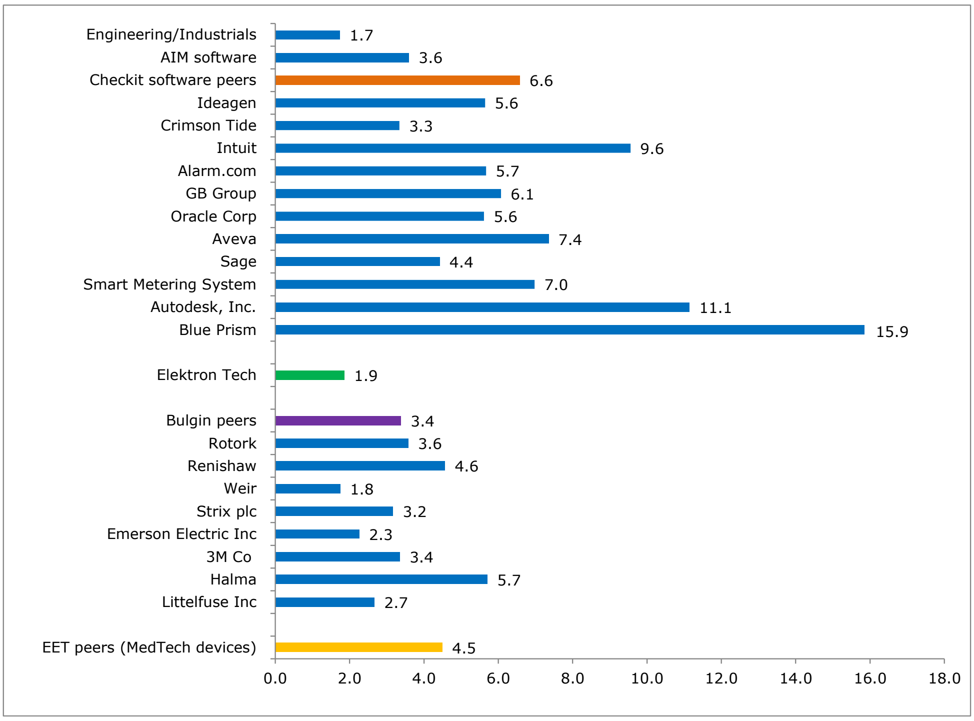
Source: Equity Development

Current year EBIT margins



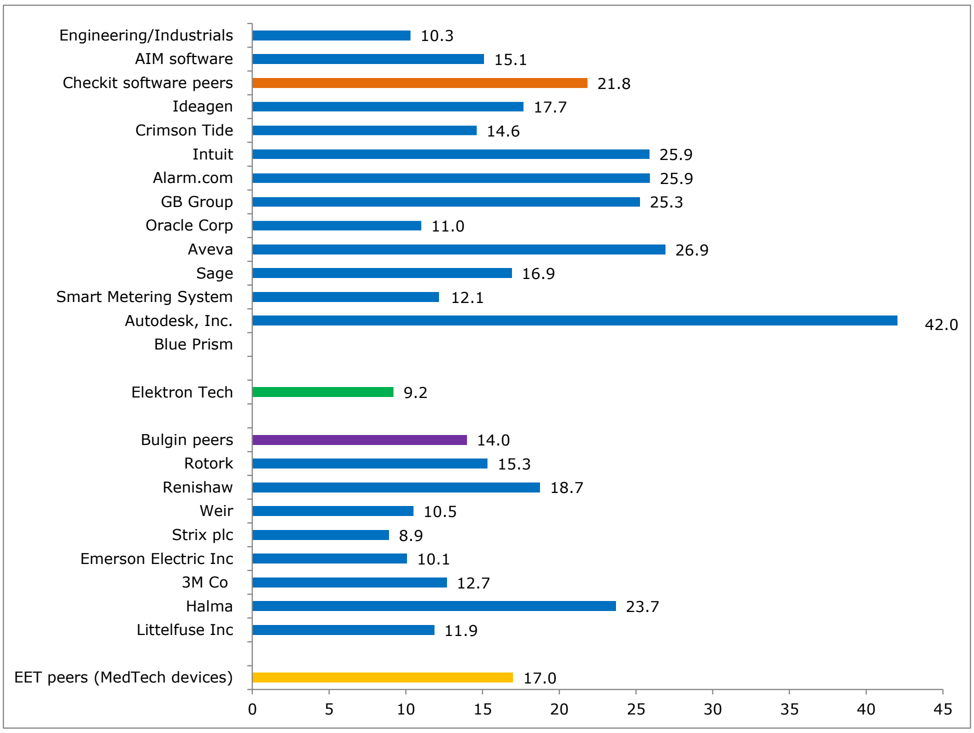
Source: Equity Development

Current year EV/sales



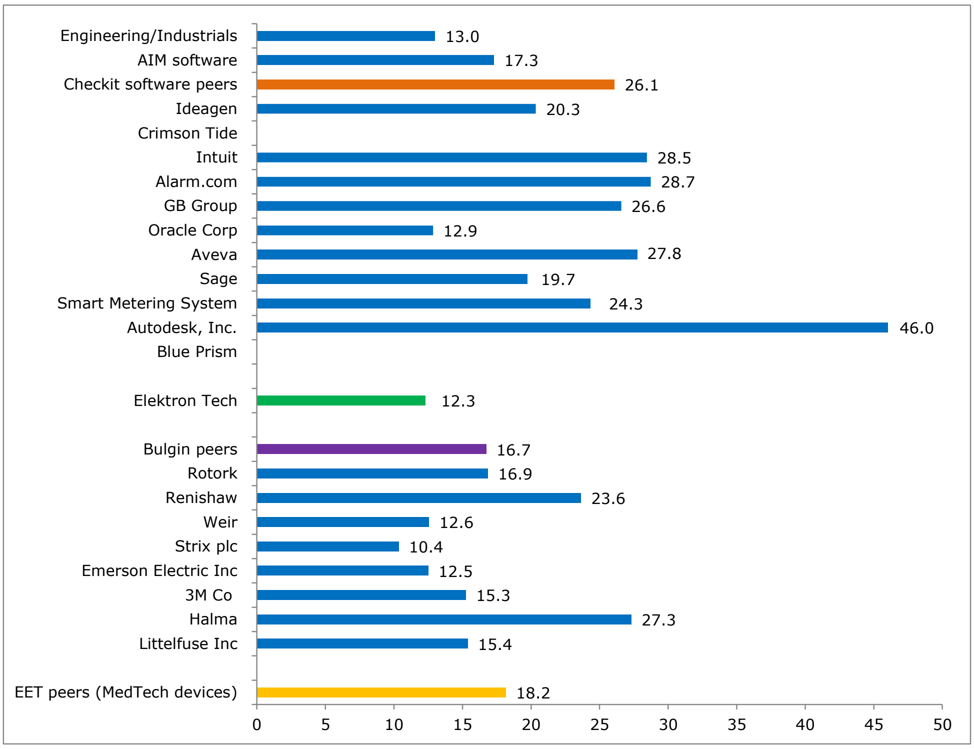
Source: Equity Development

Current year EV/EBITDA



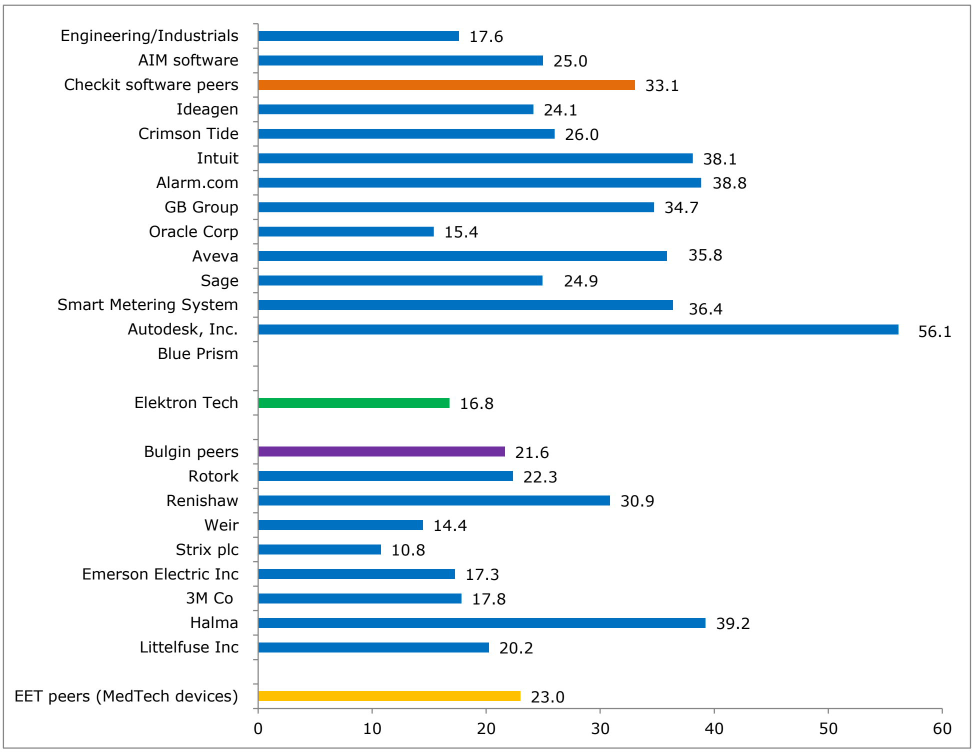
Source: Equity Development

Current year EV/EBIT



Source: Equity Development

Current year PER



Source: Equity Development

Investor Access

Hannah Crowe
Direct: 0207 065 2692
Tel: 0207 065 2690
hannah@equitydevelopment.co.uk