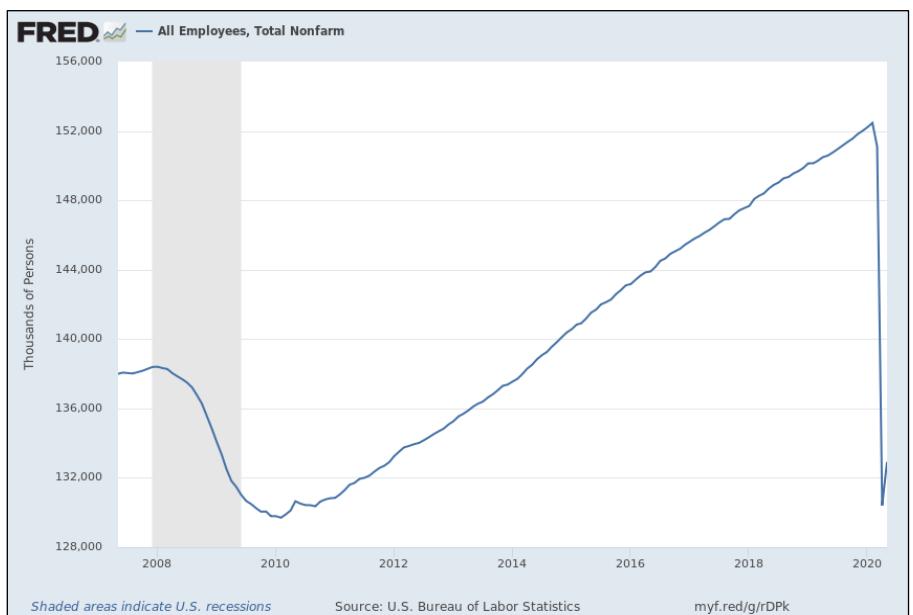


16th June 2020

## Bouncing back quicker than anticipated

In April, America lost 20.7m jobs (see below), equivalent to 10.3% of the workforce. Shocking as this is, the good news is that green shoots are already starting to appear. Not least with May's non-farm payrolls figure coming in at +2.5m (13.3% unemployment) vs an estimated 8m decline. Reinforced by a +290k print north of the border in Canada (13.7%).

### After initial shock, US labour market is recovering

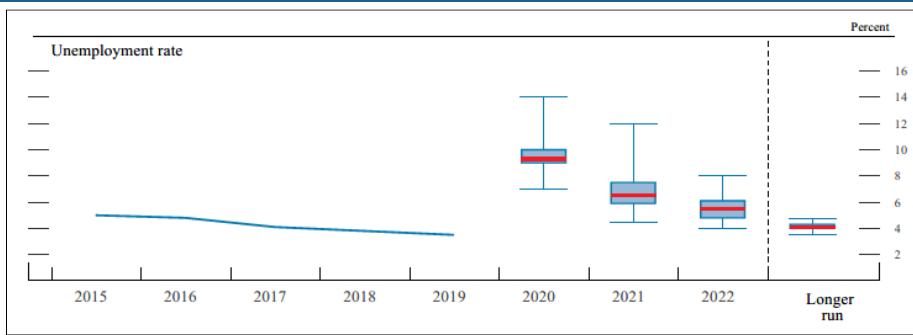


Source: Equity Development, US Dept of Labor

### So what happens next?

Well nobody knows for sure. Albeit last week, the Federal Reserve (see below) predicted unemployment would steadily fall to 9.3% in H2 and 5.5% by Dec'22, thanks to a rebound in economic activity (5.0% 2021).

### 10m+ net new jobs set to be created by Dec'22



Source: Federal Reserve. Red line = base case

This looks directionally correct, and should provide a **supportive backdrop for US background screening & medical testing expert ClearStar**, as a net 10m+ jobs are created over the next 2.5 years (average 330k/month).

### Company Data

EPIC	AIM: CLSU
Share price	38p
52 week Hi/Lo	73p/37p
Market cap	£13.8m
Sharecount	36.3m
Net debt 15 <sup>th</sup> June	\$1.5m
ED valuation / share	Withdrawn

### Share Price, p



Source: Share Cast

### Description

Floated at 54p/share in July'14, ClearStar is a tech-enabled Human Capital Integrity specialist serving the \$4bn global background & medical (MIS) screening market, which is growing at c. 4%-7% pa.

The firm is HQ'd in Georgia (99% US facing), and derives the majority of its revenues from high volume, low cost, 'everyday repeat' screens. Hence providing robust forward visibility and downside resilience.

**LFL growth** is being driven by multiple factors, including the rise of the gig economy, government crackdowns on illegal workers, legalisation of cannabis for recreational use and 'MIS & Direct'.

**Next News:** Trading update July 2020

**Paul Hill (Analyst)\***

0207 065 2690  
[paul.hill@equitydevelopment.co.uk](mailto:paul.hill@equitydevelopment.co.uk)

\*Paul Hill is a shareholder in CLSU

## Further endorsements from household names

But that's not all. Elsewhere, **the company has retained all its existing clients** during the COVID-19 lockdowns, and even **won a handful of new ones**.

For example, the on-boarding of 3 financial institutions, including **a global investment bank**, alongside one of the largest US operators of home-delivered meals for vulnerable people. Similarly ClearStar is receiving increasing interest from healthcare agencies, and is also performing greater volumes for a domiciliary care business.

Additionally, the firm signed a **substantial new contract with a bluechip technology testing and industrial automation group** (mrkcap >\$10bn) last month, where revenues should commence over the summer. Coupled with securing another prestigious agreement - this time with a property rental firm to supply tenant screening.

## Poised for a powerful H2 rally

Non-exec Chairman Barney Quinn adding: "*We entered the year with our highest ever order book and a healthy pipeline. As noted, the COVID-19 outbreak significantly impacted business [April down 50%] due to the widespread job losses and freeze on recruitment. However, we are encouraged that all 50 states in the US have commenced easing lockdown restrictions and the unemployment rate is beginning to come down.*

*ClearStar has the right solutions to support employers in quickly and securely re-establishing their workforce, which is reflected in the significant uptick in our revenue run rate from the end of May. We also recently launched our COVID-19 testing service that is specifically designed to assist employers with the back-to-work process.*

**While we have not yet returned to our pre-COVID-19 revenue run rate, the increase in sales so far is extremely encouraging.** As the US recovery progresses and our customers are able to resume more normal trading, **we expect this growth to continue."**

## Industry approval expected shortly by CDC

In terms of employee CV19 testing, we understand the US government (via Centers for Disease Control) has temporarily delayed the start of all new operations of this type, in order to ensure there is nationwide consistency (Re data privacy, etc).

**This brief pause is not company specific**, but instead industry-wide. Plus, given the urgency of the pandemic and state re-openings, we suspect appropriate Federal authorisations are likely to be granted shortly, especially as millions of staff return to work. And when it does, **ClearStar has already been awarded 5 deals**, which should provide a further lift to the top line.

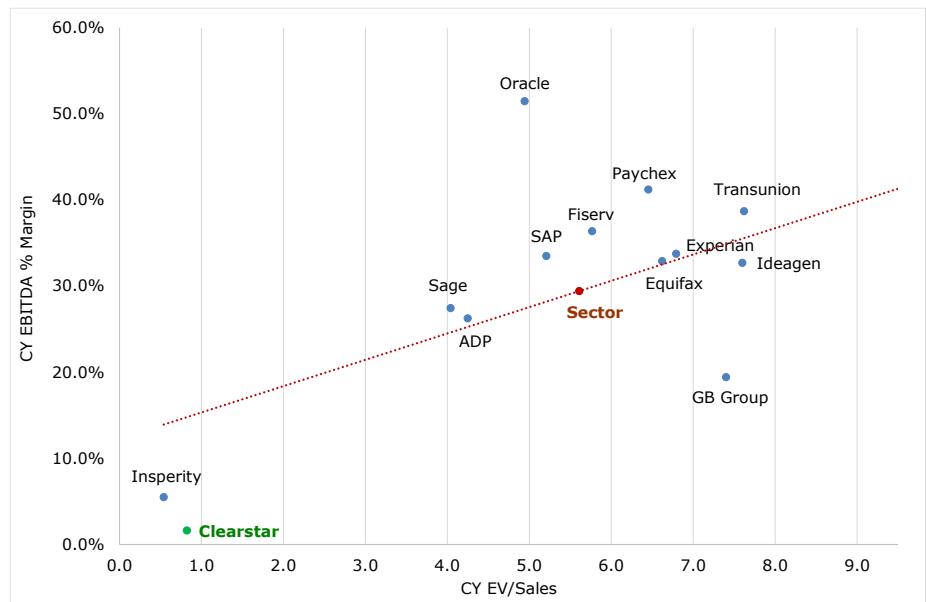
Exactly how much is difficult to quantify, but MIS conducts approx. 7,000 medical screens per month. So at a price point of say between \$100-\$175/unit, the solution (once fully rolled out) hypothetically might generate incremental turnover of between \$0.5m-\$1.0m/month. Excluding any extra clients, who may be attracted to the service too.

## Stock is attractively priced

Lastly with regards to valuation, **the shares** (at 38p) trade **on a modest 2019 EV/revs of 0.8x vs peers** (pre coronavirus) **at 2.5x–3.5x**. As at 15 June 2020, there was \$1.5m of net debt and \$2.1m of available funds vs net borrowings of \$1.0m on 5th May, including a \$1.1m loan received under the Paycheck Protection Program.

The US government's PPP is aimed at helping small businesses get through the pandemic, with all/part of the money being forgiven, provided 60% or more of the funds are used for employee costs, such as payroll, healthcare, vacations, sick leave, etc. Moreover, bearing in mind the importance of SMEs to future job creation, we believe Congress will almost certainly increase the size of the current scheme over the coming months.

### Current Year EV/sales multiple vs EBITDA margin



Source: Equity Development. ClearStar & GB Group use 2019 numbers.

### Range of sector valuation benchmarks pre COVID-19 crisis

Valuation benchmarks	ClearStar 2019 Trailing	Typical HR screening multiples pre COVID-19 crisis	
		Low	High
EV/Revenues	0.8	2.5	3.5
EV/EBITDA		12.5	14.0
EV/EBIT		15.0	16.5
PER		18.8	20.6
EBITDA margins	1.6%	20.0%	25.0%

Source: Equity Development

## Costs & cashflow continue to be tightly controlled

Mr Quinn summing up: "While it remains too early to estimate the impact of COVID-19 on full year 2020, **we are increasingly optimistic that it will not be as bad as we once feared**. Equally, the markets that ClearStar addresses continue to remain attractive in the longer-

term and we have established a strong competitive position for targeting these markets. Consequently, the Board remains confident of delivering value for our shareholders and we thank you for your ongoing support".

### Summary financials

<b>ClearStar (December yearend)</b>	<b>Act'14 \$'000s</b>	<b>Act'15 \$'000s</b>	<b>Act'16 \$'000s</b>	<b>Act'17 \$'000s</b>	<b>Act'18 \$'000s</b>	<b>Act'19 \$'000s</b>
Channel partners (non MIS)	6,554	6,980	7,387	7,475	7,056	6,468
Medical/drug testing - channel	3,890	4,770	4,850	5,610	7,055	8,567
Direct services (incl 15% medical)	477	3,766	3,795	4,700	6,002	7,918
<b>Turnover</b>	<b>10,921</b>	<b>15,516</b>	<b>16,032</b>	<b>17,785</b>	<b>20,113</b>	<b>22,953</b>
<i>MIS &amp; Direct % of group</i>	<i>40.0%</i>	<i>55.0%</i>	<i>53.9%</i>	<i>58.0%</i>	<i>64.9%</i>	<i>71.8%</i>
<i>Channel partners (non MIS)</i>	<i>-13.4%</i>	<i>6.5%</i>	<i>5.8%</i>	<i>1.2%</i>	<i>-5.6%</i>	<i>-8.3%</i>
<i>Medical/drug testing - channel</i>		<i>22.6%</i>	<i>1.7%</i>	<i>15.7%</i>	<i>25.8%</i>	<i>21.4%</i>
<i>Direct services (incl 15% medical)</i>	<i>59.0%</i>	<i>689.5%</i>	<i>0.8%</i>	<i>23.8%</i>	<i>27.7%</i>	<i>31.9%</i>
<b>% total growth</b>	<b>37.0%</b>	<b>42.1%</b>	<b>3.3%</b>	<b>10.9%</b>	<b>13.1%</b>	<b>14.1%</b>
<b>Gross Profit</b>	<b>6,331</b>	<b>9,493</b>	<b>9,835</b>	<b>10,349</b>	<b>11,340</b>	<b>12,410</b>
% margin	58.0%	61.2%	61.3%	58.2%	56.4%	54.1%
<b>EBITDA (post SBPs)</b>	<b>-1,267</b>	<b>-956</b>	<b>-666</b>	<b>-462</b>	<b>-108</b>	<b>370</b>
% Margin	-11.6%	-6.2%	-4.2%	-2.6%	-0.5%	1.6%
<b>Adj. EBITDA (pre SBPs)</b>	<b>-1,267</b>	<b>-956</b>	<b>-542</b>	<b>-398</b>	<b>157</b>	<b>381</b>
Opex	-8,071	-11,736	-11,930	-12,281	-12,674	-13,095
Opex growth			1.7%	2.9%	3.2%	3.3%
<b>Adj. EBIT (post SBPs)</b>	<b>-1,740</b>	<b>-2,243</b>	<b>-2,095</b>	<b>-1,932</b>	<b>-1,334</b>	<b>-685</b>
% Margin	-15.9%	-14.5%	-13.1%	-10.9%	-6.6%	-3.0%
Net interest	-17	-22	-16	-17	-68	-171
<b>Adj. Profit before Tax</b>	<b>-1,757</b>	<b>-2,265</b>	<b>-2,111</b>	<b>-1,949</b>	<b>-1,402</b>	<b>-856</b>
<b>Adjusted EPS (cents)</b>	<b>-4.8</b>	<b>-6.1</b>	<b>-5.6</b>	<b>-5.4</b>	<b>-4.0</b>	<b>-2.4</b>
EPS growth rate	-26.2%		7.3%	4.5%	25.1%	40.5%
Dividend (cents)						
<i>Yield</i>						
<b>Valuation benchmarks</b>						
P/E ratio						-19.9
EV/Sales	1.7	1.2	1.2	1.1	0.9	0.8
EV/EBITDA					-175.1	51.1
EV / adj EBIT					-14.2	-27.6
Implied EBITDA drop through rates		6.8%	56.2%	11.6%	15.2%	16.8%
Adjusted tax rate	-0.2%	-2.3%	-2.9%	0.0%	0.0%	0.0%
Cash conversion (ie (EBTDA - Cap R&D - W/Cap)/EBIT)						
PEG ratio						
<b>Net cash/(debt)</b>	<b>6,124</b>	<b>3,630</b>	<b>2,253</b>	<b>1,240</b>	<b>923</b>	<b>-346</b>
Net debt : EBITDA						0.94
Capitalised NPD	-803	-1,396	-886	-712	-665	-1,422
Depreciation & amortisation	-473	-1,287	-1,429	-1,470	-1,226	-1,055
R&D + capitalised NPD as % sales	-8.8%	-14.2%	-15.9%	-14.6%	-11.5%	-12.0%
Sharecount (Ks)	36,303	36,303	36,303	36,303	36,303	36,363
<b>Shareprice (p)</b>	<b>38.0p</b>					

Source: Equity Development estimates, Company historic data. NB. SingleSource was acquired in December 2014

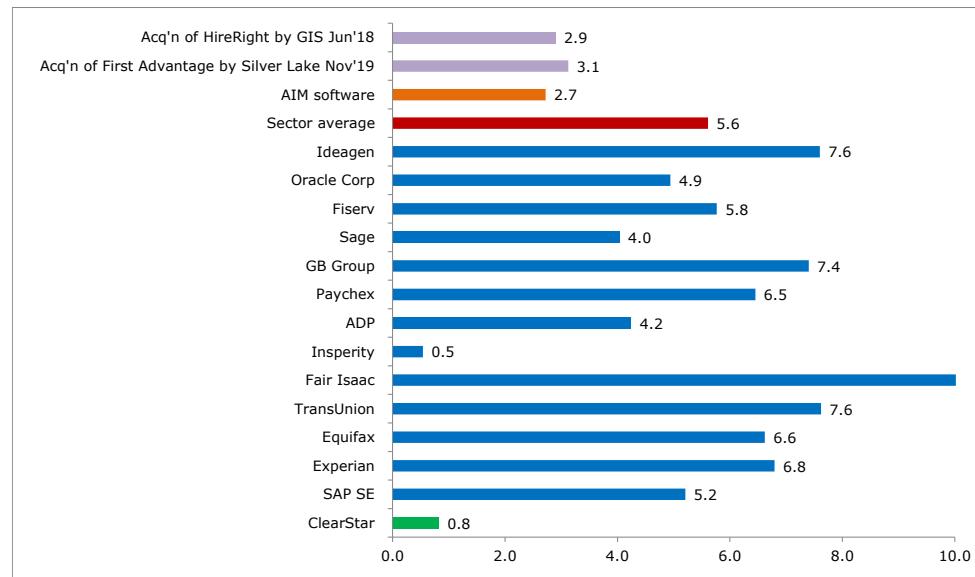
Note: As at 31st December 2019, CLSU had \$10,193k of unutilised tax losses, which can be utilised in future periods. These carry forwards however will begin to expire in 2023, but last until 2038.

## Key risks

- Impact of a future recession on employment screening.
- Customer concentration, with the biggest account generating 11% of 2019 sales. This is a long term relationship with churn typically occurring only when a client is taken-over.
- Possible increase in bad debts due to COVID-19 induced downturn.
- Foreign exchange fluctuations for UK holders, given that >90% of turnover is derived from America.
- Being relatively small, ClearStar could get squeezed by its larger rivals, especially if there is further industry consolidation.
- The firm is presently loss making - hence it is important that sufficient resources continue to be made available. In the event more funding is required, then it is not certain that future capital would be available at commercial rates.
- Generic risks of greater competition, retention/recruitment of key staff, etc. Albeit this goes with the territory in the small-cap arena.
- Disruption caused to ClearStar's cloud based "Aurora & Sphere" platforms, such as from service outages, security breaches, etc.
- Supplier concentration. In 2019, CLSU bought \$5.7m of services from two vendors, representing 54% of group purchases.
- Possible adverse changes in employment law and local recruitment practises.
- ClearStar is registered in the Cayman Islands, and therefore does not fall under the UK Takeover Panel if it was ever approached by a third party.
- Protection of minorities, given that 49% of the shares are still held by directors/co-founders.

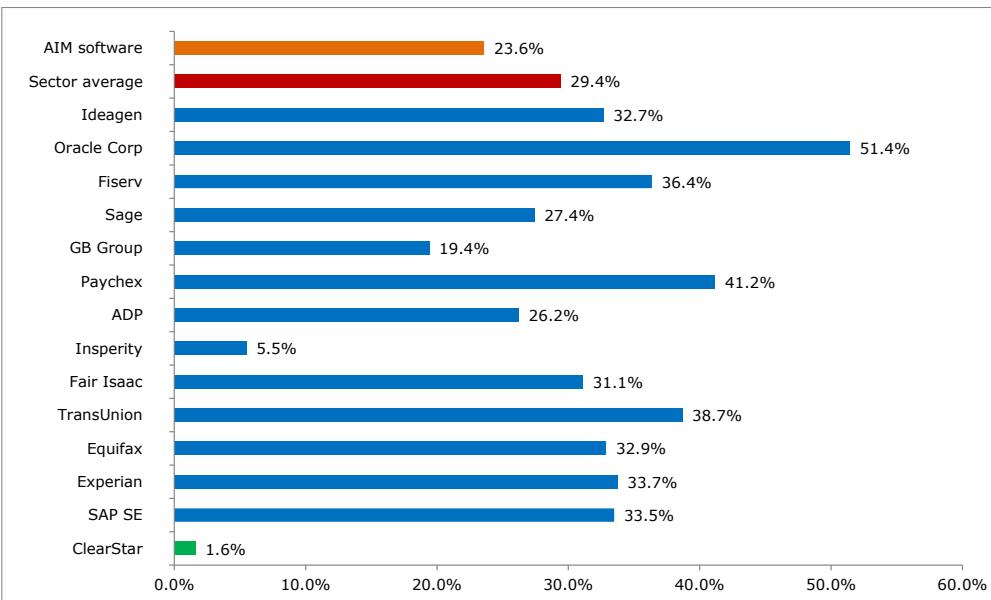
## Appendices - Sector valuation metrics and KPIs

### Current Year EV/revenue multiples



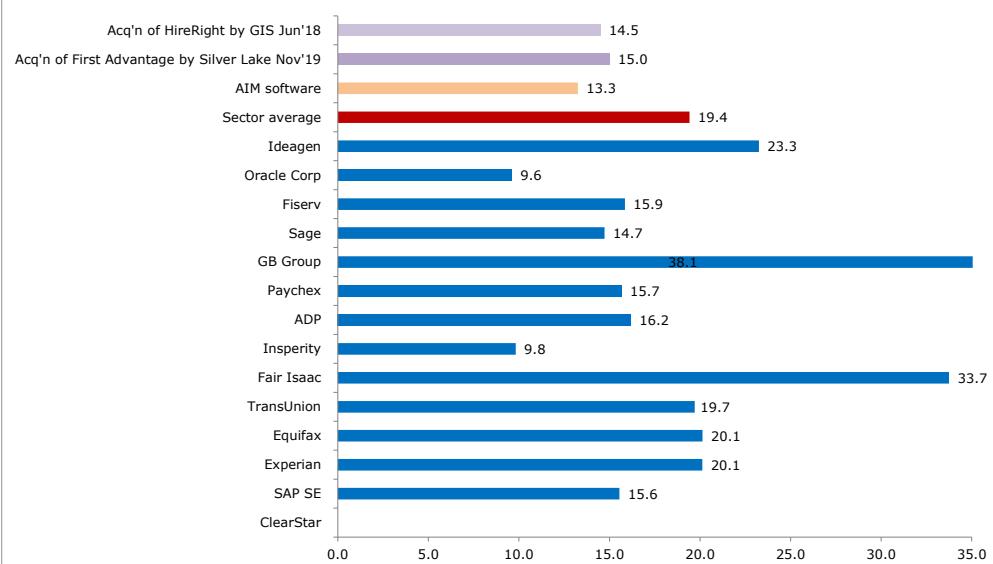
Source: Equity Development. ClearStar & GB Group use 2019 numbers

### Current Year EBITDA margins (post SBPs)



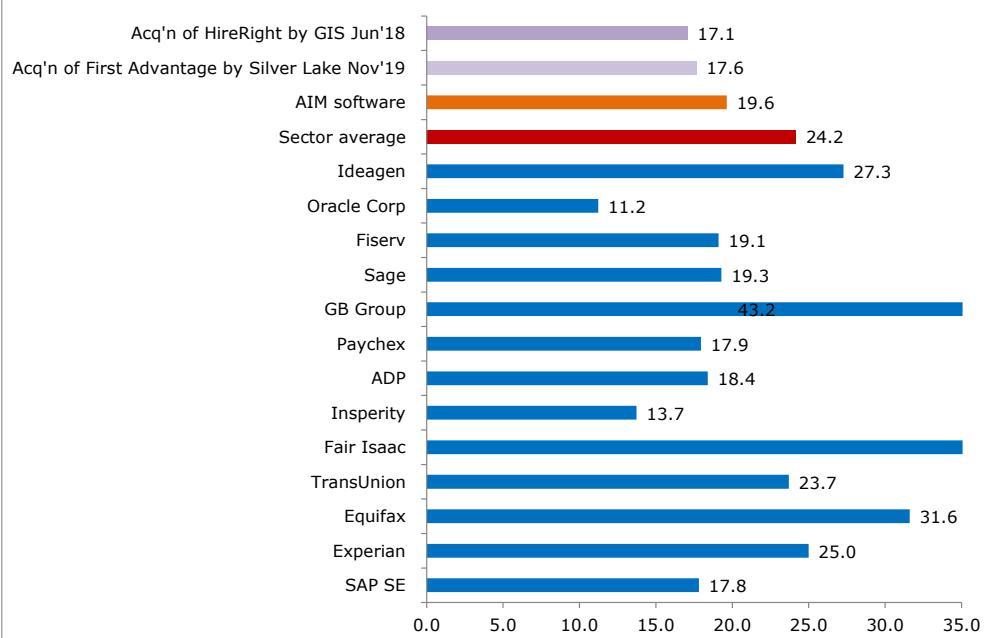
Source: Equity Development. ClearStar & GB Group use 2019 numbers

### Current Year EV/EBITDA multiples



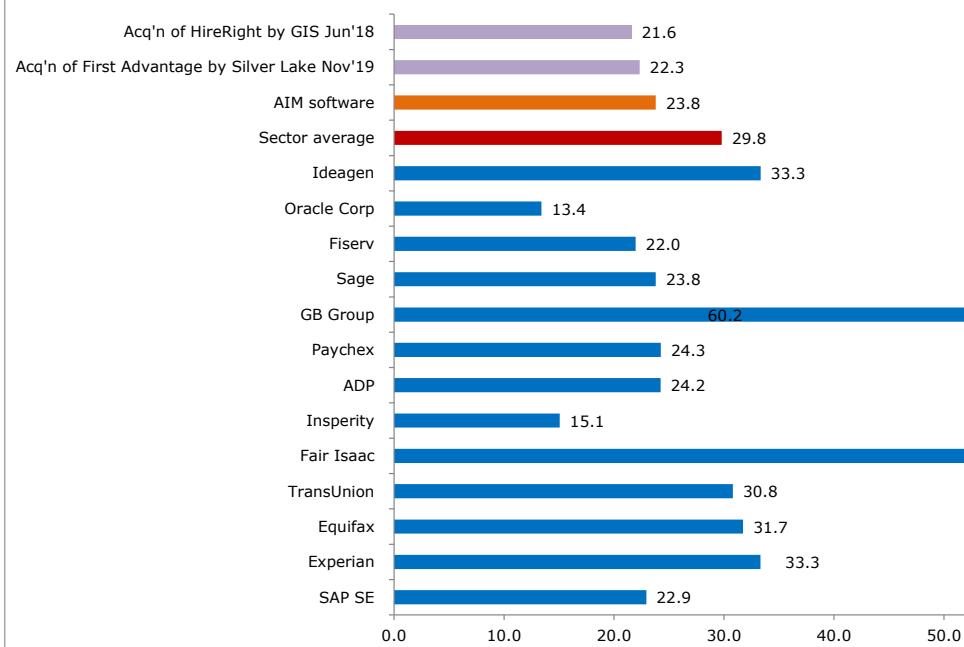
Source: Equity Development, arithmetic average for sector. 2019 numbers for GB Group

### Current Year EV/EBIT multiples



Source: Equity Development, arithmetic average for sector. 2019 numbers for GB Group

## Current Year PERs



Source: Equity Development, arithmetic average for sector. 2019 numbers for GB Group

## Market capitalisation of peers

	Description	Shareprice	Mrk Cap (Millions)	CY Net cash / (debt) Millions	Enterprise Value (Millions)
ClearStar	Tech-enabled employment & medical screening services	38p	£13.8	-£1.2	£15.0
SAP SE	ERP, accounting & HR software	€ 114	€ 135,660	-€ 10,586	€ 146,246
Experian	Credit checking & info services	\$34.65	\$31,532	-\$3,835	\$35,367
Equifax	Credit checking & info services	\$165	\$20,031	-\$2,980	\$23,011
TransUnion	Credit checking & info services	\$88	\$16,520	-\$3,383	\$19,903
Fair Isaac	Credit checking & info services	\$412	\$12,010	-\$781	\$12,791
Insperity	HR services	\$55	\$2,255	-\$161	\$2,416
ADP	Payroll services	\$143	\$61,776	-\$498	\$62,274
Paychex	Payroll services	\$73	\$26,280	-\$84	\$26,364
GB Group	ID verification	644p	£1,251	-£42	£1,292
Sage	ERP, accounting & HR software	645p	£7,031	-£394	£7,425
Fiserv	Financial services	\$98	\$67,130	-\$21,006	\$88,136
Oracle Corp	ERP, accounting & HR software	€ 52.00	€ 169,000	-€ 27,818	€ 196,818
Ideagen	Regulatory software	180p	£407.5	-£18.0	£425.5

Source: Equity Development



## Investor Access

### Hannah Crowe

Direct: 0207 065 2692

Tel: 0207 065 2690

[hannah@equitydevelopment.co.uk](mailto:hannah@equitydevelopment.co.uk)

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Equity Development, 15 Eldon Street, London, EC2M 7LD. Contact: [info@equitydevelopment.co.uk](mailto:info@equitydevelopment.co.uk) 0207 065 2690