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RESEARCH



## Tekcapital

8<sup>th</sup> May 2018

**Full year results highlight value creation and growth in services – shares now trade at a discount to NAV and the UK IP sector**

AIM listed Tekcapital is an international provider of technology and intellectual property investment services. The company's objective is to create value from investing in new, university-developed intellectual properties and to produce returns through capital appreciation.

### FY2017 results show good progress and value creation

For the year to 30<sup>th</sup> November 2017 Tekcapital grew total revenues to \$7,263,048. Combined with administration costs falling by 16% to \$2,417,284, this resulted in a pre-tax profit of \$4,153,154 compared to loss of \$2,558,198 in 2016. On the balance sheet, net assets were up 240% over the year to \$10,675,961, with NAV per share up from 9 cents to 25 cents.

### Upward revaluation of two companies drives NAV

Tekcapital's investment portfolio was valued at \$7,307,696 at the period end following rises in the value of medical device business Belluscura and smartglasses company Lucyd. Belluscura's value was up from \$731,930 to \$981,762 despite an aborted IPO and the fair value of Lucyd was increased by \$5,833,393 to just over \$6 million after an external valuation of the company following a successful token generation event.

### Shares now trade at a modest discount to NAV and more substantial discount to the UK IP sector average

Following the rise in NAV, combined with a modest slip in the share price, Tekcapital now trades at a discount of 2% to net assets as at 30<sup>th</sup> November 2017 and at a 30% discount to the sector's average price to book value. **A 40% premium to NAV, in line with the sector, implies a share price of 25.84p, implying 44% upside from the current price. We therefore move our stance from Speculative Buy to Conviction Buy.**

Table: Financial overview. Source: Company & Align Research

Year to end Nov	2013A	2014A	2015A	2016A	2017A
Revenues (\$m)	0.04	0.21	0.41	0.76	7.26
Pre-tax (\$m)	(0.04)	(0.99)	(1.46)	(2.56)	4.15
EPS (c)	(0.3)	(5.0)	(4.9)	(6.3)	10.8

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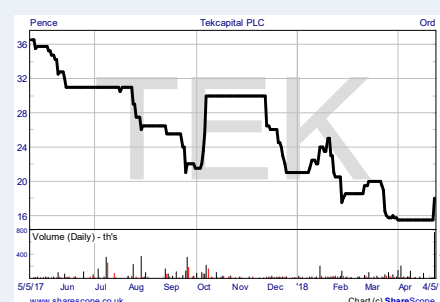
## CONVICTION BUY



### Key data

EPIC	TEK
Share price	18p
52 week high/low	36.5p/15.5p
Listing	AIM
Shares in issue	42,654,707
Market Cap	£7.7m
Sector	Intellectual Property

### 12 month share price chart



### Analyst details

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## Final Results

### Financials

Tekcapital's services business saw good growth during the year to 30<sup>th</sup> November 2017, revenues growing by 13% to \$813,714. This came on the back of expansion of the Invention Evaluator service into Latin America with a number of universities and organisations, along with growth in technology transfer services. Product sales (relevant only for first 5 months of the year due to deconsolidation of portfolio company Belluscura) grew from \$43,021 to \$139,452.

The main contributor to revenues for the period was a \$6,083,225 net unrealised gain on the revaluation of investments. This was up from zero in the previous year as during the period Tekcapital adopted a new accounting policy, triggered by the classification of the company as an investment entity under IFRS 10. As a result the company now measures and evaluates the performance of substantially all of its investments on a *fair value* basis.

Added to a \$226,656 profit on the derecognition of subsidiaries, this took total revenues for the year to \$7,263,048. Combined with administration costs falling by 16% to \$2,417,284, this resulted in a pre-tax profit of \$4,153,154 for the full year compared to loss of \$2,558,198 in 2016.

### Balance sheet & cash flow

On the balance sheet, net assets were up 240% over the year to \$10,675,961, with NAV per share up from 9 cents to 25 cents. This mainly reflected the increase in fair value of financial assets being realised through the profit and loss account. Tekcapital ended the year with cash of \$1,797,729 and had no debt at the period end. The cash position was down marginally from \$1,839,603 a year earlier following a net \$2,741,385 outflow from operations and \$655,208 used in investing activities being offset by a \$3,253,184 inflow from financing activities. Please note approximately \$0.8m of cash used was attributed to Belluscura plc through deconsolidation date of May 1, 2017.

### Portfolio Highlights

#### Belluscura

Medical device business Belluscura has made good progress with its portable oxygen concentrator (POC) product development programme and plans to file a 510(K) application with the US FDA in 2018. According to Knowledge Sourcing Intelligence, the POC market is projected to reach US\$1.7 billion by 2022.

Belluscura has recently launched a number of products in both the US and UK and has acquired the rights to a portfolio of portable oxygen concentrator (POC) patents and know-how, which it is developing into a commercial product with several unique and competitive attributes. Its Curv™ POC prototype weighs less than 3.5 lbs, is modular and its capability can be expanded to provide more oxygen as a user's lung disease progresses and with replaceable filters. The prototype POC is quiet and once developed is expected to be lower cost than the competition.

Belluscura has also made progress on the development of a prototype SNAP III™ device for the anaesthesia monitoring market. The current prototype unit for SNAP III™ is 1/10th the size and projected to be less than 1/10th of the cost of the originally licensed SNAP II™ product. Belluscura also continues to sell its Slyde™, Passport® and WireCaddy™ products.

Post period end, in February, Belluscura concluded a private placement of approximately \$1.33 million and converted loans equal to c.\$268,000 to equity under the same terms.

## Lucyd

Lucyd, the developer of augmented reality (AR) smartglasses, received approximately \$6.1 million in contributions from its blockchain token generation event in March 2018. The proceeds will be spent on the development of a prototype product, which is expected to be launched in March 2019.

## Other investee companies

The remaining portfolio companies, Salarius, Smart Food Tek, Frigidus, Guident, eSoma, Non-Invasive Glucose Tek and eGravitas, continue to seek commercialisation opportunities as discussed in our recent initiation of coverage note, with no significant further developments made since then.

According to management, the company remains committed to pursuing new commercialisation opportunities as evidenced by the establishment of Guidant and eSoma in 2017. Also of note, Salarius, which holds the patent for micro-salt ( $\mu$ Salt™), manufactured its first patented micro-salt samples and had them independently tested for both flavour and sodium content with a leading brand of potato chips (crisps). Results indicated that Salarius salted crisps have all the flavour and roughly half of the sodium of traditional crisps. We view this as a significant breakthrough for producing healthier snacks. According to Grand View Research, the global healthy snack market is expected to reach \$32.8 billion by 2025. Salarius is both continuing to seek an out license for its patented product while exploring the potential launch of a healthier snack food brand.

## Portfolio Valuation

Tekcapital's total investment portfolio was valued at \$7,307,696 at the period end, with movements in the value of Belluscura and Lucyd being the main talking points of the year. Notable was the movement in the value of Belluscura, which was revised down by \$2,200,738 compared to the interim stage of the year. This followed an aborted IPO and subsequent equity financing which was completed at a lower level than the previous fundraise. Nevertheless, Belluscura's value did still increase over the full year on a net basis, from \$731,930 to \$981,762. The fair value of Lucyd was increased by \$5,833,393 following an external valuation of the company following its successful token generation event. The remaining portfolio companies were valued at the cost of the original funds invested. We note that Guident was formed since the period end and therefore not included in the portfolio valuation.

Portfolio company	Ownership	Opening value	Additions (\$)	Fair value change (\$)	Value as at 30/11/2017 (\$)
Lucyd	100.00%	-	190,562	5,833,393	6,023,955
Belluscura	47.35%	-	731,930	2,450,570 - 2,200,738	981,762
Non Invasive Glucose Tek	100.00%	-	24,199	-	24,199
Smart Food Tek	100.00%	-	44,167	-	44,167
eGravitas	100.00%	-	154,535	-	154,535
Frigidus	100.00%	-	52,968	-	52,968
eSoma	100.00%	-	10,983	-	10,983
Salarius	100.00%	-	15,128	-	15,128
<b>TOTAL</b>			<b>1,224,472</b>	<b>3,632,655</b>	<b>7,307,696</b>

Source: Tekcapital accounts

## Assessment

These are a good set of accounts from Tekcapital in our view. While the downward revision of the Belluscura valuation in the second half of the year is disappointing we point out that the valuation did in fact rise by 34% over 12 months and the company is on-track with filing a 510k with the US FDA in 2018 for the POC, which is a major potential milestone for the company. In any case, this minor disappointment was more than offset by the rise in the fair value of Lucyd following its impressive token generation event. In addition, we note the strong financial position of the company. With total current assets of \$2,761,640 at the period end and current liabilities of just \$238,149 Tekcapital remains in a good position to continue to support its investee companies.

We also note that at the period end Tekcapital's NAV of \$10,675,961 surpassed the total amount of capital raised since inception (c.\$9.54 million/£7 million). This is a good measure of the effectiveness of IP companies as their basic job is to take capital, invest it and make decent returns for shareholders.

Tekcapital's total return to date (measured as NAV divided by capital raised) is c.12%, or c.3.9% on a compound annual growth (CAGR) basis since formation in 2014. While this figure is relatively low compared to expected returns from venture capital type businesses we note that Tekcapital is still in the early stage of its development (when returns are expected to be lower), and perhaps more importantly, this CAGR figure is at the top of the wider UK peer group. **IP Group (IPO)** for example currently has net assets of £1.496 billion but with an estimated £1.33 billion raised since formation in 2001 the total return of c.12.5% results in a CAGR of just 0.74% - less than investors could have expected to earn in a Cash ISA over that period.

Company	Year founded	Net Assets (£m)*	Capital raised since inception (£m)	Total return	CAGR
IP Group	2001	1,495.6	1,329.9	12.5%	0.74%
Allied Minds	2004	353.8	313.9	12.7%	0.91%
Mercia Technologies	2014	123.6	118.2	4.5%	1.48%
NetScientific	2008	15.8	62.5	-74.7%	-14.16%
Frontier IP	2007	12.23	11.6	5.3%	0.52%
Tekcapital	2014	7.87	7.0	12.0%	3.85%

\* as at last published balance sheet date

Table: UK IP peer group and returns since formation. Source: Align Research

## Valuation

To illustrate the current valuation of Tekcapital we compare the business to other UK listed IP peers. We identify seven other peers but omit life sciences investor **Amphion Innovations (AMP)** as an anomaly as the company has a complex debt structure and negative net asset position due to large historic losses.

For **Allied Minds (ALM)**, as the company exercises control over all of its investments in subsidiary undertakings their activities are fully consolidated in the group accounts and the value of those investments is not separately disclosed in the balance sheet. Instead a measure known as Group Subsidiary Ownership Adjusted Value (GSOAV) is used, which represents Allied Minds' interest in the equity value of each subsidiary. The GSOAV was estimated at \$395.6 million as at 22<sup>nd</sup> March 2018. Combining the subsidiary valuations with the holding company's cash position of \$84.2 million as at 31<sup>st</sup> December 2017 we attribute a net asset value to Allied Minds of \$479.8 million, or £353.8 million at current FX rates.

For **NetScientific (NSCI)** we account for the proceeds of a recent £5 million placing.

Company	EPIC	Market cap (£m)	Net Assets (£m)*	Price to book value
IP Group	IPO	1,419	1,495.6	0.95
Allied Minds	ALM	299.2	353.8	0.85
Mercia Technologies	MERC	113.7	123.6	0.92
NetScientific	NSCI	33.8	15.8	2.14
Frontier IP	FIPP	31.4	12.23	2.57
Tekcapital	TEK	7.7	7.87	0.98
<b>AVERAGE</b>				<b>1.40</b>

*Table: UK listed IP companies analysis. Exchange rate of £1:\$1.356 assumed. Source: Align Research.*

In terms of price-to-book value (or premium to NAV) we calculate a current sector average premium of 40% - investors often apply a premium to NAV for IP companies as they anticipate future increases in the fair value of their investment portfolios. Following the rise in NAV since our initiation of coverage note, combined with a modest slip in the share price, Tekcapital now trades at a discount of 2% to net assets as at 30<sup>th</sup> November 2017 and at a 30% discount to the sector's average price to book value. **A 40% premium to NAV, in line with the sector, implies a share price of 25.84p for Tekcapital, implying 44% upside from the current price.**

We also note that c.82% of Tekcapital's current portfolio value is derived from one investment – Lucyd. The remainder comes from the eight other portfolio companies, all of which apart from Belluscura are conservatively valued at cost of the acquired intellectual property plus associated expenses. **Therefore, an uplift in the valuation of any one additional portfolio company, driven by a fundraising or other value event, could have a significant impact on the balance sheet and increase NAV further.**

**As a result of the modest discount to NAV and more substantial discount to the wider UK IP sector we change our stance from Speculative Buy to Conviction Buy.**

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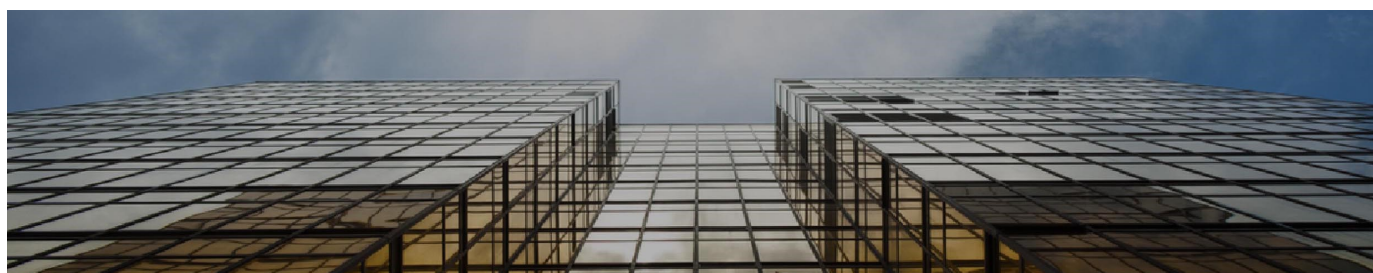
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