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RESEARCH

Tekcapital

13th August 2018

Shares continue to trade at a discount to NAV and the wider UK IP sector despite a string of positive updates

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.

■ Belluscura further funds product development

On 17th May, 33% owned medical device business Belluscura raised an additional c.\$603,000 via a private placement of new shares and converted c.\$78,000 of loans to equity. The funds will be used for further product development, specifically the innovative CURV™ portable oxygen concentrator (POC) and Snap III™ level of consciousness monitor. Belluscura has also hired an experienced VP of Operations to work on the FDA clearance process and launch of new products.

■ Salarius strengthens management team and looks to the snack market

Low sodium salt products business Salarius has appointed experienced executives Eduardo Souchon and Steve McCready to its board of directors. In addition, former Fortune 500 executive Victor H. Manzanilla has been appointed as CEO. Salarius has confirmed it is looking at the possible development & launch of low-sodium salt and healthy choice snacks.

■ Lucyd adds to management, opens e-shop & files new patent application

Next gen eyeglasses developer Lucyd has hired Gina Avila as Global Marketing Manager and Dr. Ira A. Clement as a science advisor. Lucyd's eyewear e-shop was recently opened and provides cutting-edge spectacles, with a new patent application also filed to improve the utility of Augmented Reality glasses.

■ Shares trade at a discount to NAV and the UK IP sector average

Tekcapital shares currently trade at a 35.6% discount to NAV as at 30th Nov 2017 and at a 44% discount to the wider UK IP sector average price-to-book value ratio. **This, combined with additional value creation opportunities, leads us to retain our stance of 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	12.5p
52 week high/low	30p/10.5p
Listing	AIM
Shares in issue	42,654,707
Market Cap	£5.33m
Sector	Intellectual Property

12 month share price chart



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Investee Company Updates

Since our last update on Tekcapital on 8th May 2018 several positive updates have been announced across the various investee companies.

Belluscura

On 17th May medical device business Belluscura confirmed the raising of \$603,000 via a private placement of new shares, along the conversion of c.\$78,000 of loans to equity. This followed a private placement of c.\$1.33 million and c.\$268,000 loan conversion completed in February. Both issues were completed at a price of \$0.18 (13p) per share, giving Belluscura a current post-money valuation of c.\$4.3 million. Tekcapital now owns approximately 33% of Belluscura.

The funds raised will be used for further product development, specifically for the CURV™ portable oxygen concentrator (POC) and Snap III™ level of consciousness monitor, and for general working capital purposes.

POCs are typically prescribed to people suffering from chronic obstructive pulmonary disease (COPD), a condition which the World Health Organization estimates 64 million people are suffering from around the world in moderate to severe form. **According to analysts at Winter Green Research the portable oxygen concentrator market is expected to nearly double to \$2.2 billion by 2021.** The CURV™ POC prototype weighs less than 3.5 lbs, is uniquely modular and its capability can be expanded to provide more oxygen as a user's lung disease progresses and with replaceable filters, giving the product a potential competitive advantage over currently available devices. The prototype POC is quiet and once developed is expected to be lower cost than the competition. Belluscura plans to file a 510(K) application with the US FDA in 2018 for the product.

SNAP is level of consciousness monitor for use during surgical procedures requiring general anesthesia. The core technology also has significant potential for retail applications in markets outside anaesthesia, particularly in the field of sleep measurement and evaluating and identifying sleep disorders. 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.

Also in 2018 Belluscura added a Vice President of Operations, Dr. Paul Bray, PhD. Amongst other duties Dr Bray is working on the FDA clearance process for the Curve™. Paul has 20+ years of leadership experience in the US Air Force and medical device industry. After completing the bachelor's degree in engineering physics at Cornell University, Paul's professional career began with a commission in the United States Air Force. He served for over seven years as a navigator on the KC-135A air refueling tanker and as a bioenvironmental engineer in the Biomedical Sciences Corps. He attend Texas Tech University, where he obtained a PhD in chemical engineering. Since 2010, Paul has been a manufacturing engineer in the neuromodulation division of St. Jude Medical; a consultant with Maetrics while providing support to Johnson & Johnson; and a manufacturing and quality engineer at Apollo Endosurgery. He is a co-inventor of the deep brain stimulation lead with segmented electrodes (US patent 9,370,653 B2). Paul brings his expertise in product development, supporting regulatory submissions, setting up manufacturing lines, and launching new products.



Salarius

On 22nd May low-sodium salt product developer Salarius appointed Eduardo Souchon and Steve McCready to its board of directors. Souchon is a business, brand and marketing executive with two decades of experience in taking businesses focused on snacks (Pringles®), health products and office supplies to commercial success in the consumer packaged goods industry and the retail industry. Meanwhile, Steve McCready has 18 years of innovation-focused product development experience in multiple product categories, with particular expertise in process development, scaling, and commercialisation. Recently, Steve served as Director of Product Development at Albertson's Companies, Inc., a U.S. supermarket company with more than \$60 billion in sales and 2,300 locations.

The management team was further strengthened in August, with Victor H. Manzanilla appointed as CEO. Manzanilla has significant business management experience, having previously served as Marketing Director for Office Depot and holding several positions at Procter & Gamble including Home Care Marketing Innovation Manager and Brand Manager for Global New Business Development for Febreze. Along with the appointment, Manzanilla purchased a 2.5% stake in Salarius through his consulting firm VHM Global Research for \$50,000, with Tekcapital owning the remaining 97.5%. **We note that this implies a valuation for the business of \$2 million, compared to a balance sheet valuation of just \$15,128 as at 30th November 2017.**



Salarius owns the patented process for producing Microsalt, a low-sodium salt product which has the potential to enable the commercialisation of a 1:1 replacement for regular salt in a variety of applications including table top, dry snacks such as chips and crisps, popcorn, cereals, and other dry surface applications that have salt in spice mixes. The Salarius product has up to c.67% less sodium by weight than standard table salt due to its smaller size, claiming to be the world's smallest salt crystal. The product meets a growing need for the reduction of sodium in salt containing products, driven by negative health effects that excess sodium consumption can cause. Salarius is currently looking to out license its patented product while exploring the potential launch of a healthier snack food brand.

This is a large market to be involved in, with a recent report from analysts at Future Market Insights titled, *"Sodium Reduction Ingredient Market: Global Industry Analysis and Opportunity Assessment, 2015 – 2025"*, suggesting that the global sodium reduction ingredient market will grow at a CAGR of 11.7% during the forecast period to a value of \$1.758 billion. The snacks segment is estimated to account for 26.9% of the global sodium reduction ingredient market and to grow at a CAGR of 11% over the forecast period.

This latter point is noteworthy as Salarius recently confirmed it is looking at the possible development and launch of Neosnax™, a new, healthy choice snack food brand that has all of the flavour and roughly half the sodium of most currently available snack foods. Neosnax filed a trademark in the UK on 21st May 2018, covering potato snacks, potato-based snack foods, vegetable-based snack foods, salted nuts, low-salt snacks, flour based savory snacks, puffed cheese balls [corn snacks], puffed corn snacks, edible salt, salt and snack-bars.

Lucyd

Lucyd, 100% owned by Tekcapital, is a developer of augmented reality (AR) smartglasses and in March 2018 received c.\$6.1 million in contributions from an innovative, non-dilutive, blockchain token generation event. The proceeds are being spent on growing the business and on the development of a prototype AR smartglasses product, which are expected to be launched in Q1 2019. **The company is targeting a market which according to analysts at Zion Market Research is predicted to reach \$133.78 billion by 2021.**

On 22nd May Lucyd announced the appointment of Gina Avila as Global Marketing Manager. Ms. Avila is an experienced marketing professional with expertise in social media management, market research, and market segmentation. Previously, she served as U.S. Digital Manager at For Eyes, a chain of 116 optical stores owned by Grandvision, and Marketing Manager at GA Telesis.

Gina orchestrated the recent launch of Lucyd's eyewear e-shop, opened to provide cutting-edge spectacles and smartglasses. The Lucyd eShop will feature the latest technologies and trends in eyewear, including Lucyd-developed smartglasses, designer frames, and other innovations in spectacles. Other unique offerings include advanced prescription eyewear such as Bluetooth enabled glasses to connect with a mobile phone, high tech and fashion forward frames, a try before you buy service with a sophisticated virtual try-on app, the ability to pose eye health questions to a licensed optometrist for free and a loyalty program based on purchases, referrals and Lucyd's token.

The first four product lines are Lucyd Loud, a Bluetooth “soundglass” that enables hands-free music and voice assistant; Turboflex, a line of durable, flexible frames; Di Valdi, cutting-edge Italian designer frames, and Lucyd Looks, basic frames with a unique understated style.

Lucyd has also recently hired Dr. Ira A. Clement, a licensed optometrist, as a science advisor. Dr. Clement has over 40 years of experience in the practice of optometry. He has served as Past-President of the Westchester-Rockland-Putnam Optometric Society. As part of his pro bono activities, Dr. Clement served as Past-President of the Suffern LIONS Club. Since its founding in 1917, Lions Clubs International® has worked on projects designed to prevent blindness, restore eyesight and improve eye health and eye care for hundreds of millions of people worldwide.

Finally, on 2nd July 2018, Lucyd announced the filing of a patent application No. 16/022,097 to improve the utility of Augmented Reality glasses. The application is directed to smartglasses, with prescription lenses, and methods to control the presentation and display of information related to mobile device tasks that can be performed with these smartglasses. Lucyd believes the new patent application may significantly enhance the ergonomics of AR glasses while maintaining a transparent interface.



Valuation

After hitting an all-time low of 10.5p at the end of July shares in Tekcapital have rallied to the current 12.5p. Nevertheless, the shares continue to trade at a discount to net assets as at 30th November 2017. **With NAV standing at \$10.68 million (£8.28 million) at the period end the NAV per share is 19.42p, with the current share price representing a 35.6% discount.**

We note that if the recent share purchase in Salarius by Victor H. Manzanilla is used as a valuation benchmark then we can add another c.\$1.935 million (£1.5 million) to NAV, or another c.3.52p per share.

Peer analysis

As per our update of 8th May 2018 we also highlight Tekcapital's valuation in comparison to its listed peers.

Company	EPIC	Year founded	Market cap (£m)	Net Assets (£m)*	Price to book value
IP Group	IPO	2001	1,288	1489.8	0.86
Allied Minds	ALM	2004	203.5	372.4	0.55
Mercia Technologies	MERC	2014	85.8	123.5	0.69
NetScientific	NSCI	2008	28	15.8	1.77
Frontier IP	FIPP	2007	28.9	12.23	2.36
Tekcapital	TEK	2014	5.33	8.28	0.64
AVERAGE					1.15

** as at last published balance sheet date*

Table: UK listed IP companies' analysis. Exchange rate of £1:\$1.2883 assumed. Prices as at 10th August 2018. Source: Align Research.

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 22nd March 2018. Combining the subsidiary valuations with the holding company's cash position of \$84.2 million as at 31st December 2017 we attribute a net asset value to Allied Minds of \$479.8 million, or £372.4 million at current FX rates.

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

In terms of price-to-book value (or premium to NAV) we calculate a current sector average premium of 15% - investors often apply a premium to NAV for IP companies as they anticipate future increases in the fair value of their investment portfolios. This is down from 40% as at the date of our last update note mainly due to a fall in share prices across the sector. **Applying this 15% premium to NAV to Tekcapital implies a share price of 22.33p per share, 79% upside from the current price.**

Conclusion

With Tekcapital shares trading at a substantial discount to NAV and to the wider IP investment sector we see an attractive buying opportunity at present. What's more, we see further upside from many other areas.

We 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.** In this respect we have already demonstrated above the potential uplift should the recent director purchase in Salarius be accounted for in the valuation.

In our view Belluscura seems primed for a valuation uplift as the company is making good progress in developing its suite of medical devices. The CURV™ product in particular looks to have significant potential in the portable oxygen concentrator market.

One company already taking advantage is Nasdaq listed **Inogen (INGN)**, which develops, manufactures and markets oxygen concentrators used to deliver supplemental long-term oxygen therapy to patients suffering from chronic respiratory conditions. Inogen recently reported that revenues were up by 51.6% to a record \$97.2 million in Q2 2018, with net income up by 75.2% at \$14.6 million. Total units sold were 54,700, an increase of 22,300, or 68.8%, over the same period in 2017. The company expects to make revenues of \$340 million to \$350 million for the full year.

Inogen is currently valued at \$4.8 billion and trades on a forward PE ratio of 158 times (Source: Nasdaq). While applying this kind of valuation to Belluscura isn't appropriate given its early stage of development, it does go to show the opportunities available in the sector.

Our stance on Tekcapital remains at Conviction Buy.

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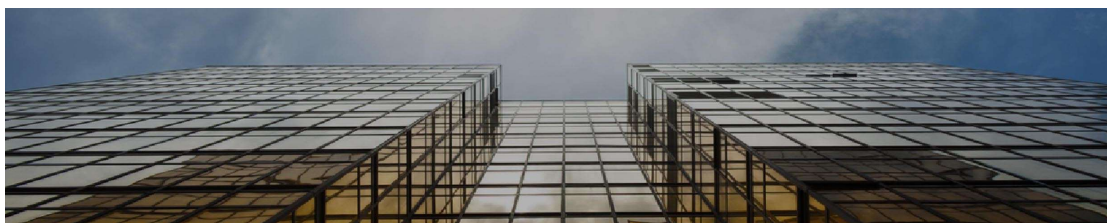
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