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Tekcapital – Full Year Update

26th February 2019

Discount to net assets reaches record level whilst strong news pipeline for 2019 to come. Stock remains undervalued.

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.

■ Service revenues continue strong year-on-year growth

Numbers for the 12 months to 30th November 2018 showed a 28% rise in revenue from services to \$1.04 million. This came on the back of expansion into the Latin American markets and the launch of two new services, technology commercialisation training and an Invention Evaluator report customised for startups. **The goal remains to have all operating costs covered by service revenues in the next few years.**

■ The best year for value creation in the company's history

The highlight of the year in our view was the **51% increase in net assets to a record level of \$16.13 million**. The main driver of the increase in NAV for the period was an 88% increase in the value of the company's investment portfolio, from \$7.31 million to \$13.7 million.

■ Portfolio companies set for major milestones in 2019

Across the investment portfolio, Tekcapital saw its investee companies make further commercial progress and strengthen their management teams in 2018. Into 2019, several companies are expecting to see further milestones including Belluscura receiving 510(K) clearance from the FDA for its POC system in Q3, Lucyd launching further hi-tech products in Q2 and Salarius expected to start selling low sodium salt and snacks in Q4.

■ Shares trade at a substantial and unjustified discount to NAV

Despite the progress made, Tekcapital shares currently trade at near all time lows. **At the current price of 7.25p the company is capitalised at just £3.94 million, a massive 68% discount to NAV of £12.34 million** (equivalent to 22.96p per share), 217% above the current price, which we set as our new target price and remain with our **Conviction Buy stance**.

Table: Financial overview. Source: Company & Align Research

Year to end Nov	2014A	2015A	2016A	2017A	2018A
Revenues (\$m)	0.21	0.41	0.76	7.26	6.83
Pre-tax (\$m)	(0.99)	(1.46)	(2.56)	4.15	4.55
EPS (c)	(5.0)	(4.9)	(6.3)	10.8	10.3

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CONVICTION BUY – Price target 22.96p



Key data

EPIC	TEK
Share price	7.25p
52 week high/low	20p/4.75p
Listing	AIM
Shares in issue	54,353,042
Market Cap	£3.94m
Sector	Int. Property

12 month share price chart



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Full year results

Financials

At the top line, numbers for the 12 months to 30th November 2018 showed a 28% rise in revenue from services to \$1.04 million. This came on the back of expansion into the Latin American markets and the launch of two new services, technology commercialisation training and an Invention Evaluator report customised for startups. To further support growth, two senior hires were made during the year with Michael Rosen (previously at Pfizer, Monsanto) appointed as Managing Director of Academic Training to accelerate growth in the Latin American market and Eduardo Giacomazzi appointed as business development advisor in Brazil. Currently, c.60% of administrative expenses are covered by service revenues, with the goal remaining to have all operating costs covered by service revenues in the next few years.

A \$5.79 million net unrealised gain on the revaluation of investments (see more below) took net revenues to \$6.83 million, down from \$7.26 million in the previous year due to a slightly lower revaluation gain and the lack of revenue from discontinued operations and profit made on the de-recognition of subsidiaries.

At the bottom line, net profits for the year were up from \$4.15 million to \$4.55 million but the total comprehensive gain for the period was down marginally, from \$4.58 million to \$4.42 million, the company seeing a \$0.135 million foreign exchange loss in comparison to a \$0.424 gain in the previous year. Notably, administration costs for the period were cut by 29% to \$1.72 million.



Selected Tekcapital clients. Source: Company

Balance sheet

The highlight of the year in our view was the 51% increase in net assets to a record level of \$16.13 million. Offset by an increase in the number of shares during the year, the NAV per share rose from 25 cents to 30 cents. The main driver of the increase in NAV for the period was an 88% increase in the value of the company's investment portfolio, from \$7.31 million to \$13.7 million. Movements in the value of portfolio companies are highlighted in the table below. We also note that three portfolio companies were closed during the period (Non Invasive Glucose Tek Limited, eGravitas Limited and Frigidus Limited) as Tekcapital believes capital can be allocated to projects with higher potential returns.

Portfolio company	(\$)	Opening value	Additions	FX revaluation	Fair Value change	Value as at 30th Nov 2018
Guident Limited		0	23,494	-7	8,521,616	8,545,103
Lucyd Limited		6,023,954	15,760	-16,757	-2,982,341	3,040,616
Salarius Limited		15,128	27,466	-708	881,944	923,830
Belluscura Limited		981,762	560,090	-60,839	-354,698	1,126,315
Smart Food Tek Limited		44,167	972	-2,066	0	43,073
eSoma Limited		10,983	13,768	-1	0	24,750
Non Invasive Glucose Tek Limited		24,199	425	-981	-22,976	667
eGravitas Limited		154,535	43,955	-5,807	-192,683	0
Frigidus Limited		52,968	7,483	-1,853	-58,598	0
TOTAL		7,307,696	693,413	-89,019	5,792,264	13,704,354

As the table above shows, there were significant movements in the values of four portfolio companies during the year. The net fair value change of \$5.79 million mainly reflected the upward revaluation of Guident, boosted by a rise in the value of Salarius and offset by a reduction in the values of Lucyd and Belluscura. Further details on how the valuations were carried out will be released with the publication of the full annual report but **we re-iterate that portfolio companies are either independently valued by industry experts, valued at a recent arms-length funding round or at the company's cost for the acquisition of the IP rights – all conservative and solid bases.**

Tekcapital confirmed that it will continue to invest in its portfolio companies and that it is looking at a new potential investment in cannabidiol intellectual properties to address the current market demand.

Cashflow

Cash at the period end stood at \$1.166 million. This was down from \$1.8 million 12 months previously, with the major cash outflows being a \$0.87 million net outflow from operations and \$0.74 million net used in investing activities. The cash position was boosted just prior to the year-end after Tekcapital completed a fundraising of \$1.16 million via the placing of 11,698,335 new shares with new and existing investors at a price of 7.5p per share.

Portfolio companies' progress

Progress of the companies four most commercially advanced portfolio companies is discussed below.

Salarius

Food technology business Salarius, which is 97.5% owned by Tekcapital, owns a patented process to produce nanoparticle sized salt. These dissolve faster on the tongue, reducing the quantity needed for the same level of saltiness, so can help to reduce levels of consumed sodium and therefore reduce the risk of developing heart disease.

During the year Salarius significantly strengthened its management team in anticipation of a commercial product launch. In August, the business appointed Victor H. Manzanilla, who has significant business management experience in Fortune 500 companies (including Procter & Gamble), as its CEO. Manzanilla also purchased 2.5% of the shares of Salarius for \$50,000. Other management hires include Eduardo Souchon a former brand manager from Pringles®, and Steve McCready, the former director of product development at Albertsons a leading \$60b supermarket chain. Following the period end, Javier Contreras, who has significant experience in developing supply chains with Clorox and other companies, was appointed as COO.

On the product front Salarius completed successful test production of its salt crystals and conducted focus group testing of consumer packaging. The current guidance is that the company is expected to start selling Salarius low sodium salt and snacks in Q4 2019. **The business is targeting a low sodium ingredient market which, according to analysts at Future Market Insights, is estimated to reach US\$1.76 billion by 2025.**



Guident

Wholly owned portfolio company Guident Ltd, owns an exclusive licence to a patented technology that enables the development of software apps for controlling autonomous vehicles using artificial intelligence. Guident plans to launch its company website in Q1 2019 and an out-licensing program in Q2. **The company is targeting a market which according to Statista, is projected to reach \$6 billion by 2025 in the US alone.**

Expanding the management team was a key focus for Guident during the last financial year, with Harald Braun, previous CEO of Siemens Networks USA (NYSE: SI) amongst other relevant executive roles, appointed as its Chairman. Following the period end Johan De Nysschen and Daniel Grossman have joined the company as directors. De Nysschen recently served as Executive Vice President of General Motors and President of Cadillac Division, while Grossman helped create General Motors' mobility division, "Maven", and led all operations as COO, was a Vice President at Zipcar.



Belluscura

Tekcapital owns 29.2% of medical device business Belluscura which is currently focussing on developing a proprietary oxygen concentrator (POC) system, X-PLOR™, with a planned commercial release in 2019 following the receipt of clearance of its 510(K) application with the US Food and Drug Administration (FDA).

Belluscura's POC is designed to provide on-the-go supplemental oxygen and the company believes that its patented device will be smaller, lighter and quieter than competitive products and will have a replaceable filter cartridge that will allow the user to upgrade the unit as their disease progresses. The system will be used to deliver supplemental long-term oxygen therapy to patients suffering from chronic respiratory conditions such as COPD, asthma, occupational lung diseases and pulmonary hypertension. **According to Global Market Insights, the medical portable O2 market is currently valued at \$1.4 billion a year and will reach \$2.4 billion by 2024.**

Current guidance is that Belluscura expects to receive 510(K) clearance from the FDA in Q3 2019 and begin sales in late 2019. Following the period end, in conjunction with exclusive research partner Separation Design Group, Belluscura filed of a broad patent application covering oxygen enrichment inventions relating to a portable artificial lung and wound care devices.



Lucyd

Lucyd, 100% owned by Tekcapital, offers advanced technology eyewear with prescription combined with an improved online experience and competitive pricing. The current online market for eyewear is \$3.8b according to Statista.

During the period Lucyd launched its eShop for high-tech and fashionable eyewear and launched sales of its Lucyd Loud 1.0 audio glasses. These are a pair of Rx Bluetooth prescription glasses with bone conducting speakers that can be used to listen to music, answer a mobile phone or talk to mobile voice assistants. The product is said to have been well received and the company is focused on launching Lucyd Loud 2.0, featuring ten modern styles and a slimmer, more comfortable fit, in Q2 2019. The company has also launched Turbo Flex, a line of nearly indestructible frames. In October the business formed its first reseller partnership with a Brazilian optical retailer and in November launched a global affiliate and reseller program using the Leaddyno and Shareasale affiliate platforms, with over 70 affiliates signed in the first week.

Following the period end Lucyd has engaged Richard Sherman, an American football star, as a brand ambassador, and will introduce a line of athletic sunglasses (Sherman Shades) that he will help to curate in Q3. Also, the business has filed an additional U.S Patent designed to improve inter-device communications & control and forms the basis of an IOT communication app called LINK.



Assessment & Valuation

These are an excellent set of results from Tekcapital in our view. Revenue from the services business continues to grow strongly year-on-year, with the company demonstrating that its strategy of investing into potential high growth companies is delivering increased asset value. **Into 2019, and with the advancement of commercialisation activities across the various investee companies, we expect a strong flow of news and the potential for further valuation uplift events.** In particular, we consider the expected 510(K) clearance from the FDA for Belluscura's portable oxygen concentrator as being a major potential price catalyst.

Despite the progress made Tekcapital shares currently trade at near all time lows. At the current price of 7.25p the company is capitalised at just £3.94 million, a massive (and in our view unjustified) 68% discount to NAV of £12.34 million as at 30th November 2018 (at current exchange rates). **In sterling, NAV as at 30th November 2018 is equivalent to 22.96p per share, 217% above the current price, which we set as our new target price.**

Peer analysis

As per our previous notes we also highlight Tekcapital's valuation in comparison to its listed peers and also add a new constituent Crossword Cybersecurity (CCS). Crossword focuses on the development and commercialisation of university research-based cyber security related software & cyber security consulting and moved from the NEX Exchange to AIM in December last year.

Company	EPIC	Market cap (£m)	Net assets (£m)*	Price to book value
IP Group	IPO	1,111	1489.8	0.75
Allied Minds	ALM	123.2	318.7 ¹	0.39
Mercia Technologies	MERC	114	125.17	0.91
NetScientific	NSCI	3.3	14.745	0.22
Crossword Cybersecurity	CCS	15.77	1.89	8.34
Frontier IP	FIPP	36.8	15.21 ²	2.42
Tekcapital	TEK	3.94	12.34	0.32
SECTOR AVERAGE				1.90

*Table: UK listed IP companies. Exchange rate of £1:\$1.30679 assumed. Prices as at 25th February 2019. ¹ Group Subsidiary Ownership Adjusted Value used plus net cash of parent. ² Includes £2.49 million placing post period end. * as at last published balance sheet date. Source: Align Research.*

We note two significant outliers in the above analysis. First, NetScientific has recently proposed to cancel its shares from trading on AIM so the price has been severely depressed. Second, Crossword Cybersecurity only has minimal investments recorded on its balance sheet and trades at a large premium to net assets. **Sensibly removing these two companies from the analysis, we calculate that the UK IP sector currently trades at an average 4% discount to book value. This is down from a 15% premium at the time of our last note largely due to share price falls across certain constituents. Nevertheless, even applying a 4% discount to Tekcapital's latest NAV figure would imply a share price of 22.04p, 204% above the current share price.**

Overall, with Tekcapital shares continuing to trade at a substantial discount to NAV & discount to the last placing price, we continue to see a very attractive buying opportunity for investors who want to gain exposure, effectively at a third of the price, to a portfolio of promising early stage technology companies. As ever, 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. **Our stance remains at Conviction Buy.**

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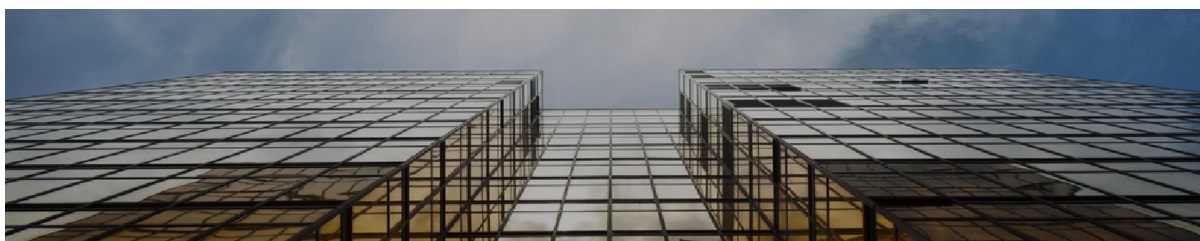
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