

Elektron knocks it out the park

Deciding how to react during a FTSE rout is never easy, especially for smallcaps where price swings can often be extreme. Nonetheless smart investors prepare for such eventualities, hold their nerve and importantly have a shopping list of high quality names to buy amid any indiscriminate selling.

To us, one stock that fits the bill is Elektron Technology, down >20% from its highs of 48p in mid-September, and now firmly in bear-market territory. What's more the business is firing on all cylinders - with CEO John Wilson saying today that **"the Board expects FY19 to be significantly ahead of market expectations,"** after enjoying an **"exceptional Q3"**. Thanks to **"record sales" of £8.8m (+13% LY) at Bulgin** (re unprecedented demand), alongside a **similarly impressive performance from EET** (Optometry equipment), posting revenues up +33% to £0.8m.

"Q3 performance has been exceptional"

Better still, due to **management's continued focus on product profitability**, augmented by **positive operational gearing** and **in-house capacity improvements**, **Bulgin's FY19 EBIT margins are anticipated to be c.30%** (vs 26.4% LY & 25% H1). Substantially ahead of our previous forecast of 27.6%, and delivering an estimated 34% for H2.

Elsewhere **Checkit has also made excellent progress**, reporting Q3 turnover up 200% to £300k (£100k LY) – and completing the development of its next generation Work Management module, which added Android compatibility and GPS tracking. Both key system enhancements for customers, particularly outside the food industry, as evidenced by the recent adoption by the Blood Sciences Department of Leeds Teaching Hospitals NHS Trust (50 locations). Here Checkit is being used to ensure that samples, reagents and equipment are kept under exactly the right conditions (eg whilst in transit). In addition, Checkit was launched on the US West Coast ahead of schedule, with sales staff having already identified regional and national opportunities.

Valuation hiked 20% to 83p/share vs 69p before

So what does this all mean in terms of the numbers? Well in total, Q3'19 turnover came in at £9.9m (+16.5% vs £8.5m LY, & +17% YTD at £25.8m) with September **net cash closing at an equally healthy £8.5m** (vs £6.8m July). In turn, leading us to **raise our FY19 revenue, EBIT and cash projections to £33.5m, £4.6m and £9.7m respectively** vs £31.9m, £2.7m and £8.3m before. Indeed as an indication of the strong momentum behind the business, this is the fourth consecutive upgrade we have made in only 4.5 months.

Likewise our FY20 projections have been lifted too, thus **boosting the overall SOTP valuation from 69p to 83p/share** - split 62p Bulgin, 14p Checkit, 2p EET and 5p net funds (see below).

1 November 2018

Company Data

EPIC	AIM: EKT
Price (last close)	37p
52 week Hi/Lo	48p/14p
Market cap	£69m
ED SOTP valuation	83p/share
Avg. daily volume	200k

Share Price, p



Source: Web Financial

Description

Elektron (EKT) is a specialist niche product OEM and B2B operational service provider, enjoying a wide economic moat. It runs 3 separate divisions (see below), each targeting distinct markets, yet bound together by a single centre of engineering excellence located in Cambridge.

- 1) Bulgin designs and manufactures premium, fail-safe, hermetically sealed (ie air/water tight) circular connectors and electronic components.
- 2) Checkit is a hi-growth (>100%+ LFL) real-time operational management platform, that digitises, streamlines, and vastly improves the management of routine activities, providing top to bottom visibility.
- 3) EET – develops field vision and macular pigment screening devices to the ophthalmic industry.

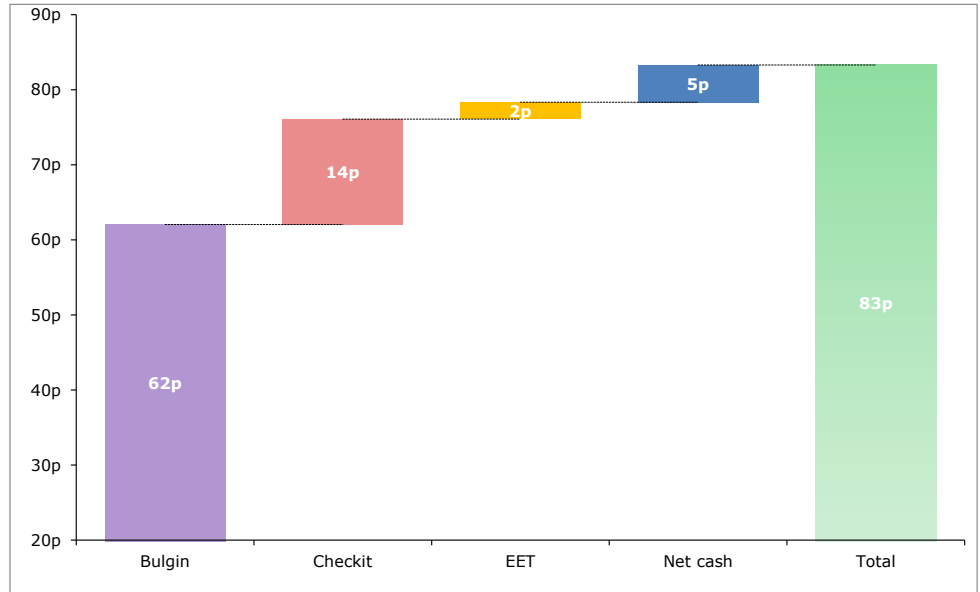
Next News: Pre-close trading update in Feb'19

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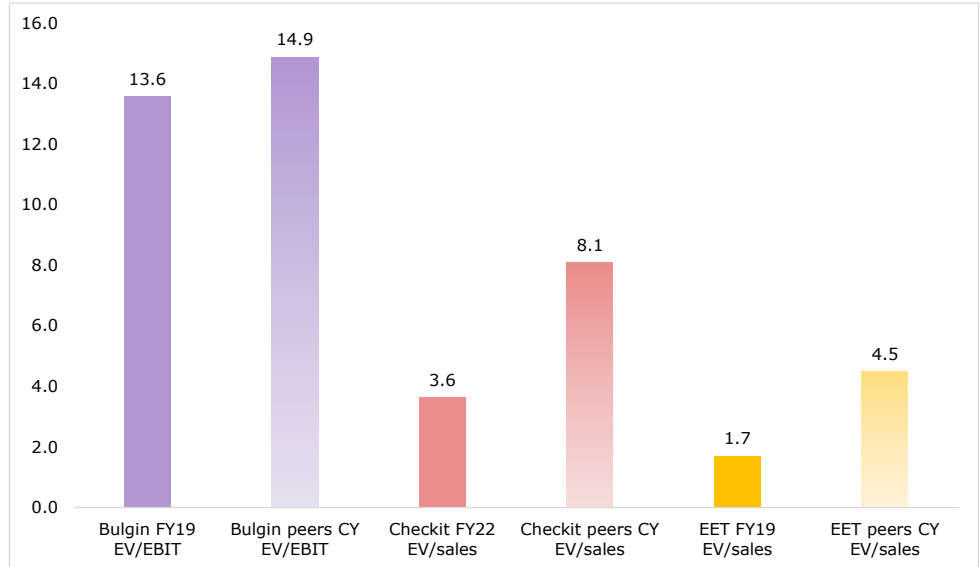
Sum of the parts valuation (pence/share)



Source: Equity Development

We suspect the stock will respond favourably this morning at the bell. Plus, even at 83p it still doesn't look expensive, trading on undemanding divisional multiples vs peers (see below).

Implied divisional multiples at SOTP of 83p/share



Source: Equity Development

Summary financial projections

Elektron Technology (January yearend)	2017 Act £ms	2018 Act £ms	2019 Est £ms	2020 Est £ms	2021 Est £ms	2022 Est £ms	2023 Est £ms	2024 Est £ms	2025 Est £ms
Bulgin	24.1	27.3	29.9	30.9	32.4	34.1	35.8	37.6	39.4
Checkit	0.3	0.5	1.0	2.1	4.2	7.6	12.1	18.7	28.1
EET	2.4	2.0	2.6	3.0	3.4	4.0	4.5	5.2	6.0
Turnover	26.8	29.8	33.5	36.0	40.1	45.6	52.4	61.5	73.6
<i>Bulgin</i>		13.3%	9.5%	3.3%	5.0%	5.0%	5.0%	5.0%	5.0%
<i>Checkit</i>		66.7%	100.0%	110.0%	100.0%	80.0%	60.0%	55.0%	50.0%
<i>EET</i>		-16.7%	30.0%	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%
<i>% growth</i>		11.2%	12.4%	7.4%	11.4%	13.7%	15.0%	17.4%	19.6%
Gross Profit	11.2	14.8	17.0	18.4	20.8	24.0	28.0	33.3	40.3
<i>% margin</i>	41.8%	49.7%	50.7%	51.1%	51.8%	52.6%	53.3%	54.1%	54.8%
Bulgin	4.3	7.9	9.4	9.9	10.4	10.9	11.5	12.1	12.7
Checkit	-2.8	-2.7	-2.7	-1.7	-0.3	3.0	4.7	7.4	10.5
EET	-0.2	-0.1	0.2	0.3	0.5	0.6	0.8	1.0	1.3
Adj. EBITDA	1.3	5.1	7.0	8.6	10.6	14.6	17.0	20.4	24.4
<i>Bulgin</i>	17.8%	28.9%	31.3%	32.1%	32.1%	32.1%	32.1%	32.1%	32.1%
<i>Checkit</i>	-933.3%	-540.0%	-265.0%	-81.7%	-6.1%	39.6%	38.8%	39.3%	37.4%
<i>EET</i>	-8.3%	-5.0%	8.9%	11.6%	14.0%	16.1%	17.9%	19.5%	20.9%
% EBITDA margin	4.9%	17.1%	20.7%	23.8%	26.6%	32.0%	32.4%	33.2%	33.2%
Bulgin	3.3	7.2	9.0	9.5	10.0	10.5	11.0	11.6	12.1
Checkit	-3.5	-4.4	-4.5	-3.9	-2.9	0.0	1.4	3.7	6.5
EET	-0.4	-0.3	0.1	0.2	0.3	0.4	0.6	0.8	1.0
Adj. EBIT	-0.6	2.5	4.6	5.8	7.5	10.9	13.0	16.0	19.6
<i>Bulgin</i>	13.7%	26.4%	30.0%	30.8%	30.8%	30.8%	30.8%	30.8%	30.8%
<i>Checkit</i>	-1166.7%	-880.0%	-445.0%	-185.7%	-67.9%	0.1%	11.3%	19.7%	23.1%
<i>EET</i>	-16.7%	-15.0%	3.8%	6.6%	9.0%	11.1%	12.9%	14.5%	15.9%
% EBIT margin	-2.2%	8.4%	13.8%	16.2%	18.6%	24.0%	24.7%	26.0%	26.7%
Adj. Profit before Tax	-0.6	2.6	4.6	5.8	7.5	10.9	13.0	16.0	19.6
Adjusted EPS (p)	-0.1	1.1	2.0	2.4	3.1	4.6	5.4	6.6	8.0
<i>EPS growth rate</i>		-1939.1%	82.7%	25.2%	27.5%	46.0%	18.0%	22.9%	21.8%
Dividend (p)	0.0	0.0	0.0	0.0	0.0	1.5	1.8	2.2	2.7
<i>Yield</i>	0.0%	0.0%	0.0%	0.0%	0.0%	4.1%	4.8%	5.9%	7.2%
Valuation benchmarks									
<i>P/E ratio</i>	-637.1	34.6	19.0	15.1	11.9	8.1	6.9	5.6	4.6
<i>EV/Sales</i>	2.2	2.0	1.8	1.6	1.5	1.3	1.1	1.0	0.8
<i>EV/EBITDA</i>	45.5	11.6	8.5	6.9	5.6	4.1	3.5	2.9	2.4
<i>EV / EBITA</i>	-98.6	23.7	12.8	10.2	7.9	5.4	4.6	3.7	3.0
<i>Adjusted tax rate</i>	-83.3%	-26.9%	-21.0%	-21.0%	-21.0%	-21.0%	-21.0%	-21.0%	-21.0%
<i>EBITDA drop through rates</i>		126.7%	50.0%	64.3%	51.1%	71.4%	35.4%	37.8%	33.2%
<i>PEG ratio</i>		-0.02	0.23	0.60	0.43	0.18	0.38	0.24	0.21
Net cash/(debt)	2.5	5.2	9.7	14.3	20.2	25.9	32.4	40.1	48.9
Sharecount (Ks)	172.2	177.9	187.0	188.0	188.9	189.9	190.8	191.8	192.7
Shareprice (p)	37.0								

Source: Equity Development estimates, Company historic data

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.
- 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.



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