EDISON

Checkit

On the front foot

FY21 results

Software & comp services

Checkit's results confirm that FY21 was a game of two halves: in H1 it coped with COVID-19 disruption and kept costs and cash burn under control; H2 saw the return to more normal trading while working on business transformation to lay the groundwork for future growth. Despite the pandemic, FY21 revenue grew 3% y-o-y and ARR grew 46% y-o-y. So far in FY22, the company has expanded operations in the US and ramped up its sales and marketing efforts. We have revised our forecasts to reflect faster growth in ARR combined with higher sales and marketing spend.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	EV/Sales (x)
01/20	9.8	(6.4)	(4.0)	0.0	N/A	2.8
01/21	13.2	(3.1)	(5.2)	0.0	N/A	2.1
01/22e	15.2	(4.5)	(7.2)	0.0	N/A	1.8
01/23e	17.8	(2.7)	(4.3)	0.0	N/A	1.5

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

FY21: Transforming the business

Despite COVID-19 restrictions making it harder to undertake certain customer projects in H121, Checkit reported 3% revenue growth (on a normalised basis) for FY21. A combination of new business wins, shifting existing customers from one-off to subscription contracts and better pricing resulted in growth in annualised recurring revenue (ARR) of 46% y-o-y. The EBITDA loss of £2.5m for FY21 was reduced from the £4.9m in FY20 due to good cost control and initial benefits from the group's business transformation programme, while the company maintained spending on product development during the year.

FY22: Hitting the accelerator

According to management, FY22 started well. Checkit has strengthened its presence in the US with an acquisition and the hire of a country MD, and has decided to accelerate its sales and marketing efforts to take advantage of the opportunity it sees to sell its workflow management and monitoring software globally. We have revised our forecasts to reflect faster growth in ARR driven by the higher sales and marketing spend. We forecast ARR growth of 34% in FY22 and 50% in FY23, with EBITDA of -£3.9m in FY22 (from -£2.4m previously) and -£2.0m in FY23. We forecast net cash of £3.5m by the end of FY23.

Valuation: Sum of parts suggests upside

On an EV/sales multiple of 1.8x for FY22e and 1.5x for FY23e, Checkit trades at a significant discount to the UK software sector (6.5x current year sales). On a sum-of-the-parts basis attributing EV/sales multiples that better reflect the performance and prospects for each division, we estimate that the stock is significantly undervalued. For example, using a 4x FY22e multiple for Checkit Connect and 1x for Checkit BEMS would result in a valuation of 83p per share (see page 4 for details).

29 April 2021

Price	**62.0p**
Market cap	**£39m**
Net cash (£m) at end FY21	11.5
Shares in issue	62.4m
Free float	56.2%
Code	CKT
Primary exchange	AIM
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	17.0	21.9	64.8
Rel (local)	13.2	14.1	33.7
52-week high/low		58.5p	30.0p

Business description

Checkit optimises the performance of people, processes and physical assets with connected digital solutions. It is headquartered in Cambridge, UK and has its operations centre in Fleet, UK.

Next events

Q122 trading update	May 2021

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Edison profile page

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Review of FY21 results

Exhibit 1: Checkit FY21 results highlights

£m	FY20a*	FY21e	FY21a	Diff	y-o-y
Revenues	9.8	13.2	13.2	0.0%	34.7%
Gross profit	2.6	4.8	4.7	-1.1%	80.8%
Gross margin	26.5%	36.0%	35.6%	-0.4%	9.1%
EBITDA	(4.9)	(2.5)	(2.5)	-1.8%	-49.0%
EBITDA margin	-50.0%	-19.3%	-18.9%	0.4%	31.1%
Normalised operating profit	(6.5)	(3.3)	(3.1)	-7.4%	-52.3%
Normalised operating profit margin	-66.3%	-25.4%	-23.5%	1.9%	42.8%
Reported operating profit	(9.2)	(4.1)	(5.3)	29.4%	-42.4%
Reported operating margin	-93.9%	-31.0%	-40.2%	-9.1%	53.7%
Normalised PBT	(6.4)	(3.3)	(3.1)	-7.4%	-51.6%
Reported PBT	(9.1)	(4.1)	(5.3)	29.4%	-41.8%
Normalised net income	(6.4)	(3.3)	(3.1)	-7.4%	-51.6%
Reported net income	80.8	(3.2)	(4.4)	37.6%	N/A
Normalised basic & diluted EPS (p)	(4.0)	(5.4)	(5.2)	-3.7%	30.8%
Reported basic & diluted continuing EPS (p)	(5.6)	(6.6)	(8.3)	25.8%	48.2%
Reported basic & diluted EPS (p)	50.2	(5.2)	(7.2)	39.0%	N/A
Net debt/(cash)	(14.3)	(11.5)	(11.5)	0.0%	-19.6%

Source: Checkit. Note: *Checkit has restated FY20 results to reflect changes to intangibles accounting treatment. Further detail below.

Exhibit 2: Revenue performance

Revenue	FY20 normalised*	FY20a	FY21a*
Checkit Connect	**6.0**	**4.8**	**6.7**
Recurring	3.9	3.2	5.1
Non-recurring	2.1	1.6	1.6
Checkit BEMS - all non-recurring	**6.8**	**5.0**	**6.5**
Total revenue	**12.8**	**9.8**	**13.2**
Recurring	*30.5%*	*32.7%*	*38.6%*
Non-recurring	*69.5%*	*67.3%*	*61.4%*
Revenue growth (y-o-y)			
Checkit Connect			13%
Checkit BEMS			(5%)
Total			3%
Revenue growth – recurring			*33%*
Revenue growth – non-recurring			*(9%)*

Source: Checkit. *Note: FY21 growth is with respect to FY20 normalised revenue, which treats Checkit UK Ltd as owned for the whole of FY20 (acquired on 14 May 2019).

Checkit's trading update in February provided detail on the expected divisional split of revenue and the mix between recurring and non-recurring revenue for FY21 and this has not changed (see Exhibit 2). Revenue was therefore in line with our forecasts, with gross profit just slightly lower. EBITDA was in line and normalised operating loss was slightly smaller than expected due to lower than expected depreciation. One-off charges in FY21 totalled £0.9m (£0.8m restructuring costs, £0.1m costs related to the Tutela acquisition). There was zero tax charge in the year and a £0.3m deferred tax credit with losses carried forward of more than £15m for use against future profits. Net cash at year-end was £11.5m.

The company noted that annualised recurring revenue (ARR) was £5.7m at year-end, an increase of 46% y-o-y. The increase was the result of:

- £0.7m in new business, particularly from the NHS and food retail sector;
- £0.6m conversion of healthcare contracts from a combination of recurring revenues with one-off revenues to a subscription-based agreement; and
- £0.5m from pricing changes.

Explanation of FY20 restatements

In FY20, the company took the decision in the light of COVID-19 uncertainty to write down goodwill and acquired intangibles to zero, resulting in impairment charges totalling £7.3m. In addition, it decided to write down previously capitalised development costs to zero, resulting in a further charge of £2.3m. This resulted in a qualified audit opinion for FY20. In FY21, management has revisited this policy and decided to reinstate both the goodwill and acquired intangible balances, although it has retained the write-down of the capitalised development costs. This reduces one-off charges in FY20 from £10.3m to £1.7m and increases amortisation of acquired intangibles from zero to £1.3m in FY21.

Certain costs in the FY20 income statement have since been classified as relating to discontinued operations and have been stripped out of continuing operations (total £0.4m).

As development costs incurred in FY21 did not meet the criteria for capitalisation, they were expensed in the income statement (£2.5m, flat y-o-y).

Business update

Despite the disruption caused by COVID-19 during FY21, the company made good progress in its strategy to grow its SaaS software business and convert certain one-off contracts to subscription-based contracts.

FY21: Costs managed, product development ongoing

In H121, costs were monitored closely and staff furloughed where they were not able to undertake work at client sites. Employees also took voluntary pay cuts. This allowed the company to control cash consumption, with net cash declining only £0.9m in H121. In H221, furloughed staff returned to work, and despite further lockdowns, more customer sites were open for implementation work. For FY21, operating costs before depreciation and amortisation totalled £7.2m, helped by £0.4m from the government job retention scheme. This compares to £7.5m in FY20, which only included 8.5 months of the Checkit UK acquisition.

Product development continued throughout the year to enhance the three software solutions. New or improved features for the Connected Workflow Management (CWM) solution include teamworking (which allows more than one team member to work on the same workflow at the same time), providing contextual information (eg instruction manuals, guides), Checkpoint extension (adding flexibility to Checkpoint, which links workflow to assets or locations) and label printing. Across the whole software offering, Checkit has made available business intelligence and recommendations and added multi-language capabilities.

The company also implemented a transformation plan to shape the business to better support its goal to be a global SaaS provider. This process will be ongoing in FY22 and includes integrating Salesforce into operations in H222.

FY22: Pressing the accelerator

Post year-end, Checkit acquired Tutela in the US (see our update note published on 11 February 2021), hired Steve Peck as managing director to head up the US operations and ramped up its sales and marketing effort, including the hire of Kit Kyte as chief commercial officer.

The company recently announced that it had added self-service capability to sensor network installation – this should help with international expansion as it removes the need for implementation teams (either in-house or partners) in all geographies and helps when travel restrictions are in place. Future product development includes:

- The integration of CWM with its Connected Automated Monitoring (CAM) and Connected Building Management (CBM) software, such that an alarm raised by sensors monitored within CAM or CBM can trigger a workflow within CWM.
- Process sharing across company boundaries. This is particularly useful for franchises, where franchise owners want to standardise and monitor the processes of franchisees.

The business has now shifted its focus to customer acquisition with the goal of replicating its success in Europe in the US.

Outlook and changes to forecasts

Management noted that FY22 has started well and will provide a further update in its Q122 trading update due in May. We have revised our forecasts to reflect faster expected growth in ARR as well as a step-up in sales and marketing spend in FY22. We introduce forecasts for FY23 showing an acceleration in ARR growth as a result of this increased spend on customer acquisition.

Exhibit 3: Changes to forecasts

£'m	FY22e				FY23e	
	Old	New	Change	y-o-y	New	y-o-y
Revenues	15.1	15.2	0.6%	14.9%	17.8	17.1%
Gross profit	5.6	5.7	0.7%	20.5%	8.1	42.9%
Gross margin	37.3%	37.3%	0.0%	1.7%	45.5%	8.2%
EBITDA	(2.4)	(3.9)	59.9%	55.5%	(2.0)	-48.4%
EBITDA margin	-16.1%	-25.6%	-9.5%	-6.7%	-11.3%	14.3%
Normalised operating profit	(3.2)	(4.5)	38.9%	44.7%	(2.7)	-39.7%
Normalised operating profit margin	-21.4%	-29.6%	-8.2%	-6.1%	-15.2%	14.3%
Reported operating profit	(3.6)	(6.2)	70.4%	16.7%	(3.1)	-49.8%
Reported operating margin	-24.1%	-40.8%	-16.7%	-0.6%	-17.5%	23.3%
Normalised PBT	(3.2)	(4.5)	38.9%	44.7%	(2.7)	-39.7%
Reported PBT	(3.6)	(6.2)	70.4%	16.7%	(3.1)	-49.8%
Normalised net income	(3.2)	(4.5)	38.9%	44.7%	(2.7)	-39.7%
Reported net income	(3.6)	(6.2)	70.4%	40.6%	(3.1)	-49.8%
Normalised basic & diluted EPS (p)	(5.2)	(7.2)	38.9%	38.2%	(4.3)	-39.7%
Reported basic EPS (p)	(5.8)	(9.9)	70.4%	38.5%	(5.0)	-49.8%
Net debt/(cash)	(7.1)	(5.1)	-29.0%	-56.1%	(3.5)	-31.3%
ARR	6.9	7.6	10.9%	34.2%	11.5	50.0%

Source: Edison Investment Research

Valuation

With Checkit not expected to hit full-year EBITDA profitability within our forecast period, comparison with peer multiples is restricted to EV/sales multiples. Checkit trades at a significant discount to UK software peers (on average 6.5x current year forecasts), in our view reflecting its current loss-making position and mix of recurring versus non-recurring business. Currently, around half of Checkit's revenues could be considered as SaaS-based (ie Checkit Connect revenues), but we expect this proportion to increase over time as Checkit Connect grows more quickly than Checkit BEMS. Within Checkit Connect, we also expect recurring revenues to increase as a proportion of divisional revenues, which should also be more highly valued.

Looking at the business on a sum-of-parts basis, in the table below we show the potential valuation on the basis of a range of multiples for each part of the business. Using a multiple of 4x FY22e sales for Checkit Connect (at a discount to UK software peers and well below larger US SaaS peers) and 1x for Checkit BEMS (reflecting limited growth prospects for this part of the business) would suggest a fair value of 83p per share, well ahead of the current share price of 62.0p.

Exhibit 4: Sum-of-parts per share valuation (pence) based on EV/sales multiples

		Checkit Connect multiple (x)							
		1.0	2.0	3.0	4.0	5.0	6.0	7.0	8.0
Checkit BEMS multiple (x)	0.2	34	48	61	75	88	102	116	129
	0.4	36	50	63	77	91	104	118	131
	0.6	38	52	66	79	93	106	120	133
	0.8	41	54	68	81	95	108	122	136
	1.0	43	56	70	**83**	97	111	124	138
	1.2	45	58	72	86	99	113	126	140
	1.4	47	61	74	88	101	115	128	142

Source: Edison Investment Research

Exhibit 5: Financial summary

£m	2019	2020	2021	2022e	2023e
31-January	IFRS	IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT					
Revenue	1.0	9.8	13.2	15.2	17.8
Cost of Sales	(1.0)	(7.2)	(8.5)	(9.5)	(9.7)
Gross Profit	0.0	2.6	4.7	5.7	8.1
EBITDA	(2.3)	(4.9)	(2.5)	(3.9)	(2.0)
Normalised operating profit	(4.4)	(6.5)	(3.1)	(4.5)	(2.7)
Amortisation of acquired intangibles	(0.1)	(1.0)	(1.3)	(1.3)	(0.4)
Exceptionals	0.0	(1.7)	(0.9)	(0.4)	0.0
Share-based payments	0.0	0.0	0.0	0.0	0.0
Reported operating profit	(4.5)	(9.2)	(5.3)	(6.2)	(3.1)
Net Interest	0.0	0.1	0.0	0.0	0.0
Joint ventures & associates (post tax)	0.0	0.0	0.0	0.0	0.0
Exceptionals	0.0	0.0	0.0	0.0	0.0
Profit Before Tax (norm)	(4.4)	(6.4)	(3.1)	(4.5)	(2.7)
Profit Before Tax (reported)	(4.5)	(9.1)	(5.3)	(6.2)	(3.1)
Reported tax	0.0	0.1	0.3	0.0	0.0
Profit After Tax (norm)	(4.4)	(6.4)	(3.1)	(4.5)	(2.7)
Profit After Tax (reported)	(4.5)	(9.0)	(5.0)	(6.2)	(3.1)
Minority interests	0.0	0.0	0.0	0.0	0.0
Discontinued operations	8.6	89.8	0.6	0.0	0.0
Net income (normalised)	(4.4)	(6.4)	(3.1)	(4.5)	(2.7)
Net income (reported)	4.1	80.8	(4.4)	(6.2)	(3.1)
Basic average number of shares outstanding (m)	178	161	62	62	62
EPS - basic normalised (p)	(2.5)	(4.0)	(5.2)	(7.2)	(4.3)
EPS - diluted normalised (p)	(2.5)	(4.0)	(5.2)	(7.2)	(4.3)
EPS - basic reported (p)	2.3	50.2	(7.2)	(9.9)	(5.0)
Dividend (p)	0.00	0.00	0.00	0.00	0.00
Revenue growth (%)	N/A	880.0	34.7	14.9	17.1
Gross Margin (%)	0.0	26.5	35.6	37.3	45.5
EBITDA Margin (%)	-230.0	-50.0	-18.9	-25.6	-11.3
Normalised Operating Margin	-440.0	-66.3	-23.5	-29.6	-15.2
BALANCE SHEET					
Fixed Assets	5.0	8.5	6.8	7.7	7.3
Intangible Assets	2.9	7.3	6.0	6.8	6.2
Tangible Assets	1.7	1.2	0.8	0.9	1.1
Investments & other	0.4	0.0	0.0	0.0	0.0
Current Assets	19.5	19.8	17.5	11.2	9.8
Stocks	4.3	1.7	1.1	1.2	1.3
Debtors	5.1	3.4	4.4	4.8	5.1
Cash & cash equivalents	10.1	14.3	11.5	5.1	3.5
Other	0.0	0.4	0.5	0.1	0.0
Current Liabilities	(7.9)	(5.6)	(5.9)	(6.7)	(8.0)
Creditors	(7.6)	(5.1)	(5.6)	(6.4)	(7.7)
Tax and social security	(0.3)	0.0	0.0	0.0	0.0
Short term borrowings	0.0	0.0	0.0	0.0	0.0
Other	0.0	(0.5)	(0.3)	(0.3)	(0.3)
Long Term Liabilities	(0.3)	(1.3)	(0.8)	(0.8)	(0.8)
Long term borrowings	0.0	0.0	0.0	0.0	0.0
Other long-term liabilities	(0.3)	(1.3)	(0.8)	(0.8)	(0.8)
Net Assets	16.3	21.4	17.6	11.4	8.3
Minority interests	0.0	0.0	0.0	0.0	0.0
Shareholders' equity	16.3	21.4	17.6	11.4	8.3
CASH FLOW					
Op Cash Flow before WC and tax	(2.3)	(4.9)	(2.5)	(3.9)	(2.0)
Working capital	(0.5)	(1.0)	0.3	0.3	1.0
Exceptional & other	9.1	5.3	(0.7)	(0.4)	0.0
Tax	(0.5)	(0.5)	0.0	0.0	0.0
Net operating cash flow	5.8	(1.1)	(2.9)	(4.0)	(1.0)
Capex	(2.2)	(0.3)	(0.3)	(1.8)	(0.3)
Acquisitions/disposals	1.3	84.2	0.3	(0.2)	0.1
Net interest	0.0	0.1	0.0	0.0	0.0
Equity financing	0.0	(77.9)	0.5	0.0	0.0
Dividends	0.0	0.0	0.0	0.0	0.0
Other	0.0	(0.8)	(0.4)	(0.4)	(0.4)
Net Cash Flow	4.9	4.2	(2.8)	(6.4)	(1.6)
Opening net debt/(cash)	(5.2)	(10.1)	(14.3)	(11.5)	(5.1)
FX	0.0	0.0	0.0	0.0	0.0
Other non-cash movements	0.0	0.0	0.0	0.0	0.0
Closing net debt/(cash)	(10.1)	(14.3)	(11.5)	(5.1)	(3.5)

Source: Checkit, Edison Investment Research

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