Qualification Check Limited ("QCL")

Review of Financial Performance
Period Ending September 2019

EXECUTIVE SUMMARY

This is the fifth investor update following your investment in Qualification Check Limited, in February 2017. The period under review covers the six months' trading for the business to the end of September 2019.

This report feels something akin to 'Groundhog Day', in that whilst a reasonable level of underlying growth has been seen, once again the anticipated step-change volume increases from large new customer wins has continued to prove elusive. Notwithstanding the scepticism that might ensue, there remain reasons for optimism, and the founders' commitment is unwavering.

A brief summary of financial results for the six months ended 30 September 2019 is provided below:

SUMMARY RESULTS (6 months to 30/09/2019)	ACTUAL	BUDGET	VARIANCE
	£000'S	£000'S	£000'S
SALES	381	522	(141)
GROSS PROFIT	160	255	(95)
	42.0%	48.9%	(6.9)%
UNDERLYING EBITDA	(59)	36	(95)

TRADING

Sales

Revenue growth year-on-year has reduced to 5.8% in the first six months, with a significant miss compared to budget.

In the previous report, with the Neeyamo deal having already fallen flat, UK NARIC and CSCSE were the large new clients that were expected to be major contributors to new business growth.

Whist CSCSE has gone live, volumes to date have been way behind expectations, and with subsequent engagement having been much diminished, the company has been unable to ascertain specific reasons or clarity on if / when the originally trailed activity levels may be achieved at some future point. More positively, UK NARIC have embraced the partnership, as can be seen from the web-site link below;

https://www.naric.org.uk/naric/Organisations/QCAS/default.aspx

Whilst the collaboration went live in the Spring, UK NARIC itself does not generate verification demand, it is the underlying member organisations that have to adopt the service, with UK NARIC acting as a quasi-channel partner. The relationship has, however, triggered multiple engagements with the member institutions, albeit with a time-lag as each individual sale process develops. As such, there has been modest contribution in the period under review (less than a thousand checks in the last year). QCL attended a Compliance

Seminar earlier in the year and were presenting at the UK NARIC Annual Conference in early November, which demonstrate the buy-in from the organisation.

Imperial College are the first major institution to sign up (October), verifying qualifications of post-graduates from overseas, with Queen Marys and Ulster Universities also towards the 'top of the sales funnel'.

Elsewhere, progress has largely been seen in developing partnerships and advancing pipeline opportunities, rather than in generating significant sales activity which have resulted in incremental revenue in the period.

These include Audit One https://www.audit-one.co.uk/, a not-for-profit organisation derived from NHS consortia in the North of England, providing risk assurance services to public sector clients, where introductions to around 30 NHS trusts have recently been made.

QCL has also partnered with GB Group https://www.gbgplc.com/, initially to tender for a contract with the Solicitors Regulation Authority ("SRA") for verifying qualifications of candidates wishing to sit the new solicitors examinations, but thereafter as an 'approved supplier' in seeking to drive opportunities with other existing and potential GB Group clients, with the Scottish Government being the next live prospect.

In terms, however, of revenue generated in the period, the business has increasingly been seeing its value as verifying qualifications of foreign, rather than domestic, graduates. This is probably partly due to this is where demand is highest, but also where the main domestic competitor, HEDD, has no capacity, and where it is harder for UK institutions, employers and regulatory bodies to reliably access the degree-awarding institutions.

With overall check volumes up just over 10% year-on-year, the variation in activity levels between the different geographies / types is stark;

CHECK VOLUMES	2019/20	2018/19	% Change
UK – Exclusive	2,862	2,885	-0.8%
UK- Other	3,239	3,594	-9.9%
CISI	890	1,036	-14.1%
US	596	632	-5.7%
China	464	425	+9.2%
Rest of the World	6,492	4,569	+42.1%

The chart below shows the pattern of check volumes over the last three years

Margins

Historically, lower than budget revenues have resulted in a significant shortfall at the gross margin level (percentage and absolute). Whilst this period shows an improvement to the same period last year and the March year-end (both around 37%), there is still a material gap to the budget figure.

As reported before, there is no particular variation in check prices or cost of sales, so it is mix and volume which drive variation to budget. Although post-period-end, there will be a series of price increases, particularly in respect of overseas verifications, given the absence of any direct comparator (as with HEDD in the UK), and no price rises over recent years. This should begin to have an impact towards Q4 of the financial year.

Overheads

Overhead expenditure has always been well understood / controlled, and the period under review is no exception.

On the face of it, overheads are exactly in line with budget, albeit with some variances at a more granular level. Savings in the advertising and marketing categories have been off-set by increased information security costs, as the company's compliance and security regime came under greater scrutiny from some of their larger partners.

Towards the end of the period, a new (unbudgeted) marketing hire, from a major PE-backed international competitor, Dataflow, was also brought on board to help with engagement with larger / international corporates / institutions.

Overheads have increased, as envisaged, compared to prior periods, with the remuneration of the MD all being expensed, following repayment to him of the original directors' loan.

Summary

A summary of trading over the six months is as follows:

SIX MONTHS TO 30/09/2019	ACTUAL £000's	BUDGET £000's	VARIANCE £000's
SALES	381	522	(141)
GROSS PROFIT	160	255	(95)
	42.0%	48.9%	(6.9)%
OVERHEADS	(219)	(219)	-
UNDERLYING EBITDA	(59)	36	(95)
ONE OFF & NEW OWNERSHIP COSTS	(10)	(10)	-
EBITDA	(69)	26	(95)
DEPRECIATION	(1)	(1)	-
INTEREST COSTS	-	-	-
EBT	(70)	25	(95)
CORPORATION TAX	-	-	-
NET PROFIT	(70)	(25)	(95)

BALANCE SHEET SUMMARY

BALANCE SHEET £000	ACTUAL SEP-19	BUDGET SEP-19
TANGIBLE FIXED ASSETS	25	28
CURRENT ASSETS		
TRADE RECEIVABLES	47	116*
PREPAYMENTS	20	-
CASH	49	27
TOTAL CURRENT ASSETS	**116**	**143**
TOTAL ASSETS	**141**	**171**
CURRENT LIABILITIES		
TRADE CREDITORS	(30)	(101)*
PAYE & NI	(10)	-
VAT	(13)	-
OTHER CREDITORS	(11)	-
ACCRUALS	(18)	-
DIRECTORS' LOAN	(40)	(-)
CORPORATION TAX	(-)	(-)
TOTAL CURRENT LIABILITIES	**(122)**	**(101)**
NET CURRENT ASSETS	**(6)**	**42**
TOTAL LIABILITIES	**(122)**	**(101)**
NET ASSETS	**19**	**70**
EQUITY INVESTMENT	800	800
SUBSIDIARY EQUITY	20	20
CURRENT YEAR EARNINGS	(31)	20
RETAINED RESERVES	(770)	(770)
CAPITAL EMPLOYED	**19**	**70**

Notes:
*The forecasts did not distinguish between the different current asset / current liability categories

There are a couple of points to note in the Balance Sheet, when compared to budget;

- Although cash is ahead of budget, despite the adverse profit performance, the variance is through a combination of unbudgeted directors' loans (£20,000 at the start of the year, plus £20,000 additional) and receipt of a R&D tax credit claim

- The current year earnings are showing as (£31,000), compared to the net loss of (£70,000) shown in the Profit & Loss statement. The difference relates to monies received in respect of the unbudgeted R&D tax credit claim referred to above (c. £33,000), together with c. £7,000 of advance purchase of verification search credits, which have now expired

CASH POSITION

FUNDS FLOW STATEMENT £000	ACTUAL 6m TO SEP-19
PROFIT FROM OPERATIONS	(70)
DEPRECIATON & AMORTISATION	1
EBITDA	(69)
NET MOVEMENT IN WORKING CAPITAL	22
CASH FROM OPERATIONS	(47)
CAPITAL EXPENDITURE	(-)
INTEREST PAID	(-)
CORPORATION TAX	(-)
R&D TAX RECLAIM	33
DIRECTORS' LOAN ADVANCED	20
NET INCREASE / (DECREASE) IN CASH	6

The profit shortfall flows through to cash, partly off-set by better than anticipated debtor receipts, together with the R&D tax reclaim and additional directors' loans, referred to above.

FORECASTS TO MARCH 2020 & OTHER DEVELOPMENTS

With the business still losing money at an operational level and with a negligible cash buffer, there has been close attention given to short term forecasting.

The latest view of the second six months is predicated on a continuation of recent organic growth trends, with the addition of modest incremental revenues from an element of the UK NARIC prospects, alongside the benefit of the price rises referred to earlier in this report. This would see revenues in the region of £475,000 over the second half, reducing monthly cash-burn to £2-5,000 by the period-end.

Whilst a new service proposition, employment checks (in addition to the core degree check proposition), is expected to go live in November, in the short term this is anticipated to be a facilitator in terms of winning new core business, rather than being a major revenue stream in its own right. Further product enhancements are also in the pipeline.

Management are expecting to commit a further £20,000 of new directors' loans over the six months, bringing their 'informal' investment to £60,000.

Despite significant debate, management have resisted the temptation to take cost out with a view to achieving a sustainable business more quickly. Whilst landing transformational new clients has eluded the company, the business continues to grow and foster strategically interesting opportunities with both potential end-users and channel partner organisations.

QCL continues to provide a scarce and sought-after commodity, and there is little doubt that the business has 'grown up' considerably since the time of the initial Investor Club commitment. Investors may well be frustrated at the pace of change, but the direction of travel remains positive, and the opportunity remains within the company's grasp.

However, with the initial investment now exhausted, there's a recognition that managements' goals are unlikely to be achieved from the current equity base, and whilst there is a willingness to continue to invest in the business on their part, there is not the access to capital necessary to facilitate this growth opportunity over the medium term.

There is an expectation that further investment, possibly in the region of £1m, may be sought by mid to late 2020. It is anticipated that this will likely require a new investor coming on board at that stage. With the revenue run-rate expected to be at £1m per annum, and the business close to or at break-even at that point, we believe such a proposition should be credible to the institutional investment community. Plans in this respect are still at a very early stage but will evolve over the coming six months.

CONCLUSION

As alluded to at the start of this report, whilst there continues to be positive sentiment, the financial performance of the company has yet to match the management ambition and the market opportunity, which would still appear to exist, has not been fully exploited.

Recent partnerships with UK NARIC and GB Group serve both to endorse the conviction that the potential is very much there, as well as demonstrating the willingness to explore new routes to market as a means to better execute on the apparent opportunity.

Against this backdrop it is hard to object violently to the growth-focused strategy being adopted, rather than the alternative cost-cutting approach, but in pursuing these objectives, the need for additional capital is inescapable. It is also reasonable to assume that the Investor Club alone, whilst potentially having a willingness to participate in any future funding round, is unlikely to have the appetite to lead such an endeavour.

The plans in this respect should become much clearer over coming months and will be reported on further in the next full-year report.

Richard Bucknell
November 2019