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Check-Cap (NASDAQ/CHEK)

March 17, 2021

Lowering to Neutral from Buy as we wait for Pivotal Study

Check-Cap's stock price has exceeded our price target of \$2.00, so we must either raise our valuation or lower our rating. We see no good reason to raise our valuation at this time as the U.S. Pivotal study has not yet begun. We additionally expect that the company is likely to raise capital prior to C-Scan completing the pivotal program.

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Investment Highlights

Pivotal Status? The U.S. pivotal study for C-Scan is planned to begin this year. The company reports that C-Scan is still undergoing some optimization in advance of starting the study. The company currently has capital on the balance sheet (\$21M at end of Q320). We anticipate that the company is likely to raise additional capital.

Check-Cap reported \$6M in cash and \$15M in ST investments at the end of 3Q20. We do anticipate additional raises before C-Scan completes the planned pivotal trial.

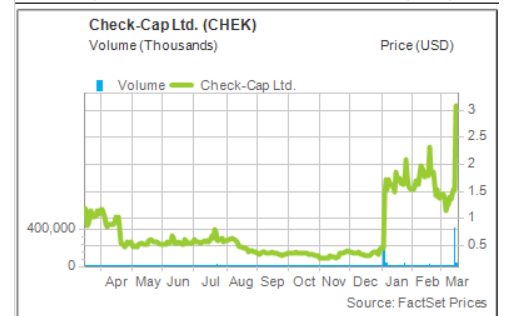
TikTok? We recently caught Ankon's NaviCam on TikTok. This is an optical-magnetic capsule (vs. Check-Cap, which uses X-ray). The company describes the unit as a "Magnetically Controlled Capsule Endoscope (MCCE) system which enables complete-real-time visualization of the stomach for the first time offering a non-invasive, patient-friendly alternative to traditional endoscopy Proprietary system integrates advanced robotic technologies and innovative software."

Need Super-Pill. Check Cap's imaging device is able to literally X-ray the colon, activating the sensors only when the device reaches the target area. The device uses a tiny X-ray source (with a harmless amount of radiation) and is "flushed" when eliminated from the body. No bowel prep, no diet changes, no invasive devices such as a scope, and no anesthesia are needed for a physician to see a detailed map of the entire colon and detect precancerous polyps – a paradigm shift. The data is then transmitted to a sensor, and the examination is completed.

Valuation. Our valuation is based on the assumed success of the E.U. and U.S. launches of Check-Cap's imaging capsule. We use a 30% probability of success for the EU and US approvals and commercialization. The product revenue models then flow into our income statement, which is projected out to 2030. On top of these therapeutic success probabilities, we apply a discount rate (r) of 30% (our highest rate for emerging growth companies), and we assume additional capital raises (dilution) in our final projected share count of 124M (2030). We then apply these projections to our Free Cash Flow to the Firm or FCFF, discounted EPS or dEPS, and sum-of-the-parts or SOP models, which are equal-weighted, averaged and rounded to the nearest whole number to derive our 12-month price target.

Risk Factors: These include Clinical Risk, Partnership Risk, Investment and Financial Risk, Regulatory Risk, Market Share Risk, and Legal and Commercial Risks.

Current Price	\$2.38		
Price Target	\$2.00		
Estimates	F2019A	F2020E	F2021E
Expenses (\$000s)	\$ 14,069	\$ 13,631	\$ 13,114
1Q March	\$ 3,164	\$ 3,419	\$ 3,147
2Q June	\$ 3,494	\$ 2,949	\$ 3,016
3Q September	\$ 3,564	\$ 3,631	\$ 3,410
4Q December	\$ 3,847	\$ 3,632	\$ 3,541
	F2019A	F2020E	F2021E
EPS (diluted)	\$ (1.73)	\$ (0.51)	\$ (0.17)
1Q March	\$ (0.44)	\$ (0.34)	\$ (0.04)
2Q June	\$ (0.41)	\$ (0.06)	\$ (0.04)
3Q September	\$ (0.42)	\$ (0.06)	\$ (0.04)
4Q December	\$ (0.46)	\$ (0.05)	\$ (0.05)
EBITDA/Share	(\$1.73)	(\$0.43)	(\$0.23)
EV/EBITDA (x)	0.0	0.0	0.0
Stock Data			
52-Week Range	\$0.44	-	\$2.80
Shares Outstanding (mil.)	25.2		
Market Capitalization (mil.)	\$60		
Enterprise Value (mil.)	\$60		
Debt to Capital	0%		
Book Value/Share	\$0.53		
Price/Book	2.3		
Average Three Months Trading Volume (K)	72		
Insider Ownership	2.6%		
Institutional Ownership	1.4%		
Short interest (mil.)	0.6%		
Dividend / Yield	\$0.00/0.0%		



Please find Important Disclosures beginning on Page 4.

Exhibit 6. Income Statement

Check-Cap: Income Statement (\$000)																	
YE December 31	2018A	2019A	1Q20A	2Q20A	3Q20A	4Q20E	2020E	2021E	2022E	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E
Product sales																	
Imaging capsule EU	-	-	-	-	-	-	-	-	-	-	14,422	74,067	104,419	135,193	166,393	198,023	230,087
Imaging capsule US	-	-	-	-	-	-	-	-	-	-	3,904	8,256	16,793	42,700	86,859	176,682	269,548
Total Product Sales	-	-	-	-	-	-	-	-	-	-	18,326	82,323	121,213	177,894	253,252	374,705	499,635
Expenses																	
Cost of Goods Sold			0	0	0	0	0	0	0	0	4,581	20,581	30,303	44,473	63,313	93,676	124,909
			%COGS	%COGS	%COGS	%COGS	%COGS	%COGS	%COGS	%COGS	25%	25%	25%	25%	25%	25%	25%
Research and Development	7,618	10,474	2,462	2,051	2,664	2,545	9,427	8,484	7,636	6,872	6,185	5,566	5,622	5,678	5,735	5,792	5,850
			%R&D	%R&D	%R&D	%R&D	%R&D	%R&D	%R&D	%R&D	33%	33%	33%	33%	33%	33%	33%
General and Administrative	3,445	3,595	957	898	967	1,087	4,026	4,630	5,093	5,348	5,615	5,896	6,250	6,625	7,023	7,444	7,891
			%SG&A	%SG&A	%SG&A	%SG&A	%SG&A	%SG&A	%SG&A	%SG&A	30%	30%	30%	30%	30%	30%	30%
Total expenses	11,063	14,069	3,419	2,949	3,631	3,632	13,631	13,114	12,729	12,220	16,382	32,043	42,175	56,777	76,070	106,913	138,649
Operating Income (Loss)	(11,063)	(14,069)	(3,419)	(2,949)	(3,631)	(3,632)	(13,631)	(13,114)	(12,729)	(12,220)	1,944	50,279	79,038	121,117	177,181	267,793	360,985
Finance income	473	233	(12)	61	13	-	-	-	-	-	-	-	-	-	-	-	-
Finance expenses	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total other income	473	233	(12)	61	13	-	-	-	-	-	-	-	-	-	-	-	-
Pretax Income	(10,590)	(13,836)	(3,431)	(2,888)	(3,618)	(3,632)	(13,631)	(13,114)	(12,729)	(12,220)	1,944	50,279	79,038	121,117	177,181	267,793	360,985
change in fair value of cash flow hedge	(13)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Income Tax Benefit (Provision)	1	(13)	-	-	-	-	-	-	(636)	(1,222)	979	8,548	15,808	30,279	47,839	80,338	115,515
Tax Rate									5%	10%	15%	17%	20%	25%	27%	30%	32%
GAAP Net Income (loss)	(10,602)	(13,823)	(3,431)	(2,888)	(3,618)	(3,632)	(13,631)	(13,114)	(12,092)	(10,998)	965	41,732	63,230	90,838	129,342	187,455	245,470
GAAP-EPS	(2.61)	(1.73)	(0.34)	(0.12)	(0.09)	(0.07)	(0.63)	(0.23)	(0.21)	(0.16)	0.08	0.62	0.93	1.33	1.89	2.72	3.55
GAAP EPS (dil)	(2.61)	(1.73)	(0.34)	(0.06)	(0.06)	(0.05)	(0.51)	(0.17)	(0.15)	(0.12)	0.01	0.41	0.60	0.82	1.13	1.57	1.98
Wgtd Avg Shrs (Bas) - '000s	4,058	7,986	9,971	23,396	41,518	51,560	31,611	56,696	56,923	67,166	67,435	67,705	67,977	68,249	68,522	68,797	69,072
Wgtd Avg Shrs (Dil) - '000s	4,058	7,986	9,971	50,000	60,000	70,600	47,643	77,458	80,603	94,027	97,845	101,818	105,952	110,254	114,731	119,390	124,237

Source: Dawson James estimates, company reports

Risk Analysis

Clinical Trial Risk. Check-Cap is dependent on the outcome of multiple clinical trials.

Commercial Risk. Check-Cap hopes to initially commercialize the device in Europe and Israel, followed by the U.S. There can be no assurances that the company can achieve meaningful market share.

Financial Risk. Check-Cap is likely to require additional capital raises before the company can be self-sustaining. There can be no guarantees that the company will be able to raise the needed capital.

Investment Risk. Check-Cap is a small capital company, which can translate into high volatility and risk for investors. The company has no revenues and is dependent on the clinical progress of the device.

Intellectual Property. Check-Cap may face IP challenges, forcing the company to defend its patents or against claims that the company is infringing on other patents.

Regulatory Risk. Check-Cap, even with good clinical data, could face extensive delays and other regulatory setbacks.

Companies mentioned in this report

PillCam is a product sold by Medtronic (MDT - Not Rated).

Important Disclosures:

Price Chart:



Price target and rating changes over the past three years:

Initiated – Buy – December 5, 2019 – Price Target \$4.00

Update – Buy – March 9, 2020 – Price Target \$4.00

Price Target Change – Buy – April 21, 2020 – Price Target Lowered from \$4.00 to \$2.00

Update – Buy – May 11, 2020 – Price Target \$2.00

Rating change – Neutral – March 17, 2021 – Price Target \$2.00

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- 1) **Buy:** The analyst believes the price of the stock will appreciate and produce a total return of at least 20% over the next 12-18 months;
- 2) **Neutral:** The analyst believes the price of the stock is fairly valued for the next 12-18 months;
- 3) **Sell:** The analyst believes the price of the stock will decline by at least 20% over the next 12-18 months and should be sold.

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Ratings Distribution	Company Coverage		Investment Banking	
	# of Companies	% of Total	# of Companies	% of Totals
Market Outperform (Buy)	21	72%	6	29%
Market Perform (Neutral)	8	28%	0	0%
Market Underperform (Sell)	0	0%	0	0%
Total	29	100%	6	21%

Does not reflect the current rating change.

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