

5 December 2017

Alexium International

Going organic

2017 has been a break-out year for Alexium, generating first significant revenues in H217 and producing first cash profits through Q118. Not without hiccups along the way (Q1 revenue decline -15%), we think that Alexium is on a solid growth trajectory. As with many companies in their initial post-commercialisation phase, Alexium management have chosen to refocus their business model, cutting low margin customers and reshaping their focus towards six refined sales channels. While this has impacts on near term revenues, it has boosted GP margins and sets the base for more profitable growth into the future. We re-examine our forecasts in light of such changes, noting reasonable top line impacts as we also remove risk-weighted forecasts for contracts not already secured. As such, we now forecast what we feel is an organic base case; a revenue and earnings run rate based on the current, awarded pipeline. Any future contract wins would therefore be earnings and value accretive. We also undertake a detailed scenario analysis, noting that several scenarios are not so much 'blue sky' but rather potentially imminent. Revenue and earnings under either of these may be therefore be significantly higher. Nonetheless, we take a prudent view for now. Forecast changes are reflected in our revised target price (\$0.90 vs \$1.10), however, we remain positive on the business and it's growth path. Our Buy remains, with >100% upside very attractive.

Scenario analysis is the key; strong upside potential

- Scenario analysis reveals 3 potential upside cases which we would place significant weight on achieving, rather than any overly optimistic 'blue sky' targets.
- Revised base case reflects a lower risk approach to forecasting; we now focus on organic growth and what's in the current pipeline as at today.
- FY18 revenues A\$30m, down from A\$36m; FY19 revenues A\$50m, from A\$72m.

Valuation: BUY, TP \$0.90

- Valuation methodology remains unchanged; equal weighting of DCF and FY20F EBIT multiple.
- WACC 11%, Beta 1.35x, terminal growth 3%.
- FY20F EBIT multiple 20x (from 14x) reflecting an early stage, high growth business.
- TP falls to \$0.90 (from \$1.10) as a result of forecast changes.

BUY

Share Price: A\$0.40

Target Price: A\$0.90

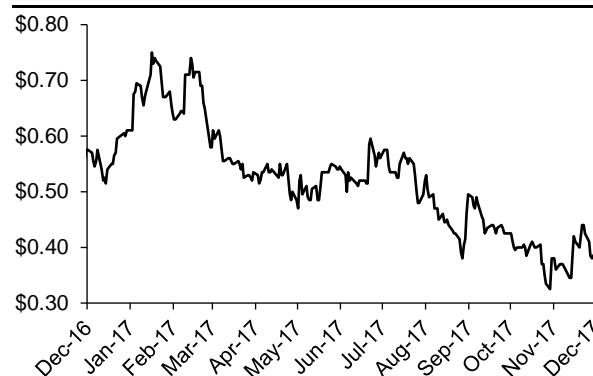
Company Data

Shares – ordinary (M)	304.6
Dilution (M)	9.1
Total (fully diluted) (M)	313.7
Market capitalisation (\$M)	120.3
12 month low/high (\$)	30.5 / 76.5
Average monthly turnover (\$M)	7.4
Index	All Ordinaries
GICS Industry	Industrials

Financial Summary (fully diluted/normalised)

Year end June	2016A	2017A	2018F	2019F	2020F
Revenue (\$M)	3.0	24.0	30.1	49.9	66.2
Costs (\$M)	(18.5)	(35.2)	(30.9)	(42.3)	(50.6)
EBITDA (\$M)	(15.5)	(11.2)	(0.7)	7.6	15.6
NPAT (\$M)	(15.7)	(12.2)	(2.9)	5.3	13.3
EPS (¢ps)	(5.0)	(3.9)	(0.9)	1.7	4.4
EPS Growth (%)	n/a	22.5%	76.0%	-287.3%	150.2%
PER (x)	(7.9)	(10.2)	(42.6)	22.7	9.1
Free Cashflow (\$M)	(3.8)	(7.7)	0.3	1.4	12.6
FCFPS (¢ps)	(0.0)	(0.0)	0.0	0.0	0.0
PFCFPS (x)	nm	nm	355.6	85.2	9.5
Enterprise Value (\$M)	109.1	123.2	130.7	129.3	116.7
EV / EBITDA (x)	(7.0)	(11.0)	(175.6)	17.0	7.5
Payout ratio (%)	0.0	0.0	0.0	0.0	0.0
Dividends (¢ps)	0.0	0.0	0.0	0.0	0.0
Yield (%)	0.0	0.0	0.0	0.0	0.0

AJX – performance over one year



Disclosure and Disclaimer

This report must be read with the disclosure and disclaimer on the final page of this document.

Analysis

Alexium International Group Ltd

Year end 30 June (A\$m)

MARKET DATA	
Recommendation	BUY
Price	\$ 0.40
Price target (12-month)	\$ 0.90
52 week high / low	\$ 0.38 - 0.90
Market capitalisation (fully diluted)	\$m 120.3
Shares on issue (basic)	no. 304.6
Options / rights	no. 9.1
Other equity	no. 0.0
Shares on issue (diluted)	no. 313.7

INVESTMENT FUNDAMENTALS	FY16	FY17	FY18F	FY19F	FY20F
Reported NPAT	\$m (15.7)	(12.2)	(2.9)	5.3	13.3
NPAT normalised	\$m (15.7)	(12.2)	(2.9)	5.3	13.3
Reported EPS (undiluted)	¢ (5.0)	(3.9)	(0.9)	1.7	4.2
EPS normalised (undiluted)	¢ (5.0)	(3.9)	(0.9)	1.7	4.4
...Growth	% n/a	23%	76%	(287%)	150%
PER normalised/undiluted	x (7.9)	(10.2)	(42.6)	22.7	9.1
Operating cash flow per share	¢ (0.1)	(0.0)	(0.0)	0.0	0.0
Free cash flow per share	¢ (0.0)	(0.0)	0.0	0.0	0.0
Price to free cash flow per share	x nm	nm	355.6	85.2	9.5
FCF yield	% (3.1%)	(6.4%)	0.3%	1.2%	10.5%

Dividend	¢ 0.0	0.0	0.0	0.0	0.0
Payout	% 0.0	0.0	0.0	0.0	0.0
Yield	% 0.0	0.0	0.0	0.0	0.0
Franking	% 0.0	0.0	0.0	0.0	0.0

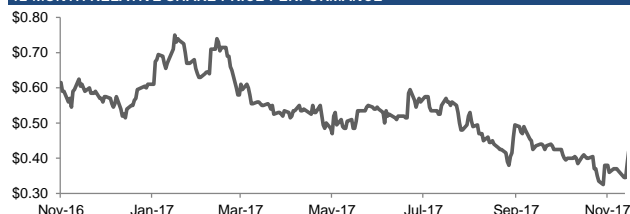
Enterprise value	\$m 109.1	123.2	130.7	129.3	116.7
EV/EBITDA	x (7.0)	(11.0)	(175.6)	17.0	7.5
EV/EBIT	x (7.0)	(10.6)	(110.8)	18.1	7.7
Price to book (NAV)	x 10.7	548.3	149.1	19.7	6.2
Price to NTA	x 10.9	2,960.5	(52.8)	30.6	6.4

KEY RATIOS	FY16	FY17	FY18F	FY19F	FY20F
EBITDA margin	% nm	nm	nm	15.2%	23.5%
EBIT margin	% nm	nm	nm	14.3%	22.8%
NPAT margin	% nm	nm	nm	10.6%	20.0%
ROE	% nm	nm	nm	86.8%	68.5%
ROA	% nm	nm	nm	13.0%	19.8%
Net tangible assets per share	¢ 0.0	0.0	0.1	0.1	0.2
Net debt / (cash)	\$m (11.2)	2.8	10.3	9.0	(3.6)
Interest cover (EBIT / net interest)	x nm	19.8	0.7	(3.9)	(8.2)
Gearing (net debt / EBITDA)	x 0.7	nm	nm	1.2	nm
Leverage (net debt / (net debt + equity))	x nm	0.9	0.9	0.6	nm

DUPONT ANALYSIS	FY16	FY17	FY18F	FY19F	FY20F
Net Profit Margin	% (522.9)	(50.6)	(9.7)	10.6	20.0
Asset Turnover	x 0	2.5	0.8	0.9	0.9
Return on Assets	% (111)	(126.0)	(7.6)	9.6	17.4
Financial Leverage	x 1.3	44.0	47.3	9.0	3.9
Return on Equity	% (139)	(5,538.4)	(360.8)	86.8	68.5

INTERIM SUMMARY	
Total revenue	\$M
Operating expenses	\$M
EBITDA	\$M
Depreciation & amortisation	\$M
EBIT	\$M
Net interest	\$M Not Material
Pretax profit	\$M
Tax expense	\$M
Minorities/preference dividend	\$M
Operating NPAT	\$M
Significant items	\$M
Reported NPAT	\$M
Reported EPS (diluted)	¢
Normalised EPS	¢

12-MONTH RELATIVE SHARE PRICE PERFORMANCE



PROFIT AND LOSS	FY16	FY17	FY18F	FY19F	FY20F
Total revenue	\$m 3.0	24.0	30.1	49.9	66.2
Costs (COGS & opex)	\$m (18.5)	(35.2)	(30.9)	(42.3)	(50.6)
EBITDA	\$m (15.5)	(11.2)	(0.7)	7.6	15.6
Depreciation & amortisation	\$m (0.2)	(0.4)	(0.4)	(0.5)	(0.5)
EBIT	\$m (15.7)	(11.6)	(1.2)	7.1	15.1
Net interest	\$m 0.0	(0.6)	(1.7)	(1.8)	(1.8)
Non-operating income	\$m 0.0	0.0	0.0	0.0	0.0
Pretax Profit	\$m (15.7)	(12.2)	(2.9)	5.3	13.3
Tax expense	\$m 0.0	0.0	0.0	0.0	0.0
Minorities	\$m 0.0	0.0	0.0	0.0	0.0
Operating NPAT	\$m (15.7)	(12.2)	(2.9)	5.3	13.3
Significant items	\$m 0.0	0.0	0.0	0.0	0.0
Reported NPAT	\$m (15.7)	(12.2)	(2.9)	5.3	13.3

GROWTH PROFILE	FY16	FY17	FY18F	FY19F	FY20F
Operating revenue	% n/a	700.8	25.3	65.7	32.7
EBITDA	% n/a	90.6	(12.4)	37.1	19.7
EBIT	% n/a	26.3	89.8	(704.9)	111.6
Operating NPAT	% n/a	22.5	76.0	(281.9)	150.2
Normalised EPS	% n/a	22.5	76.0	(287.3)	150.2
DPS	% n/a	n/a	n/a	n/a	n/a

BALANCE SHEET	FY16	FY17	FY18F	FY19F	FY20F
Cash/(overdraft)	\$m 11.2	3.4	3.3	4.7	17.3
Receivables	\$m 0.2	1.4	4.7	8.7	10.5
Inventory	\$m 1.7	2.1	6.8	12.7	15.3
Other	\$m 0.1	0.1	0.1	0.1	0.1
Current	\$m 13.2	7.0	14.9	26.3	43.2
Prop, plant & equip	\$m 0.8	2.4	2.8	2.8	3.0
Other	\$m 0.2	0.2	20.6	25.8	30.0
Non current	\$m 1.0	2.6	23.3	28.6	33.0
Total assets	\$m 14.2	9.7	38.2	54.9	76.2
Accounts Payable	\$m 2.8	1.8	6.0	11.2	13.4
Borrowings	\$m 0.0	6.2	13.7	13.7	13.7
Other	\$m 0.1	1.4	0.3	0.3	0.3
Total liabilities	\$m 2.9	9.4	19.9	25.1	27.4
Net assets	\$m 11.3	0.2	18.3	29.8	48.8
Equity	\$m 51.6	52.8	52.8	52.8	52.8
Retained earnings/other	\$m (40.4)	(52.6)	(52.0)	(46.7)	(33.5)
Shareholder's equity	\$m 11.3	0.2	0.8	6.1	19.4

CASH FLOW	FY16	FY17	FY18F	FY19F	FY20F
EBITDA	\$m (15.5)	(11.2)	(0.7)	7.6	15.6
Change in provisions	\$m 0.0	0.0	0.0	0.0	0.0
Change in working capital	\$m (0.5)	(2.6)	(3.8)	(4.8)	(2.1)
Net interest	\$m 0.0	(0.9)	(1.0)	(0.9)	(0.2)
Tax paid	\$m 0.0	0.0	0.0	0.0	0.0
Other	\$m 0.0	1.5	0.0	0.0	0.0
Operating cash flow	\$m (16.0)	(13.2)	(5.5)	1.9	13.3
Stay in business capital expenditure	\$m (2.0)	(1.1)	(0.8)	(0.5)	(0.7)
Acquisitions/divestment/other	\$m (0.3)	(0.6)	0.0	0.0	0.0
Investing cash flow	\$m (2.3)	(1.7)	(0.8)	(0.5)	(0.7)
Equity	\$m 0.0	0.0	0.0	0.0	0.0
Increase / (decrease) in borrowings	\$m 14.5	6.6	6.6	0.0	0.0
Dividend/other	\$m 0.0	0.6	0.0	0.0	0.0
Financing cash flow	\$m 14.5	7.2	6.6	0.0	0.0
Free cash flow	\$m (3.8)	(7.7)	0.3	1.4	12.6

Source: Petra Capital

Revising the base; scenario analysis reveals plenty of upside

We have revised down our base case forecasts for Alexium, with revenues down -16% in FY18 to A\$30m and -30% in FY19 to A\$50m. We also pare back GP margins, now forecasting 29% in FY18 (was 40%), 35% in FY19 (41%) and 40% in FY20 (42%).

These changes are reasonably significant and reflect no additional factoring in of potential contract wins. As we note below, we see potential for forecasts to beat this should any major contract wins commence in these areas, or indeed others (e.g. tents, medical gowns).

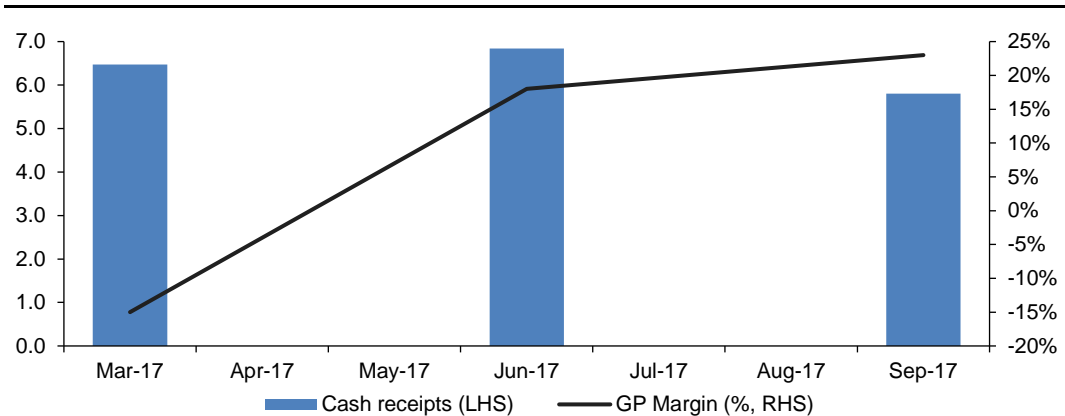
We undertake a detailed scenario analysis further in this note, which shows revenues between A\$63m - \$97m in FY19F and A\$93m - A\$160m in FY20F. We place a reasonably high probability of securing contracts in both bedding and military before the end of 2018. We do not consider these to be a blue sky target and expect to hear further updates on these through Q318.

For FY18, following a weaker than expected Q118 and softer Q218, combining with feedback from the recent roadshow, it appears the target of reaching A\$36m, which would have implied A\$24m in H2 revenues, or +100% y/y growth was too optimistic. Beyond this, the bulk of the changes both on forward looking revenues and margins come about due to the reshaping and refocusing of the business, namely:

- new, but refined sales channels;
- discarding of lower margin customers;
- refinement of the corporate and overhead cost base; and
- **most significantly of all, moving the sales strategy from product push, to customer pull.**

This last point has the most bearing on how this business will look into the future. We can see below the impacts on margin development to date; moving from -15% to +23% in just three quarters. While FY18 may be a transitional year, we do not underestimate the profitable changes Management are making; while we continue to highlight the operating leverage available to this business, as additional revenues drop through to the bottom line.

Figure 1: Quarterly cash receipts (A\$m) vs GP margins (%)



Source: Petra Capital estimates

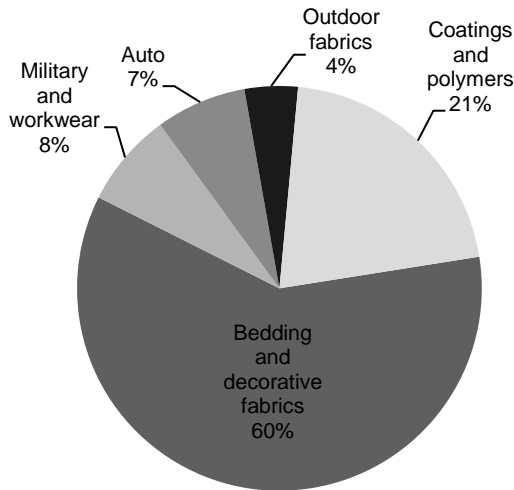
We like where this business is heading; BUY

Teething pains for a business in it's infancy are inevitable, while growth is unlikely to ever continue in a straight line for any business at this stage in their development. However, with a Management team clearly focused on developing a viable product suite, and with sales inroads continuing to be made into growing consumer markets, we remain positive both now and into the longer term. Buy maintained, however our Target Price of A\$0.90 (was A\$1.10) falls on revised forecasts, but still shows a very healthy >100% upside from these levels.

New divisions reflect refocus on sales channels

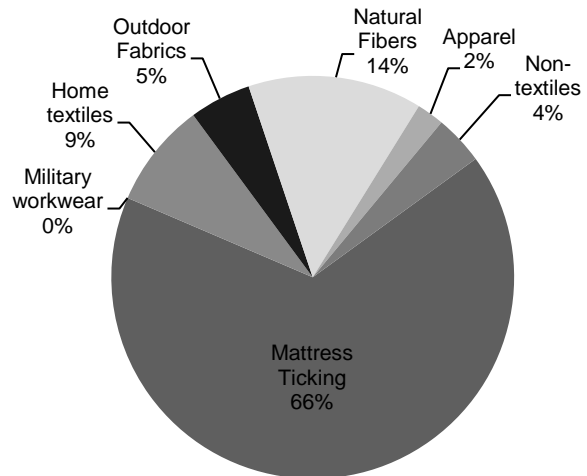
Below we set out the new operating divisions for Alexium. Management have made the decision to refocus their energies towards these 6 areas, again reflecting the sales opportunities in markets they are already selling to.

Figure 2: FY18 Revenue split old



Source: Petra Capital estimates

Figure 3: FY18 Revenue split new



Source: Petra Capital estimates

Changes to forecasts

Below we set out changes to forecasts. Keys include:

- Forecasts reflect organic growth opportunities while no longer including any risk weighting on potential future contracts wins (especially military).
- We reduce SG&A costs below A\$10m in FY18F and FY19F, as reduced staff and admin costs aid profitability.
- Capex costs fall to 1% of sales, down from 2%.
- Working capital investment increases from c8% of sales to 'low teens' percentage on average over the forecast period.
- Cash outflow is expected in Q218, while we expect a cash outflow of -\$0.5m over the full year. In effect, this utilises all of the second working capital facility (US\$5m) plus A\$0.4m of Alexium's remaining cash. This places net debt at A\$10.3m in FY18F.

Figure 4: Changes to forecasts FY18 – FY20F

Year end June	FY18F			FY19F			FY20F		
	New	Old	Chg. %	New	Old	Chg. %	New	Old	Chg. %
Revenue (\$M)	30.1	36.1	(16.5)%	49.9	71.4	(30.1)%	66.2	97.7	(32.2)%
Costs (\$M)	(30.9)	(33.1)	(6.8)%	(42.3)	(55.3)	(23.4)%	(50.6)	(74.6)	(32.1)%
EBITDA (\$M)	(0.7)	3.0	(125.0)%	7.6	16.2	(53.0)%	15.6	23.1	(32.5)%
NPAT (\$M)	(2.9)	1.5	(288.1)%	5.3	14.8	(64.1)%	13.3	22.2	(40.4)%
EPS (¢ps)	(0.9)	0.5	(288.1)%	1.7	4.8	(64.1)%	4.4	7.3	(40.4)%
EPS Growth (%)	76.0%	112.7%	(32.5)%	(287.3%)	882.0%	(132.6)%	150.2%	50.6%	196.8%
PER (x)	(42.6)	69.9	(160.9)%	22.7	7.1	219.1%	9.1	4.7	92.0%
Free Cashflow (\$M)	0.3	6.1	(94.5)%	1.4	0.5	167.6%	12.6	18.9	(33.4)%
FCFPS (¢ps)	0.0	0.0	0.0%	0.0	0.0	167.6%	0.0	0.1	(33.4)%
PFCFPS (x)	355.6	17.1	n/a	85.2	199.1	n/a	9.5	5.6	n/a
Enterprise Value (\$M)	130.7	113.0	15.6%	129.3	102.5	26.2%	116.7	83.6	39.6%
EV / EBITDA (x)	(175.6)	38.0	(562.4)%	17.0	6.3	168.6%	7.5	3.6	106.8%
Payout ratio (%)	0.0	0.0	n/a	0.0	0.0	n/a	0.0	0.0	n/a
Dividends (¢ps)	0.0	0.0	n/a	0.0	0.0	n/a	0.0	0.0	n/a
Yield (%)	0.0	0.0	n/a	0.0	0.0	n/a	0.0	0.0	n/a

Source: Petra capital estimates

Where does the upside come from?

In the table overleaf we provide 3 scenario's for the business. All are achievable, and we place a strong possibility of achieving both scenario's one and two in FY19/20.

- **Scenario 1: Base Case + Bedding**
- **Scenario 2: Base Case + Bedding + Military**
- **Scenario 3: Base Case + Bedding + Military + Alexiflam NF**

We provide some detail around the specifics of each opportunity below.

- **Bedding:** In addition to the current sales of Alexicool, which currently sits at c80t per month, there exists an opportunity to expand these to c400-500t per month with an existing major customer. This would involve an application into a much greater and broader range of products, as the customer looks to internalise its fabric manufacture, in turn necessitating greater control over supply chain (i.e. chemistry).
- **Military:** Alexium has been pursuing a contract with the US military for c7 years. While testing for the Army Combat Uniform (ACU) FR requirement is at an advanced stage (c100k uniforms and annual revenues cUS\$50m) there exists an opportunity to have a lesser level of FR applied to a greater number of uniforms, as the Military looks to provide a minimum level of cover to all troops. This would result in c1.5m uniforms per year being treated with a minimal level of FR chemistry. Alexium management believe they are in a very good position to obtain this contract, with revenue potential US\$40m per annum, with user evaluations scheduled for H218, and potential to commence FY19 (note a 2 year ramp up).
- **Alexiflam NF:** Alexiflam NF is the Company's chemistry for application to Flame Retardant Cotton. With this market cUS\$150-200m in the US alone, there could be a significant opportunity for the company to displace the incumbent producers, Proban (owned by Solvay) and Pyrovatex (owned by Huntsman). Several licensing deals are nearing finalisation and this could lead to additional revenues of US\$5m in FY19F and US\$15m in FY20F.

Our scenario analysis is broken down overleaf at Figure 5.

Figure 5: Scenario analysis

	Base case - current forecasts			Base case + Bedding			Base Case + Bedding + Military			Base Case + Bedding + Military + NF		
	FY18	FY19	FY20	FY18	FY19	FY20	FY18	FY19	FY20	FY18	FY19	FY20
Sales (A\$m)												
Mattress Ticking	20.0	29.5	33.6	20.0	42.9	60.3	20.0	42.9	60.3	20.0	42.9	60.3
Military workwear	0.0	0.0	0.0	0.0	0.0	0.0	0.0	26.7	53.3	0.0	26.7	53.3
Home textiles	2.5	5.1	10.1	2.5	5.1	10.1	2.5	5.1	10.1	2.5	5.1	10.1
Outdoor Fabrics	1.5	3.0	3.3	1.5	3.0	3.3	1.5	3.0	3.3	1.5	3.0	3.3
Natural Fibers	4.2	8.3	12.5	4.2	8.3	12.5	4.2	8.3	12.5	4.2	14.9	25.9
Apparel	0.7	1.3	2.7	0.7	1.3	2.7	0.7	1.3	2.7	0.7	1.3	2.7
Non-textiles	1.2	2.7	4.0	1.2	2.7	4.0	1.2	2.7	4.0	1.2	2.7	4.0
Total Sales (A\$m)	30.1	49.9	66.2	30.1	63.2	92.9	30.1	89.9	146.2	30.1	96.6	159.6
Sales growth y/y (%)	37%	66%	33%	37%	110%	47%	37%	198%	63%	37%	221%	65%
Gross Profit (A\$m)												
Mattress Ticking	6.6	12.1	14.3	6.6	17.6	25.6	6.6	12.1	14.3	6.6	12.1	14.3
Military workwear	0.0	0.0	0.0	0.0	0.0	0.0	0.0	8.0	16.0	0.0	8.0	16.0
Home textiles	0.6	1.5	3.0	0.6	1.5	3.0	0.6	1.5	3.0	0.6	1.5	3.0
Outdoor Fabrics	0.3	0.6	0.7	0.3	0.6	0.7	0.3	0.6	0.7	0.3	0.6	0.7
Natural Fibers	1.1	2.5	5.0	1.1	2.5	5.0	1.1	2.5	5.0	1.1	4.5	10.3
Apparel	0.1	0.3	1.1	0.1	0.3	1.1	0.1	0.3	1.1	0.1	0.3	1.1
Non-textiles	0.1	0.5	1.6	0.1	0.5	1.6	0.1	0.5	1.6	0.1	0.5	1.6
Total Gross Profit (A\$m)	8.7	17.5	25.7	8.7	23.0	37.0	8.7	25.5	41.7	8.7	27.5	47.0
Gross Profit growth y/y (%)	391%	101%	46%		164%	61%		193%	63%		20%	40%
Gross profit margin (%)	29%	35%	39%	29%	36%	40%	29%	28%	28%	29%	28%	29%
S,G&A	(9.5)	(9.9)	(10.1)	(9.5)	(9.9)	(10.1)	(9.5)	(9.9)	(10.1)	(9.5)	(9.9)	(10.1)
EBITDA	(0.7)	7.6	15.6	(0.7)	13.1	26.9	(0.7)	15.6	31.6	(0.7)	17.6	36.9
D&A	(0.4)	(0.5)	(0.5)	(0.4)	(0.5)	(0.5)	(0.4)	(0.5)	(0.5)	(0.4)	(0.5)	(0.5)
EBIT	(1.2)	7.1	15.1	(1.2)	12.6	26.4	(1.2)	15.1	31.1	(1.2)	17.1	36.4
Interest	(1.7)	(1.7)	(1.7)	(1.7)	(1.7)	(1.7)	(1.7)	(1.7)	(1.7)	(1.7)	(1.7)	(1.7)
NPBT	(2.9)	5.4	13.4	(2.9)	10.9	24.7	(2.9)	13.4	29.4	(2.9)	15.4	34.7
Tax (calculated)	0.0	1.6	4.0	0.0	3.3	7.4	0.0	4.0	8.8	0.0	4.6	10.4
Tax losses	26.0	24.4	20.4	26.0	22.7	15.3	26.0	22.0	13.2	26.0	21.4	11.0
Tax paid	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
NPAT	(2.9)	5.4	13.4	(2.9)	10.9	24.7	(2.9)	13.4	29.4	(2.9)	15.4	34.7
Shares on issue	304.6	304.6	304.6	304.6	304.6	304.6	304.6	304.6	304.6	304.6	304.6	304.6
EPS (c)	(0.96)	1.77	4.38	(0.96)	3.57	8.10	(0.96)	4.40	9.64	(0.96)	5.05	11.39
Operating cashflow	(6.3)	1.0	11.7	(6.3)	6.4	23.0	(6.3)	9.0	27.7	(6.3)	11.0	33.0

Source: Petra Capital estimates

Valuation

We value Alexium via an equal weighting of (1) EBIT multiple applied to FY20F earnings, discounted back to today and (2) Discounted Cash Flow (DCF) methodology, which we then round up to \$0.90. We think this is appropriate given:

- the early dated nature of cash flows; and
- long term margin assumptions appear achievable and appropriate rates of return on invested capex are more certain given low capex requirements.

We think it is prudent not to put too much emphasis on one valuation methodology over another. A 100% weighting to either multiples or DCF puts too much risk on key assumptions. This may change overtime as the business moves into steady state growth.

EBIT multiple valuation

We apply an EV/EBIT of 20x (Figure 6) to FY20F earnings, discounting at a cost of equity of 13.4%. Although high, this multiple reflects the still early stage nature of earnings in FY20F.

Figure 6: EBIT multiple based valuation (A\$m)

FY20	
EBIT	15.1
Multiple applied	20.0x
EV	301.8
PLUS: Value of tax losses	26.7
LESS: Net debt (cash)	(3.6)
Equity value	332.1
Present value	258.5
Fully diluted ordinary shares	303.7
Value per share (A\$)	0.85

Source: Petra Capital

DCF analysis

We use explicit forecasts from FY18-FY22F (five years) and then make long term assumptions for five years beyond this period. For our valuation, we assume the following:

- **LT GP margins** of c40% are sustainable (down from 50%). This assumes that performance enhancement remains ongoing, but competitive pressures necessitate price re-investment, while factoring no additional cyclical margin expansion.
- **Long term growth rate** of 3%. This may appear conservative, but given early nature of operations, we think this is appropriate.
- **Capex/sales** of 1% (down from 2%).
- **Working capital/sales** of 'low teens %' (LT, down from 8%).

Which is the right WACC to use?

We calculate a WACC of 11.0% for AJX, higher than a normal industrial business (c10%). We estimate a Beta of 1.35x reflecting higher risk of the current early stage of growth, and utilise a long term risk free rate of 5.25%. This delivers a Cost of Equity of 13.4%. We think both discount rates are reasonable considering (Figure 7):

- early growth nature of the business;
- lack of steady state earnings; and
- higher operating risks at this point in the growth cycle.

Figure 7: DCF summary

A\$m			
Sum of discount streams	67.8	CAPM	
Terminal growth	3.0%	Risk free rate	5.25%
Future value into perpetuity	412.5	Equity beta	1.35x
NPV of terminal value	168.6	Equity risk premium	6.00%
PV of cash flows	236.4		13.4%
		WACC	
PLUS: Value of investments	0.0	Debt	20.0%
PLUS: Value of tax losses	26.7	Equity	80.0%
LESS: Minority interests	0.0	Interest rate	5.0%
LESS: Net debt	(2.8)	Tax rate	30.0%
Equity value	260.2		11.0%
Fully diluted ordinary shares	303.7		
Value per share (A\$)	0.86		

Source: Petra Capital

Figure 8: DCF calculations

A\$m	FY18F	FY19F	FY20F	FY21F	2022	2023	2024	2025
EBIT	(1.2)	7.1	15.1	19.1	24.5	30.3	36.6	42.2
Interest	(1.7)	(1.8)	(1.8)	(0.3)	(0.2)	(0.2)	(0.2)	(0.2)
Profit before tax	(2.9)	5.3	13.3	18.8	24.3	30.1	36.3	42.0
Tax at standard rate	0.9	(1.6)	(4.0)	(5.6)	(7.3)	(9.0)	(10.9)	(12.6)
Post-tax EBIT	(0.3)	5.5	11.1	13.5	17.2	21.3	25.7	29.6
D&A	(0.4)	(0.5)	(0.5)	(0.5)	(0.6)	(0.6)	(0.7)	(0.8)
Post-tax cash flow	0.1	6.0	11.6	14.0	17.8	21.9	26.4	30.4
Less capex	(0.8)	(0.5)	(0.7)	(0.8)	(0.9)	(1.1)	(1.3)	(1.4)
Less working capital	(3.8)	(4.8)	(2.1)	(1.4)	(2.3)	(2.4)	(2.2)	(2.2)
Provisions/other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Acquisitions/disposals	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Free cash flow	(4.4)	0.7	8.9	11.8	14.6	18.4	22.9	26.7
Discounted cash flow	(4.2)	0.6	6.8	8.2	9.1	10.3	11.5	12.1

Source: Petra Capital

Enterprise value

Figure 9: Enterprise value calculations (A\$m)

A\$m	2017	2018	2019	2020	2021	2022	2023	2024
Market Capitalisation	120.3	120.3	120.3	120.3	120.3	120.3	120.3	120.3
Net Debt (cash)	2.8	10.3	9.0	(3.6)	(20.9)	(49.9)	(69.0)	(92.8)
Less: provisions	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Less: surplus assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Enterprise value	123.2	130.7	129.3	116.7	99.4	70.4	51.3	27.5
Key metrics								
EV/EBITDA	(11.0)x	(176)x	17.0x	7.5x	5.1x	2.8x	1.7x	0.7x
EV/EBIT	(10.6)x	(110.8)x	18.1x	7.7x	5.2x	2.9x	1.7x	0.8x
P/E	(9.9)x	(41.3)x	22.7x	9.1x	6.4x	3.7x	5.7x	4.7x
FCF Yield (maint)	(13.3)%	(5.6)%	0.4%	9.3%	14.5%	24.5%	14.5%	29.3%
FCF Yield	(12.9)%	(5.9)%	0.4%	9.1%	14.3%	24.1%	15.9%	28.4%
Net Debt/EBITDA	(0.3)x	(13.9)x	1.2x	(0.2)x	(1.1)x	(2.0)x	(2.2)x	(2.5)x

Source: Petra Capital



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