

Alexium International Group Ltd

Buy

1H17 result in-line, we are more cautious on future gross profit margins

Materials / Diversified Chemicals

27 February 2017

Company Update

Ticker	AJX AU
Stock Price	\$0.650
Target Price	\$1.000
Forecast Capital Return	53.8%
Forecast Dividend Yield	0.0%
Estimated Total Return - 12 Mth Forward	53.8%

Company market data

Market Cap.	\$194.2m
Free Float (%)	42.9
Enterprise Value	\$185.2m
52 Week Range	\$0.48 - \$0.87
Shares Out.	298.7m
Avg. Daily Value	\$0.4m

Estimates changes	2016a	2017e	2018e	2019e
Core NPAT - old	(15.4)	(6.5)	1.7	4.9
Core NPAT - new	(15.4)	(9.8)	0.2	5.0
% Change	0.0	52.3	(87.2)	2.2
Core EPS dil. (€) - old	(5.5)	(2.2)	0.6	1.7
Core EPS dil. (€) - new	(5.5)	(3.3)	0.1	1.7
% Change	0.0	50.8	(87.3)	1.2
DPS (€) - old	0.0	0.0	0.0	0.0
DPS (€) - new	0.0	0.0	0.0	0.0
% Change	-	-	-	-

All figures are in AUD unless otherwise specified.

Share price performance

Alexium International Group Ltd vs. AS52 (rebased index)



Analyst

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Event

AJX reported 1H17 sales of \$11.2m, a 10-fold increase on the pcp and in-line with Moelis' estimate of \$11m. Key highlights:

- 1H17 net loss was \$5.8m, down from \$9m on the pcp. AJX attributed the improvement in the bottom line to increased sales revenue and improved margins on customer orders.
- 1H17 gross profit was \$0.1m, up from -\$0.1m on the pcp. This represents a margin of 0.9%. The improvement in margin was due to infrastructure, supply chain systems and purchasing strategy implemented during 2016. AJX noted that as its scale increases, the company is able to buy raw materials in bulk and shipping costs have reduced. The gross profit margin on new specialty chemistry sales since the beginning of CY17 has exceeded 30% and over the course of 2017 AJX is forecasting average gross profit across all product lines to exceed 40%. We prefer to take a more cautious approach and have estimated 30% gross profit margins in 2H FY17 and 35% profit margins in 1H FY18. We note that our estimates still represent a significant step-up in margins.
- Due to the steady flow of customer orders and shortened debtor terms, AJX was able to secure a debt facility to purchase inventory, hence there is no requirement to raise capital to fund AJX's projects to meet customers' order needs. The company expects it will be cash neutral within 2Q CY17 (Moelis estimates positive cash flow from operations in 1H FY18).

Impact

We have decreased our FY17, FY18 and FY19 estimates on a more cautious outlook on gross profit margins. We still estimate that AJX will be NPAT breakeven in FY18.

Investment View

We view AJX as a strategic investment leveraging increased scrutiny on stringent fire safety regulations and banning of toxic and harmful chemicals in traditional brominated and halogenated flame retardant products.

Y/E Jun 30	2016a	2017e	2018e	2019e
EBITDA	(15.3)	(9.6)	0.8	7.6
EV/EBITDA	nm	nm	219.2x	24.3x
Core NPAT	(15.4)	(9.8)	0.2	5.0
Core EPS (Diluted) (€)	(5.5)	(3.3)	0.1	1.7
P/E	nm	nm	876.2x	38.7x
EPS growth	87.2%	(40.7%)	(102.3%)	2,163.7%
DPS (€)	0.0	0.0	0.0	0.0
Yield	0.0%	0.0%	0.0%	0.0%
DPS growth	-	-	-	-
Dividend Payout Ratio	0.0%	0.0%	0.0%	0.0%

All figures are in AUD.

## Significant acceleration of revenue

Figure 1: AJX - Income Statement

A\$m	1H16A	FY16A	FY16A	Moelis estimates				
				1H17A	2H17E	FY17E	FY18E	FY19E
Total Sales	1.0	2.2	3.2	11.2	19.3	30.5	51.7	70.5
Grant income	0.3	0.0	0.3	0.2	0.0	0.2	0.2	0.2
<b>Total revenue</b>	<b>1.2</b>	<b>2.2</b>	<b>3.4</b>	<b>11.4</b>	<b>19.3</b>	<b>30.7</b>	<b>51.9</b>	<b>70.7</b>
Gross Profit	(0.1)	(0.1)	(0.2)	0.1	5.8	5.9	18.1	24.7
<i>GP Margin</i>	-7%	-6%	-6%	1%	30%	19%	35%	35%
<b>EBITDA</b>	<b>(8.9)</b>	<b>(6.4)</b>	<b>(15.3)</b>	<b>(5.7)</b>	<b>(3.9)</b>	<b>(9.6)</b>	<b>0.8</b>	<b>7.6</b>
<i>EBITDA to Sales Margin</i>	-918%	-290%	-483%	-51%	-20%	-31%	2%	11%
D & A	(0.1)	(0.1)	(0.2)	(0.1)	(0.1)	(0.3)	(0.5)	(0.5)
<b>EBIT</b>	<b>(9.0)</b>	<b>(6.5)</b>	<b>(15.5)</b>	<b>(5.8)</b>	<b>(4.0)</b>	<b>(9.8)</b>	<b>0.3</b>	<b>7.2</b>
<i>% chg</i>	264%	61%	139%	-36%	-38%	-36%	-103%	2216%
Net interest income/(expense)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Less income tax	0.0	0.0	0.0	0.0	0.0	0.0	(0.1)	(2.2)
<b>NPAT Underlying</b>	<b>(9.0)</b>	<b>(6.4)</b>	<b>(15.4)</b>	<b>(5.8)</b>	<b>(4.0)</b>	<b>(9.8)</b>	<b>0.2</b>	<b>5.0</b>

Source: Company, Moelis Analysis

The \$11.2m in 1H FY17 sales represents a significant acceleration of customer orders. We estimate this acceleration to continue into 2H FY17, factoring in 72.5% growth in 2H FY17 revenue vs. 1H FY17 revenue. This estimate is predicated on AJX continuing to ramp up its existing contracts to full scale production and winning additional contracts.

AJX's 1H FY17 gross profit margin was well below our estimate at only 1%, however, not unexpected given the business is still in early commercialisation phase. It was pleasing to note that AJX said the gross profit margin on new specialty chemistry sales since the beginning of 2017 has exceeded 30%. It has guided to gross profit margins exceeding 40% over the course of 2017 as more product lines achieve the same economies of scale. We prefer to be more cautious in our estimates, factoring in a 30% gross profit margin in 2H FY17 and 35% gross profit margin in 1H FY18, these margins, whilst below AJX's guidance, still represents significant margin expansion.

## Debt facility secured to fund inventory

Figure 2: AJZ - Balance sheet

A\$m	1H16A	2H16	FY16A	1H17A	2H17E	FY17E	FY18E	FY19E
Cash	10.2	11.2	11.2	12.4	12.1	12.1	12.1	18.5
Receivables	0.1	0.2	0.2	2.3	4.1	4.1	5.9	7.9
Other Current Assets	0.5	1.7	1.7	2.2	1.7	1.7	1.7	1.7
PP&E	0.5	0.8	0.8	2.8	3.2	3.2	4.2	5.8
Other Non-Current Assets	0.3	0.2	0.2	0.3	0.3	0.3	0.3	0.3
<b>Total Assets</b>	<b>11.6</b>	<b>14.2</b>	<b>14.2</b>	<b>19.9</b>	<b>21.4</b>	<b>21.4</b>	<b>24.2</b>	<b>34.3</b>
Payables	0.6	2.8	2.8	5.9	10.2	10.2	14.8	19.8
Other Current Liabilities	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Long term borrowings	0.0	0.0	0.0	5.6	8.1	8.1	6.1	6.1
Other Non-current Liabilities	0.0	0.0	0.0	1.7	0.0	0.0	0.0	0.0
<b>Total Liabilities</b>	<b>0.7</b>	<b>2.9</b>	<b>2.9</b>	<b>13.3</b>	<b>18.4</b>	<b>18.4</b>	<b>21.0</b>	<b>26.0</b>
<b>Net Assets</b>	<b>10.9</b>	<b>11.3</b>	<b>11.3</b>	<b>6.6</b>	<b>3.0</b>	<b>3.0</b>	<b>3.2</b>	<b>8.2</b>
<b>Net debt / (cash)</b>	<b>(10.2)</b>	<b>(11.2)</b>	<b>(11.2)</b>	<b>(6.8)</b>	<b>(4.0)</b>	<b>(4.0)</b>	<b>(6.0)</b>	<b>(12.4)</b>

Source: Company, Moelis Analysis

AJX has utilised a debt facility to purchase inventory, reducing the risk of a capital raise to fund its projects to meet customers' needs. Our view is that AJX will continue to utilise this debt facility as it ramps up its commercial operations, reducing the company's net cash position to \$4m by the end of FY17.

**Figure 3: AJX - key cash flow items**

A\$m	1H16A	2H16	FY16A	1H17A	2H17E	FY17E	FY18E	FY19E
Operating cash flow	(5.4)	(4.7)	(10.1)	(4.5)	(1.5)	(6.0)	3.5	8.5
Capex	(0.1)	(0.1)	(0.2)	(1.6)	(0.6)	(2.2)	(1.5)	(2.1)
Free cash flow	(5.5)	(4.8)	(10.3)	(6.1)	(2.1)	(8.2)	2.0	6.4

Source: Company, Moelis Analysis

AJX had ~\$1m of positive working capital in 1H FY17 and the company expects to be cash neutral in 2Q CY17. Our estimates are more cautious with AJX generating positive operating cash flow and free cash flow in FY18. Our positive free cash flow assumption is predicated on capex spend in FY17 as "one-off" in nature due to the new facility in Greer, however, as sales increase in a commercial level in FY19, we have capex increasing to over \$2m.

## Changes to estimates

We have increased our revenue assumptions but reduced our gross profit margins in FY17, FY18 and FY19. The net impact of these changes is detailed in the table below.

**Figure 4: Changes to estimates**

A\$m	Old	New	% chg
<b>FY17E</b>			
Revenue	30.6	30.5	-0.3%
EBITDA	(6.2)	(9.6)	-54.1%
EBIT	(6.5)	(9.8)	-51.4%
NPAT	(6.5)	(9.8)	-51.2%
<b>FY18E</b>			
Revenue	47.8	51.7	8.2%
EBITDA	2.9	0.8	-70.9%
EBIT	2.4	0.3	-86.9%
NPAT	1.7	0.2	-86.9%
<b>FY19E</b>			
Revenue	62.0	70.5	13.8%
EBITDA	7.4	7.6	3.3%
EBIT	7.0	7.2	2.7%
NPAT	4.9	5.0	1.9%

Source: Company, Moelis Analysis

Profit and Loss (\$m)	2015a	2016a	2017e	2018e	2019e
<b>Revenue</b>	<b>0.1</b>	<b>3.2</b>	<b>30.5</b>	<b>51.7</b>	<b>70.5</b>
<i>Growth</i>	(75.6%)	5,241.6%	864.8%	69.4%	36.4%
<b>EBITDA</b>	<b>(6.4)</b>	<b>(15.3)</b>	<b>(9.6)</b>	<b>0.8</b>	<b>7.6</b>
<i>Growth</i>	132.8%	140.4%	(37.5%)	(108.8%)	802.7%
Dep'n & Amort	(0.1)	(0.2)	(0.3)	(0.5)	(0.5)
<b>EBIT</b>	<b>(6.5)</b>	<b>(15.5)</b>	<b>(9.8)</b>	<b>0.3</b>	<b>7.2</b>
<i>Growth</i>	128.7%	138.5%	(36.5%)	(103.1%)	2,216.1%
Net Interest Expense	(0.4)	0.0	0.0	0.0	0.0
<b>Profit Before Tax</b>	<b>(6.9)</b>	<b>(15.4)</b>	<b>(9.8)</b>	<b>0.3</b>	<b>7.2</b>
Tax	0.0	0.0	0.0	(0.1)	(2.1)
<i>Tax Rate (%)</i>	0.0%	0.0%	0.0%	30.0%	30.0%
Minorities	0.0	0.0	0.0	0.0	0.0
<b>NPAT (Underlying)</b>	<b>(6.9)</b>	<b>(15.4)</b>	<b>(9.8)</b>	<b>0.2</b>	<b>5.0</b>
<i>Growth</i>	106.9%	125.0%	(36.4%)	(102.3%)	2,163.7%
One-Off Items	(4.9)	0.0	0.0	0.0	0.0
<b>NPAT (Reported)</b>	<b>(11.8)</b>	<b>(15.4)</b>	<b>(9.8)</b>	<b>0.2</b>	<b>5.0</b>
<b>EPS (Underlying) (€)</b>	<b>(3.0)</b>	<b>(5.5)</b>	<b>(3.3)</b>	<b>0.1</b>	<b>1.7</b>
<i>Growth</i>	56.8%	87.2%	(40.7%)	(102.3%)	2,163.7%

Balance Sheet (\$m)	2015a	2016a	2017e	2018e	2019e
Cash	11.6	11.2	12.1	12.1	18.5
Inventory	0.0	0.0	0.0	0.0	0.0
Current Receivables	0.1	0.2	4.1	5.9	7.9
PPE	0.4	0.8	3.2	4.2	5.8
Intangibles	0.2	0.1	0.2	0.2	0.2
Other	0.3	1.8	1.8	1.8	1.8
<b>Total Assets</b>	<b>12.6</b>	<b>14.2</b>	<b>21.3</b>	<b>24.1</b>	<b>34.2</b>
Current Payables	0.6	2.8	10.2	14.8	19.8
ST Debt	0.0	0.0	0.0	0.0	0.0
LT Debt	0.0	0.0	8.1	6.1	6.1
Provisions	0.1	0.1	0.1	0.1	0.1
Other	0.1	0.0	0.0	0.0	0.0
<b>Total Liabilities</b>	<b>0.8</b>	<b>2.9</b>	<b>18.4</b>	<b>21.0</b>	<b>26.0</b>
<b>Net Assets</b>	<b>11.8</b>	<b>11.3</b>	<b>2.9</b>	<b>3.1</b>	<b>8.1</b>
Equity & Reserves	45.8	60.7	62.2	62.2	62.2
Retained Profits	(34.0)	(49.4)	(59.2)	(59.0)	(54.0)
<b>Shareholders' Equity</b>	<b>11.8</b>	<b>11.3</b>	<b>2.9</b>	<b>3.1</b>	<b>8.2</b>
Minorities	0.0	0.0	0.0	0.0	0.0
<b>Total Equity</b>	<b>11.8</b>	<b>11.3</b>	<b>2.9</b>	<b>3.1</b>	<b>8.2</b>

Cashflow (\$m)	2015a	2016a	2017e	2018e	2019e
EBITDA	(6.4)	(15.3)	(9.6)	0.8	7.6
Net Interest	(0.1)	0.0	0.0	0.0	0.0
Tax	0.0	0.1	0.0	(0.1)	(2.1)
Δ in Working Capital	(6.5)	(15.5)	3.5	2.8	3.0
Other	8.6	20.6	0.0	0.0	0.0
<b>Operating Cash Flow</b>	<b>(4.3)</b>	<b>(10.1)</b>	<b>(6.0)</b>	<b>3.5</b>	<b>8.5</b>
<i>Growth</i>	38.7%	136.0%	(40.5%)	(158.7%)	141.8%
Capex	(0.1)	(0.2)	(2.2)	(1.5)	(2.1)
Acquisitions	0.0	0.0	0.0	0.0	0.0
Divestments	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0
<b>Investing Cash Flow</b>	<b>(0.1)</b>	<b>(0.2)</b>	<b>(2.2)</b>	<b>(1.5)</b>	<b>(2.1)</b>
Equity Raised	11.9	9.5	0.0	0.0	0.0
Dividends Paid	0.0	0.0	0.0	0.0	0.0
Net Borrowings	(0.8)	0.0	9.1	(2.0)	0.0
Other	0.0	0.0	0.0	0.0	0.0
<b>Financing Cash Flow</b>	<b>11.1</b>	<b>9.5</b>	<b>9.1</b>	<b>(2.0)</b>	<b>0.0</b>
FX / Non Cash Items	0.7	0.4	0.0	0.0	0.0
<b>Change in Cash</b>	<b>7.4</b>	<b>(0.4)</b>	<b>0.9</b>	<b>0.0</b>	<b>6.4</b>
<b>Free Cash Flow</b>	<b>(4.4)</b>	<b>(10.3)</b>	<b>(8.2)</b>	<b>2.0</b>	<b>6.4</b>

Valuation Summary	
Current Mkt Capitalisation	194.2
Shares on Issue	298.7
Last Price	0.650
<b>12 Mth Target Price</b>	<b>1.000</b>
Total Estimated 12 Mth Return	53.8%
12 Mth Fwd Capital Return	53.8%
12 Mth Fwd Dividend Yield	0.0%

Valuation Ratios	2015a	2016a	2017e	2018e	2019e
<b>EPS (Underlying) (€)</b>	<b>(3.0)</b>	<b>(5.5)</b>	<b>(3.3)</b>	<b>0.1</b>	<b>1.7</b>
<i>Growth</i>	56.8%	87.2%	(40.7%)	(102.3%)	2,163.7%
<b>P/E (x)</b>	<b>nm</b>	<b>nm</b>	<b>nm</b>	<b>876.2x</b>	<b>38.7x</b>
Small Industrials (ex Fin's)	0.0x	17.3x	15.3x	13.6x	12.9x
Premium / (Discount)	nm	nm	nm	6,338.0%	199.4%
<b>EV/EBITDA (x)</b>	<b>nm</b>	<b>nm</b>	<b>nm</b>	<b>219.2x</b>	<b>24.3x</b>
Small Industrials (ex Fin's)	0.0x	22.4x	10.8x	9.8x	8.8x
Premium / (Discount)	nm	nm	nm	2,142.1%	174.4%
<b>DPS (€)</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
<i>Growth</i>	-	-	-	-	-
Yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%
Payout Ratio (%)	0.0%	0.0%	0.0%	0.0%	0.0%
Franking (%)	0.0%	0.0%	0.0%	0.0%	0.0%
NTA	11.6	11.1	2.8	3.0	8.0
NTA/Share (\$)	0.05	0.04	0.01	0.01	0.03

Performance Ratios	2015a	2016a	2017e	2018e	2019e
ROA	(54.4%)	(109.1%)	(46.1%)	0.9%	14.7%
ROE	(58.1%)	(137.1%)	(337.5%)	7.1%	61.5%
ROIC	(3,505.7%)	(31,626.8%)	880.6%	(7.5%)	(117.6%)
Net Debt (Cash) (\$m)	(11.6)	(11.2)	(4.0)	(6.0)	(12.4)
Net Debt/EBITDA (x)	1.8x	0.7x	0.4x	(7.1x)	(1.6x)
ND/(ND + Equity) (%)	(6,274.0%)	(22,907.2%)	360.6%	209.2%	291.3%
Interest Cover (x)	(15.1x)	(351.8x)	(384.9x)	10.8x	232.2x
Working Capital	(0.5)	(0.9)	(4.5)	(7.2)	(10.3)
Working Capital/Sales (%)	(882.0%)	(29.6%)	(14.7%)	(14.0%)	(14.6%)

Cash Flow Metrics	2015a	2016a	2017e	2018e	2019e
<b>FCF/Share (\$)</b>	<b>(0.02)</b>	<b>(0.04)</b>	<b>(0.03)</b>	<b>0.01</b>	<b>0.02</b>
Price/FCPS (x)	nm	nm	nm	98.4x	30.3x
Free Cash Flow Yield (%)	(2.9%)	(5.7%)	(4.2%)	1.0%	3.3%
Gross Cash Conversion	0.0%	66.4%	62.7%	429.4%	140.0%
Capex/Sales (%)	(199.5%)	(6.6%)	(7.1%)	(3.0%)	(3.0%)
Capex/Depreciation (x)	0.9x	1.0x	7.6x	2.9x	4.5x

Margins	2015a	2016a	2017e	2018e	2019e
EBITDA	(10,743.7%)	(483.4%)	(31.3%)	1.6%	10.8%
EBIT	(10,970.9%)	(489.9%)	(32.3%)	0.6%	10.1%
NPAT	(11,595.1%)	(488.5%)	(32.2%)	0.4%	7.1%

Valuation Methodology	
WACC (%)	10.9%
Discounted Cash Flow Valuation	0.852
Sum-of-the-Parts Valuation	0.000
Average Valuation	0.852
<b>12 Mth Target Price</b>	<b>1.000</b>

## RESEARCH &amp; SALES RESPONSIBILITIES

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**DISCLOSURE APPENDIX****ANALYST CERTIFICATION**

The Analyst, Olivia Bible, responsible for the content of this research report, in whole or in part, certifies that with respect to the companies or securities that the individual analyses, that (1) the views expressed in this report accurately reflect his or her personal views on the subject companies and securities, and (2) no part of his or her compensation was, is, or will be directly or indirectly linked to the specific recommendations or views expressed in this research report.

**COMPANY SPECIFIC DISCLOSURES**

Our related body corporate Moelis Australia Advisory Pty Ltd (ACN 142 008 446 AFSL 345499) ("Moelis Advisory") was appointed as Bookrunner by the Alexium International Group Ltd (AJX AU) for a capital raising as announced to ASX on 14 April 2016 for which Moelis Advisory received compensation.

**RATING DEFINITIONS**

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**Buy:** >15% **Hold:** 5% to 15% **Sell:** <5%.

**RATINGS DISTRIBUTION TABLE****Distribution of Ratings as at 27 February 2017**

<b>SELL</b>	<b>HOLD</b>	<b>BUY</b>
0.0%	34.4%	65.6%

**Rating and Price Target History: Alexium International Group Ltd (AJX AU) as of 27/02/2017****GENERAL TERMS OF USE FOR MOELIS RESEARCH REPORTS**

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