

1 September 2017

Alexium International (AJX)

BUY

Share Price: A\$0.46

All fired up

Target Price: A\$1.10

Following FY17 results, the business is substantially more de-risked in our view. Gross Margin development was exceptional, moving from negative at March '17 to +30% by June and now c40% by Q118, putting the company on a solid footing to generate cash and profits through FY18. Trading at just 9.5x FY19F represents a compelling entry point for investors. Existing products are gaining market shares (Alexicool), Alexiflam NF comes online in Q118 and upside remains in potential military contracts (H119) and further penetration of apparel, bedding, coatings and electronics markets. As the company continues to focus its efforts towards profitable revenues streams, and discards some customers where margins are sub-optimal, we cut FY18F revenues by c20%. However due to the improved GP margin, profit and cash flows remain intact. Our PT remains A\$1.10, and we remain a Buyer, seeing compelling upside from these levels.

Key takeaways from FY17 results

- GP margin development impressive, moving from -1% in H117, +6% in April to c40% in Q118.
- Operating costs down -26% in FY17, as administration costs fall -60%.
- Working capital outflows rose considerably (with revenue growth) to -\$2.6m, from -\$0.5m; new debt facility extended by US\$5m, now US\$15m in total.

Changes to forecasts

- We reduce FY18F revenues to A\$36m, down -20%. This is due to the change in strategy and discarding of non-profitable revenue streams.
- GP margins lift in FY18 to +40% from +39%.
- EBITDA lifts to A\$3m (from \$2.7m) in FY18, delivering net profit of A\$1.9m.
- This produces EPS of 0.5cps in FY18F and 4.8cps in FY19F.

Valuation

- Our target price remains A\$1.10 despite revised forecasts.
- Our methodology remains the same, an equal blend of DCF and FY20 EBIT multiple, discounted to today.
- The stock is cheap, trading at P/E of 9.5x FY19E.
- Buy maintained, over 100% upside from here.

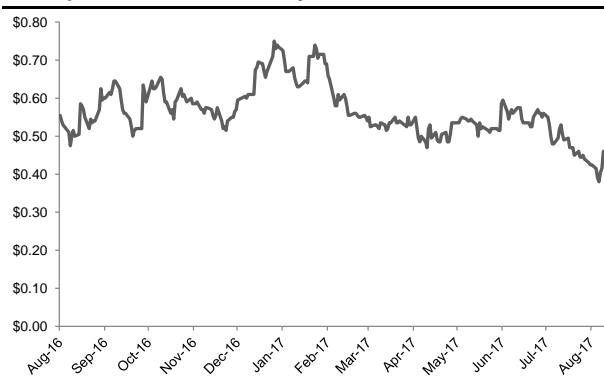
Company Data

Shares – ordinary (M)	304.6
Dilution (M)	9.1
Total (fully diluted) (M)	313.7
Market capitalisation (\$M)	140.1
12 month low/high (\$)	37.5 / 90.5
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	36.1	71.4	97.7
Costs (\$M)	(18.5)	(35.2)	(33.1)	(55.3)	(74.6)
EBITDA (\$M)	(15.5)	(11.2)	3.0	16.2	23.1
NPAT (\$M)	(15.7)	(12.2)	1.5	14.8	22.2
EPS (¢ps)	(5.0)	(3.9)	0.5	4.8	7.3
EPS Growth (%)	n/a	22.5%	112.7%	882.0%	50.6%
PER (x)	(9.2)	(11.9)	93.2	9.5	6.3
Free Cashflow (\$M)	(3.8)	(7.7)	6.1	0.5	18.9
FCFPS (¢ps)	(0.0)	(0.0)	0.0	0.0	0.1
PFCFPS (x)	nm	nm	22.8	265.5	7.4
Enterprise Value (\$M)	128.9	143.0	148.1	137.5	118.6
EV / EBITDA (x)	(8.3)	(12.8)	49.7	8.5	5.1
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	\$ 0.46
Price target (12-month)	\$ 1.10
52 week high / low	\$ 0.38 - 0.90
Market capitalisation (fully diluted)	\$m 140.1
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)	1.5	14.8	22.2
NPAT normalised	\$m	(15.7)	(12.2)	1.5	14.8	22.2
Reported EPS (undiluted)	¢	(5.0)	(3.9)	0.5	4.7	7.1
EPS normalised (undiluted)	¢	(5.0)	(3.9)	0.5	4.8	7.3
...Growth	%	n/a	23%	113%	882%	51%
PER normalised/undiluted	x	(9.2)	(11.9)	93.2	9.5	6.3
Operating cash flow per share	¢	(0.1)	(0.0)	(0.0)	0.0	0.1
Free cash flow per share	¢	(0.0)	(0.0)	0.0	0.0	0.1
Price to free cash flow per share	x	nm	nm	22.8	265.5	7.4
FCF yield	%	(2.7%)	(5.5%)	4.4%	0.4%	13.5%
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	128.9	143.0	148.1	137.5	118.6
EV/EBITDA	x	(8.3)	(12.8)	49.7	8.5	5.1
EV/EBIT	x	(8.2)	(12.4)	58.5	8.8	5.3
Price to book (NAV)	x	12.4	638.5	26.6	7.0	3.3
Price to NTA	x	12.6	3,447.7	98.1	8.7	3.6

KEY RATIOS		FY16	FY17	FY18F	FY19F	FY20F
EBITDA margin	%	nm	nm	8.2%	22.6%	23.6%
EBIT margin	%	nm	nm	7.0%	21.9%	23.0%
NPAT margin	%	nm	nm	4.3%	20.7%	22.8%
ROE	%	nm	nm	29.4%	73.7%	52.6%
ROA	%	nm	nm	6.1%	30.4%	28.5%
Net tangible assets per share	¢	0.0	0.0	0.1	0.1	0.2
Net debt / (cash)	\$m	(11.2)	2.8	7.9	(2.6)	(21.5)
Interest cover (EBIT / net interest)	x	nm	19.8	(2.6)	(17.7)	(98.9)
Gearing (net debt / EBITDA)	x	0.7	nm	2.7	nm	nm
Leverage (net debt / (net debt + equity))	x	nm	0.9	0.6	nm	nm

DUPONT ANALYSIS		FY16	FY17	FY18F	FY19F	FY20F
Net Profit Margin	%	(522.9)	(50.6)	4.3	20.7	22.8
Asset Turnover	x	0	2.5	0.9	1.4	1.2
Return on Assets	%	(111)	(126.0)	3.8	28.7	28.3
Financial Leverage	x	1.3	44.0	7.8	2.6	1.9
Return on Equity	%	(139)	(5,538.4)	29.4	73.7	52.6

INTERIM SUMMARY	
Total revenue	\$M
Operating expenses	\$M
EBITDA	\$M
Depreciation & amortisation	\$M
EBIT	\$M
Net interest	\$M
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	36.1	71.4	97.7
Costs (COGS & opex)	\$m	(18.5)	(35.2)	(33.1)	(55.3)	(74.6)
EBITDA	\$m	(15.5)	(11.2)	3.0	16.2	23.1
Depreciation & amortisation	\$m	(0.2)	(0.4)	(0.4)	(0.5)	(0.6)
EBIT	\$m	(15.7)	(11.6)	2.5	15.6	22.5
Net interest	\$m	0.0	(0.6)	(1.0)	(0.9)	(0.2)
Non-operating income	\$m	0.0	0.0	0.0	0.0	0.0
Pretax Profit	\$m	(15.7)	(12.2)	1.5	14.8	22.2
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)	1.5	14.8	22.2
Significant items	\$m	0.0	0.0	0.0	0.0	0.0
Reported NPAT	\$m	(15.7)	(12.2)	1.5	14.8	22.2

GROWTH PROFILE		FY16	FY17	FY18F	FY19F	FY20F
Operating revenue	%	n/a	700.8	50.2	97.9	36.7
EBITDA	%	n/a	90.6	(6.0)	66.9	34.9
EBIT	%	n/a	26.3	121.9	518.4	43.6
Operating NPAT	%	n/a	22.5	112.7	853.6	50.6
Normalised EPS	%	n/a	22.5	112.7	882.0	50.6
DPS	%	n/a	n/a	n/a	n/a	n/a

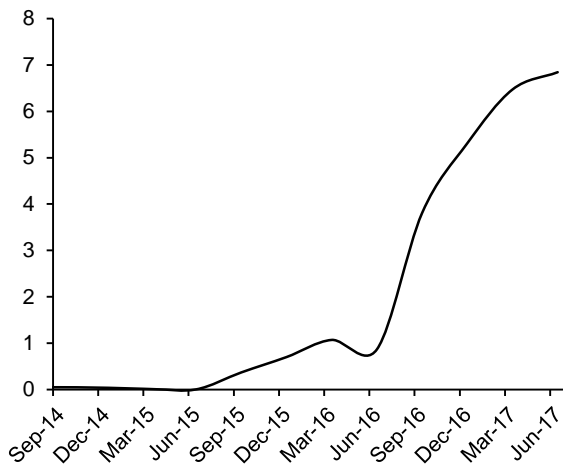
BALANCE SHEET		FY16	FY17	FY18F	FY19F	FY20F
Cash/(overdraft)	\$m	11.2	3.4	9.1	9.6	28.6
Receivables	\$m	0.2	1.4	4.0	5.7	7.8
Inventory	\$m	1.7	2.1	4.5	7.1	8.8
Other	\$m	0.1	0.1	0.1	0.1	0.1
Current	\$m	13.2	7.0	17.7	22.6	45.3
Prop, plant & equip	\$m	0.8	2.4	2.9	3.1	3.4
Other	\$m	0.2	0.2	20.6	25.8	30.0
Non current	\$m	1.0	2.6	23.5	28.9	33.4
Total assets	\$m	14.2	9.7	41.1	51.5	78.7
Accounts Payable	\$m	2.8	1.8	1.8	2.1	2.9
Borrowings	\$m	0.0	6.2	17.0	7.0	7.0
Other	\$m	0.1	1.4	0.3	0.3	0.3
Total liabilities	\$m	2.9	9.4	19.1	9.5	10.2
Net assets	\$m	11.3	0.2	22.0	42.0	68.4
Equity	\$m	51.6	52.8	52.8	52.8	52.8
Retained earnings/other	\$m	(40.4)	(52.6)	(47.6)	(32.8)	(10.6)
Shareholder's equity	\$m	11.3	0.2	5.3	20.0	42.3

CASH FLOW		FY16	FY17	FY18F	FY19F	FY20F
EBITDA	\$m	(15.5)	(11.2)	3.0	16.2	23.1
Change in provisions	\$m	0.0	0.0	0.0	0.0	0.0
Change in working capital	\$m	(0.5)	(2.6)	(5.0)	(4.0)	(3.0)
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)	(3.0)	11.2	19.9
Stay in business capital expenditure	\$m	(2.0)	(1.1)	(0.9)	(0.7)	(1.0)
Acquisitions/divestment/other	\$m	(0.3)	(0.6)	0.0	0.0	0.0
Investing cash flow	\$m	(2.3)	(1.7)	(0.9)	(0.7)	(1.0)
Equity	\$m	0.0	0.0	0.0	0.0	0.0
Increase / (decrease) in borrowings	\$m	14.5	6.6	10.0	(10.0)	0.0
Dividend/other	\$m	0.0	0.6	0.0	0.0	0.0
Financing cash flow	\$m	14.5	7.2	10.0	(10.0)	0.0
Free cash flow	\$m	(3.8)	(7.7)	6.1	0.5	18.9

Source: Petra Capital, Company data

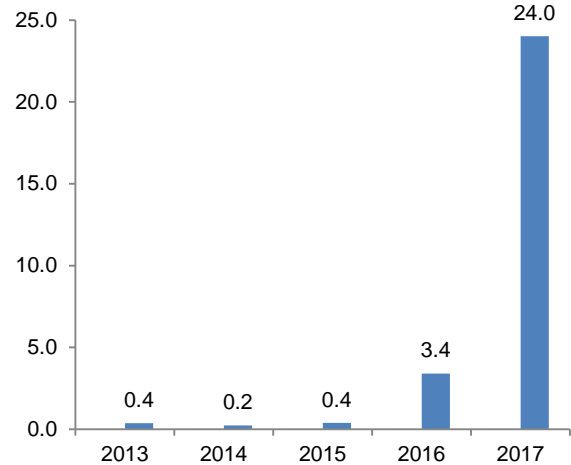
The keys to FY17 results

Figure 1: Quarterly revenues to Jun'17 (A\$m)



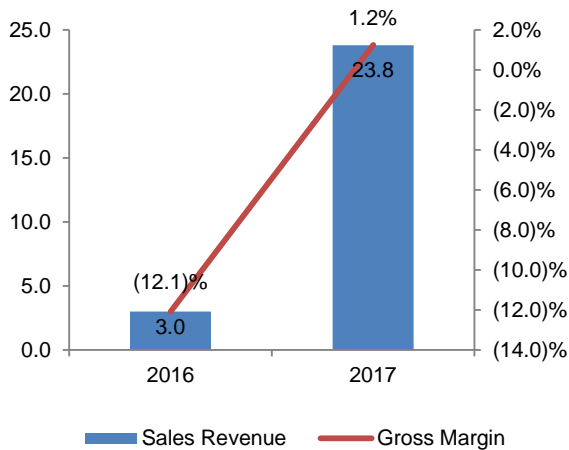
Source: Company data, Petra Capital

Figure 2: 5 year revenue trend (A\$m)



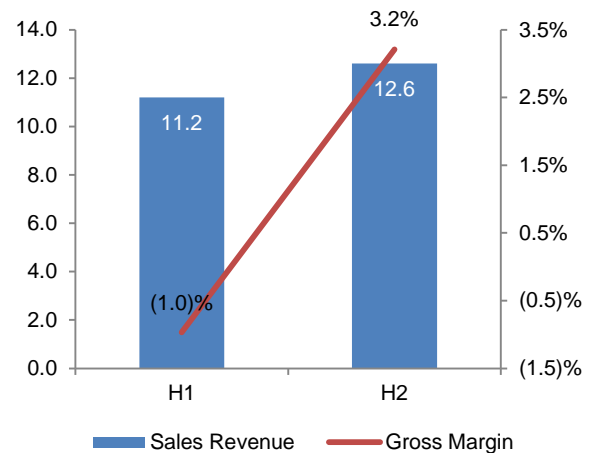
Source: Company data, Petra Capital

Figure 3: FY16/17 comparison (A\$m, %)



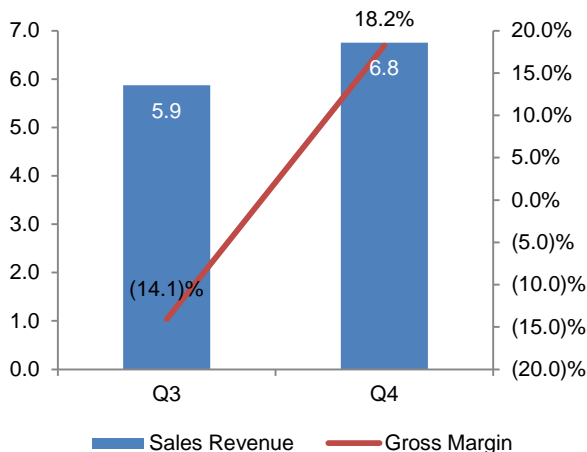
Source: Company data, Petra Capital

Figure 4: FY17 H1/H2 comparison (A\$m, %)



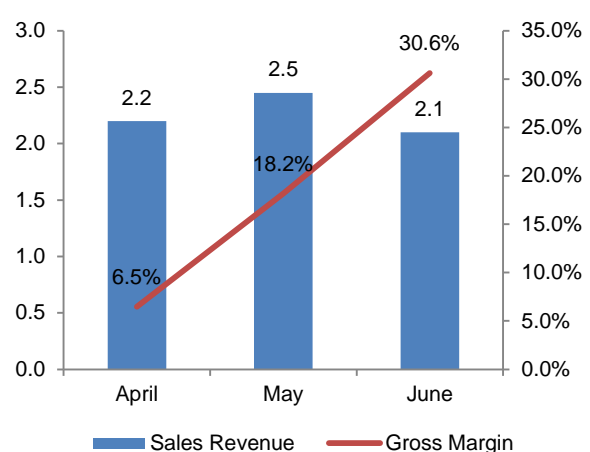
Source: Company data, Petra Capital

Figure 5: FY17 Q3/Q4 Comparison (A\$m, %)



Source: Company data, Petra Capital

Figure 6: FY17 Q4 Breakdown (A\$m, %)



Source: Company data, Petra Capital

All fired up

Today's result confirms to us that the business is on a growth path, that product launches are gaining further market share and the business is setting up for solid growth into FY18F and further again into FY19F. The key highlight from the results was GP margins, which grew into positive (albeit small) territory for FY17, -12.1% in FY16 to +1.2% in FY17 (Petra -7%). GP margins though June 2017 were above 30% and growth towards c40% has been seen through Q118. This has resulted in the company turning to positive cash generation in Q118.

Operationally, the business is on a more solid footing, with the securing of extended working capital facilities, although we remain cautious regarding about the cost of funding, still likely to remain the "teens" post signing of the debt agreements. Nonetheless, the combination of these points sees us view the business as now being substantially de-risked as a result.

One key area seemingly being missed by the market however is the significant operating leverage we start to see developing; the cost base for this business does not need to expand significantly in order to drive, or due to, revenue growth. As production is outsourced to toll manufacturers (AJX supply the raw materials), operating costs are confined primarily to running the head office and sales teams. These do not have to rise inline with revenue growth, in fact they should show only a modest rise over FY18/19F as employee costs moderate; therefore profitability should improve rapidly as the top line grows.

The outlook for Alexium remains bright, with Alexicool continuing to make significant market inroads. An exciting new product development in cotton flame retardants (Alexiflam NF) complement the existing FR suite, but has the potential to be a genuine game changer in the FR cotton market (US\$150-200m size).

We make some reasonably significant changes to our forecasts, primarily reflecting Management's decision to focus on profitable streams of revenue, while forfeiting those clients where profit is not being made, with little view to that in the future. This results in a c-20% cut to revenues in FY18F. Nonetheless, with EBITDA and profit maintained, on improved GP margins, our price target remains A\$1.10.

Trading at c9.5x P/E in FY19F, just two years out is very attractive with the current share price representing a very compelling entry point. We maintain our positive stance, and with over 100% upside to the current price, we maintain our Buy recommendation.

What to watch for in FY18

- **Pegasus** customer ramp up to take place through Q118. Management had previously guided to this being a US\$10m a year relationship, which appears reasonable given our recent conversations with Management
- **Military contracts** to progress through PyroMan tests in and later in calendar year 2018, to enter into a Limited user Evaluation. With this process to last at least 6 months, and then for feedback to be collected (an additional several months) this process is only likely to be concluded June 2018. We would expect a decision prior to December 2018, i.e. H119. This timing has not changed since we initiated on the company, 3 May 2017.
- **Results to date** suggest GP margins of 40% and cash generation. We expect this to be maintained over FY18, resulting in small profit result for the year.
- **Alexiflam NF launch in H118**, with licensing deals being actively pursued at this very minute. Recent interest from global, blue-chip customers would be a boon to the roll-out of this product if they can be secured, potentially expanding the reach from just the US market (US\$150-200m).
- **Alexicool to continue to gain market share**, following recent trade shows in las Vegas (July) and Germany (June) customer engagement has picked up once again. We remind that in this period, Alexicool went from 0t of sales in Nov-16, to c90t/month by June 2017. The next avenue for this product is into the apparel space, where the recent removal of a ghosting effect (whitening) and combination with moisture wicking opens the product up to the lucrative sports-wear market. Nonetheless, we also caution about assuming too much too soon from this, as the brand names and potential damage as a result of defective chemistry would be significant for customers. An arduous and lengthy testing is likely to take place, in our view.

Changes to forecasts

We have made some substantial changes to our forecasts, reflecting the Management strategy to pivot away from growth at any cost, to profitable revenue generation. While this does have some large impacts to revenues (-c20% in FY18F), improved GP margins and still lower operating costs should not be overlooked.

We still look for positive EBITDA and Net Profit in FY18F, which remains unchanged. We do factor in drawdown of nearly the entire working capital facility (i.e. US\$5m drawn to date, and a further US\$10m).

Figure 7: Changes to forecasts FY18-FY20F

Year end June	FY18F			FY19F			FY20F		
	New	Old	Chg. %	New	Old	Chg. %	New	Old	Chg. %
Revenue (\$M)	36.1	45.0	(19.7)%	71.4	74.3	(3.9)%	97.7	97.6	0.1%
Costs (\$M)	(33.1)	(42.2)	(21.6)%	(55.3)	(60.1)	(8.1)%	(74.6)	(72.7)	2.6%
EBITDA (\$M)	3.0	2.7	9.3%	16.2	14.2	13.9%	23.1	24.9	(7.3)%
NPAT (\$M)	1.5	1.6	(1.9)%	14.8	13.0	13.8%	22.2	24.2	(8.2)%
EPS (¢ps)	0.5	0.5	(2.2)%	4.8	4.3	13.5%	7.3	8.0	(8.5)%
EPS Growth (%)	112.7%	112.1%	0.6%	882.0%	746.6%	18.1%	50.6%	86.7%	(41.7)%
PER (x)	93.2	84.2	10.7%	9.5	10.0	(4.6)%	6.3	5.3	18.3%
Free Cashflow (\$M)	6.1	4.0	52.0%	0.5	3.3	(84.0)%	18.9	21.6	(12.4)%
FCFPS (¢ps)	0.0	0.0	0.0%	0.0	0.0	(84.0)%	0.1	0.1	(12.6)%
PFCFPS (x)	22.8	32.0	n/a	265.5	39.1	n/a	7.4	6.0	n/a
Enterprise Value (\$M)	148.1	141.5	4.6%	137.5	131.6	4.5%	118.6	110.0	7.8%
EV / EBITDA (x)	49.7	51.9	(4.3)%	8.5	9.3	(8.2)%	5.1	4.4	16.3%
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, Company data

Valuation very attractive two years out; 9.5x P/E

Below we set out key valuation metrics for the stock, Following ramp-up over the next two years, we calculate EPS of c5cps in 2019E, delivering a P/E of just 9.5x at the current share price. While there is some risk given the growth rates we assume, following FY17 results, we are now much more confident in the ability to deliver on the growth rate and on profitability.

Figure 8: Enterprise value and key metrics 2017-2021F

A\$m	2017	2018F	2019F	2020F	2021F
Market Capitalisation	140.1	140.1	140.1	140.1	140.1
Net Debt	2.8	7.9	(2.6)	(21.5)	(46.8)
Less: provisions	0.0	0.0	0.0	0.0	0.0
Less: surplus assets	0.0	0.0	0.0	0.0	0.0
Enterprise value	143.0	148.1	137.5	118.6	93.3
Key metrics					
EV/EBITDA	(12.8)x	49.7x	8.5x	5.1x	3.3x
EV/EBIT	(12.4)x	58.5x	8.8x	5.3x	3.4x
P/E	(11.5)x	90.5x	9.5x	6.3x	5.2x
FCF Yield	(11.1)%	(2.8)%	7.5%	13.5%	18.0%
Net Debt/EBITDA	(0.3)x	2.7x	(0.2)x	(0.9)x	(1.7)x
Net Debt/EV	2.0%	5.4%	(1.9)%	(18.2)%	(50.1)%

Source: Petra Capital, Company data

FY17 results summary

FY17 results showed remarkable turnaround, driven, in our view by the Alexicool roll-out in H217.

Gross profit margins turned mildly positive (+1%), beating our forecast by c8ppt (-7%). Results below this were all negative nonetheless, as the business remained in ramp-up and cash burn largely equalled revenues for the year. Group operating costs reduced A\$4m or 26% as Administration costs fell by c60%. This is a strong positive and lays a platform for profit growth into FY18/19F. Looking ahead to FY18E, we expect further moderation in operating costs as employee costs fall following the departure of the former CEO and reduction in Board pay and incentives.

Working capital drawdown was significant, at cA\$2.5m or 11% of sales, coming in well ahead of our own forecasts. As the company grows there is potential for this rate of investment to increase, and we forecast a c14% working capital/sales ratio into FY18F.

Outlook

No specific points were provided. Growth is expected to continue, from the existing product lines, particularly Alexicool and Alexiflam NF as we move into FY18. Discussions with licensee's for Alexiflam NF continues, and we understand this is with a blue-chip, and global customer base. Q118 GP margins are continuing to improve and are closer to c40%, while Management highlight the company is now generating positive cash flows.

Figure 9: FY17 results summary

Year end June	FY17A	FY16A	Growth (%)	Petra	Diff.	Notes
Revenue	24.0	3.0	700.8%	22.4	7.1%	Reasonable beat; selective on customers in Q4
Gross Profit	0.30	(0.4)	(182.2)%	(1.6)	(118.6)%	
Gross Profit margin (%)	1.2%	-12.1%	13.3ppt	-7.1%	8.4ppt	Q4 lift drove the gains, primarily in Alexicool
Operating Costs	(11.5)	(15.5)	(25.9)%	(11.2)	2.8%	
EBITDA	(11.2)	(15.5)	(27.6)%	(12.4)	(9.7)%	We forecast a positive result in FY18F
Interest	(0.6)	0.0	n/a	(0.5)	16.8%	
NPAT	(12.2)	(15.7)	(22.5)%	(13.1)	(7.0)%	
EPS (cps)	(3.9)	(5.0)	(22.5)%	(4.2)	(7.3)%	
Operating Cashflow	(12.7)	(10.1)	25.7%	(12.8)	10.0%	
Working Capital flows	(2.6)	(0.5)	433.3%	(0.2)	(242.9)%	We expect these to increase further in FY18F
Working Cap/Sales	11%	16%	(5.5)ppt	1%	10.0ppt	
Net Debt/(Cash)	2.8	(11.2)	(125.3)%	9.8	(696.1)%	We forecast a higher drawdown of debt

Source: Petra capital, Company data



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