

SciDev Ltd (ASX:SDV)

<i>Listed shares:</i>	<i>123.363 mill ord fp shares</i>
<i>Shares to be issued</i>	<i>11.900 mill ord fp shares (to Highland shareholders)</i>
<i>10¢ and 12¢ options</i>	<i>5.350 mill, expiry 23 July 2022</i>
<i>Share price:</i>	<i>73¢ as at 3 February 2020</i>
<i>Diluted market cap:</i>	<i>\$106m fully diluted</i>

Key acquisitions helping to drive growth

- Following the acquisition of Highland Fluids Technology which should be completed in coming days, and rapid growth elsewhere within the company, I have been forced somewhat belatedly to sharply increase my outdated earnings estimates and valuation.
 - My last report dated 10 October 2019 was written post the September quarterly report. At that time my revenue estimates for FY20, FY21 and FY22 were \$15m, \$25m and \$33m and my earnings projections were 0.9¢, 2.3¢ and 3.5¢. My long term valuation was 68¢.
 - For those same years my revenue estimates are now \$29m, \$60m and \$80m, and my earnings projections are 2.0¢, 5.2¢ and 7.8¢ fully diluted not just for the existing options but also the shares to be issued to ProSol and Highland shareholders. My long term valuation, now moved forward six months to 31 December 2019, is put at \$1.62.
 - Driving this increase have been a number of important announcements made in recent months, including acquisition of businesses servicing the NSW coal industry (ProSol Australia) and the US oil and gas industry (Highland Fluids Technology). In addition, the rapid growth in the company's business has necessitated adding a COO, CFO and Engineering Product Manager.
 - The global market for SDV's products and services is thought to approximate \$10b. The company is in a good position to continue to take market share from the global giants of the industry due to:
 - its alliance with large-scale low-cost Chinese chemical manufacturer Nuoer;
 - its Optiflox technology;
 - its smaller size, better service levels and more aligned management; and
 - the potential for more add-on acquisitions.
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SciDev Ltd (SDV)

Share price 73.0c, issued shares 140.0 mill incl. Highlands purchase, mkt cap \$106.1m fully diluted

June years	18a	19a	20e	21e	22e	23e
Profitability (\$m)						
Sales revenue	2.2	2.9	29.0	60.0	80.0	100.0
Cost of sales	1.3	2.0	21.5	45.0	60.0	75.0
Gross profit	0.9	0.9	7.5	15.0	20.0	25.0
Margin	43%	31%	26%	25%	25%	25%
Interest income	0.0	0.0	0.0	0.0	0.1	0.2
Other income	0.3	0.3	0.3	0.3	0.3	0.3
General expenses	2.1	3.0	5.0	7.0	8.0	9.0
EBITDA	-0.8	-1.8	2.9	8.3	12.4	16.5
Cost of finance/oj	0.0	0.0	0.0	0.0	0.0	0.0
Depn/Impair/etc	1.8	-0.2	-0.3	-0.3	-0.3	-0.3
Pretax profit	1.0	-2.0	2.6	8.0	12.1	16.2
Income tax	0.0	0.0	-0.1	-0.7	-1.0	-1.3
Net profit	1.0	-2.0	2.5	7.4	11.1	14.9
EPS (c)	0.0	-1.9	2.0	5.2	7.8	10.3
EPS (c) fully dilute	0.0	-1.4	1.7	5.2	7.8	10.1
DPS(c) declared fc	0.0	0.0	0.0	0.0	0.0	0.0
Cash flow (\$m)						
From operating activities						
Sales receipts	2.3	2.8	21.4	54.0	75.3	95.3
Paymts to supplie	-3.5	-4.6	-25.5	-50.8	-67.7	-84.0
Other	0.3	0.3	-0.1	-0.4	-0.7	-0.9
Total	-0.9	-1.6	-4.2	2.8	6.9	10.4
From investing activities						
Capex	-0.1	-0.2	-0.5	-0.2	-0.2	-0.2
Other	0.2	0.2	-0.1	0.0	0.0	0.0
Total	0.1	0.0	-0.6	-0.2	-0.3	-0.3
From funding activities						
Debt	0.0	0.0	0.0	0.0	0.0	0.0
Equity	0.4	2.9	5.1	0.0	0.0	0.6
Divs, capital retu	0.0	-0.1	0.0	0.0	0.0	0.0
Total	0.4	2.7	5.1	0.0	0.0	0.6
Cash position						
Change from abov	-0.4	1.2	0.4	2.6	6.6	10.7
Forex movements	0.0	0.0	0.0	0.0	0.0	0.0
Closing	0.6	1.7	2.1	4.7	11.4	22.0
Balance sheet (\$m)						
Current assets						
Cash	0.6	1.8	2.1	4.7	11.4	22.0
Receivables	0.7	0.8	8.7	15.0	20.0	25.0
Inventories	0.2	0.3	3.9	8.1	10.8	13.5
Other	0.0	0.0	0.0	0.0	0.0	0.0
Total	1.5	2.8	14.7	27.8	42.2	60.6
Non-current assets						
Plant & equipmer	0.3	0.3	0.6	0.6	0.5	0.5
Other	2.8	2.7	7.7	7.7	7.7	7.6
Total	3.0	3.0	8.4	8.3	8.2	8.2
Current liabilities						
Payables	0.4	0.8	5.4	10.8	13.8	16.5
Debt	0.0	0.0	0.0	0.0	0.0	0.0
Provisions	0.2	0.2	0.5	1.0	1.2	1.5
Other	0.0	0.0	0.0	0.0	0.0	0.0
Total	0.6	1.0	5.9	11.8	15.0	18.0
Non-current liabilities						
Debt	0.0	0.0	0.0	0.0	0.0	0.0
Provisions	0.0	0.0	0.0	0.0	0.0	0.0
Total	0.0	0.0	0.0	0.0	0.0	0.0
Equity						
Issued capital	74.1	76.9	82.0	82.0	82.0	82.6
Reserves	2.2	2.2	2.2	2.2	2.2	2.2
Retained earnings	-72.4	-74.4	-72.0	-64.6	-53.5	-38.6
Shareholder equit	4.0	4.7	12.3	19.7	30.8	46.2

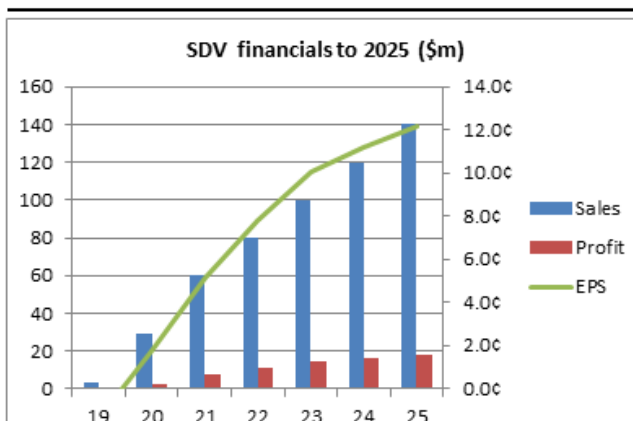
Valuation (\$m) as at 30 June 2019			
Discount rate	6%	9%	12%
Operations	330	210	142
Equity raisings post 30 June 2019	5	5	5
Cash 30 June 2019	2	2	2
Debt 30 June 2019	0	0	0
Total	337	217	149
\$ per share fully diluted	2.41	1.55	1.06
Valuation as at 31 December 2019 1.62			
Valuation based on DCF of future cash flows			
Sales revenue and costs grow 5% pa beyond 2026.			

Increase in valuation over time at a discount rate of 10% pa and revenue growth of 5% pa beyond 2026

As at 30 June	2019	2020	2021	2022	2023
Operations	210	233	257	273	287
Future net equity raisings	5	0	1	1	0
Cash	2	2	5	11	22
Debt	0	0	0	0	0
Total	217	236	262	285	309
\$ per share fully diluted	1.55	1.69	1.87	2.04	2.21

Valuation (\$/share) as at 30 June 2019 at a range of discount rates and of growth rates beyond 2026

	Discount rates			
	6%	9%	12%	
Growth rate 2.5% pa	2.5%	1.97	1.32	0.94
Growth rate 5% pa	5.0%	2.41	1.55	1.06
Growth rate 7.5% pa	7.5%	3.01	1.86	1.23



Company description

SciDev is an emerging leader in the development and application of chemistry and process control for solid-liquid separation. This is critical for reduced water use and better environmental outcomes in the mining and petroleum industries, each with annual demand of US\$2b for these services, and in other industries.

The chemicals are primarily flocculants and coagulants supplied by Chinese manufacturer Nuocer, which is also a SciDev shareholder. Process control is achieved through SciDev's OptiFlox system which gives the company a competitive advantage; it continuously measures parameters such as clay content in industrial process streams and adjusts dosage rates accordingly.

Acquisitions

Prosol Australia P/L

The acquisition of Prosol was announced on 22 October and completed on 29 November. The company operates in the same industry as SciDev. Based in the Hunter Valley it is largely focussed on the coal industry and has good relationships with the leading producers. Prosol's director Ben Gill has joined SciDev's senior management team as Technical Director while another from Prosol has slotted into middle management.

The total consideration is to be \$1.9m split as to 55% cash and 45% shares at 50¢. Cash of \$418,000 and the issue of 684,000 shares was paid on completion. A further two tranches each of \$313,500 cash and 513,000 shares will be paid if FY20 and FY21 milestones are reached. The milestones have not been disclosed.

Prosol's revenues are in the \$2-4m range. The acquisition will boost margins on Prosol contracts due to being able to access lower cost materials from Nuocer and will provide faster market access for SciDev's Optiflox technology.

Since the acquisition a design, build, install and operate contract has been executed with Yancoal for a powder flocculant plant at the Warkworth mine in the Hunter Valley.

Highland Fluids Technology Inc

The acquisition of Highland was announced on 2 January and should be completed this month. The business will be consolidated into SciDev's accounts from 1 January.

Again, the company operates in the same industry as SciDev. Headquartered in Houston, it specialises in supplying bespoke chemical solutions to the US oil and gas industry and particularly to the Permian Basin shale oil producers. It has 10 staff and in CY19 generated US\$7.8m in revenue with positive cash flow if one-off payments are excluded. Highland's management team including existing director Kevin Smith and a couple of oilfield experts will remain within the organisation.

The consideration is to be US\$5m in the form of 11.9 million SDV shares to be issued at 60¢, some escrowed for 6 months and 12 months. An additional consideration of US\$1m, to be satisfied either by cash or by issue of shares priced at the preceding 30-day weighted average, at SciDev's election, will be made if Highland achieves revenue of US\$20m in CY20 and achieves a certain (undisclosed) margin. I allow for this to be achieved in my forecasts.

The acquisition provides immediate access to the onshore US oil and gas market industry which at present purchases US\$2.5b of chemicals annually. SciDev has been keen to break into this market and indeed, as announced on 22 July 2019, the company supplied chemicals to Highland in 2019 for commercial evaluation with end users. The products passed all technical and commercial requirements and are now ready for commercial roll-out.

Access to SciDev's low-cost chemicals, manufactured by Nuoer, will boost margins and facilitate expansion. The deal should be EPS accretive from FY21.

Possibility of further acquisitions

SciDev has added significant value with two add-on acquisitions in the last three or four months. One does wonder whether there any other opportunities out there which the company is actively pursuing or researching. I would say there has to be a reasonable chance, in which case a further upgrade to the numbers would be necessary.

Quarterly report

The company released its quarterly report on 29 January. There was a \$1.8m cash outflow from operations in the December quarter. Receipts from customers were a record \$2.3m but an increase in inventories of \$1.6m and other working capital items more than offset that. Sales revenue of \$4.0m for the quarter took the total for the half year to \$6.3m.

Qtr ended	31 Dec 2018	31 Mar 2019	30 Jun 2019	30 Sep 2019	31 Dec 2019
Cash from operating activities					
Receipts from customers	669	760	766	1,532	2,261
Product manufacturing and operating costs	-917	-1,157	-679	-1,690	-3,657
Administration and corporate					
Interest received	2	10	3	2	
Interest paid	-3	-1			
Government R&D tax concession refund	333				
Total	-217	-624	-285	-709	-1,835
ACTUAL	-217	-624	-285	-709	-1,835
Cash from investing activities					
Intellectual property	-15	-4	-10	-10	-18
Sale/(Purchase) of businesses					-926
Purchase of fixed assets	-18	-3	-49	-59	-87
Sale of fixed assets			190		
Total	-33	-7	131	-69	-1,031
ACTUAL	-33	-7	131	-69	-1,031
Cash from financing activities					
Equity capital		1,737	578	4,160	1,058
Borrowings	69	-30	-46		-3
Capital raising costs				-250	
Total	69	1,707	532	3,910	1,055
ACTUAL	69	1,707	532	3,910	1,055
Cash position					
Opening balance	483	302	1,378	1,756	4,888
Net cash flow	-181	1,076	378	3,132	-1,811
Closing balance	302	1,378	1,756	4,888	3,077
ACTUAL	302	1,378	1,756	4,888	3,077

FY20 estimates

My estimate of June HY sales revenue is \$22.7 derived from: existing business \$9.0m, Prosol \$2.0m and Highland \$11.8, the latter being US\$8m translated at an AUD of 68¢. That would bring sales revenue for FY20 to \$29.1 (rounded down to \$29m). My previous estimate was \$15m.

The gross profit margin in FY19 was 31%. I had assumed it would be 28% in FY20 but I now assume 26% on the basis that Highland's existing supply and inventory is higher cost than that from Nuor.

General expenses were \$3.0m in FY19. I allow for \$5.0m in FY20 given the increase in employee numbers and the acquisitions. After government R&D grants of \$0.3m and depreciation of \$0.3m that results in pretax profit of \$2.6m compared with a loss of \$2.0m in FY19.

Previously I had not allowed for income tax expense because of the large past losses. However, these are virtually all in Australia, and Highland profits will be taxable. I allow for a small tax expense, giving rise to NPAT of \$2.4m.

Estimates beyond FY20

Sales revenue in FY21 is now put at \$60m, double that forecast for FY20 and way higher than my previous estimate of \$25m. The estimate comprises existing business \$20m, Prosol \$5m and Highland \$36.8m (US\$25m translated at an AUD of 68¢). Thereafter I allow for a \$20m increase each year through to FY26.

Other assumptions include gross profit margin of 25%, other income of \$0.3m, general expenses of \$7m in FY21, of \$8m in FY22, thereafter increasing at half the growth rate of sales revenue. A large increase in tax expense occurs in FY24 when all the tax losses are consumed.

This results in the profit projections shown on page 2 of this report.

Valuation

My valuation is now \$1.62, a huge increase on the 68¢ I estimated back in September. The main factors involved in the increase are:

- Much higher earnings estimates as a result of the acquisitions. This was by far the most important factor behind the increase.
- The previous valuation was as at 30 June 2019. I have moved the basis to 31 December 2019 by taking the average of the current valuations as at 30 June 2019 and 30 June 2020. The change added 7¢ to the valuation.

- Using lower discount rates. Previously I used a discount rate of 10% within a range of 5% to 15%. Now I use 9% within a range of 6% to 12%. This reflects the reality that the business is now more established with the company making considerable progress. Clearly the risk is lower than it was. The change added a further 20¢ to the valuation.

China

The trade war between US and China presented a difficulty for SciDev because a 15% tariff was placed on US imports from China and this included the chemicals supplied by Nuocer. It now appears that the issue is being resolved.

The coronavirus pandemic could possibly be a problem for SciDev. Supply of chemicals from China is continuing at present but there is a risk of reduced supplies if the effect of the virus worsens substantially. The company announced on 3 January that it has a significant buffer of chemicals inventory on hand (or in transit) and that it is confident of being able to mitigate any medium-term supply chain risk. Inventory at 31 December 2019 was \$2.3m (excluding Highland of course). Supply of chemicals from other sources is possible on a toll manufacturing basis but probably at a higher cost, and in addition SciDev can manufacture a certain quantity from its Sydney factory. Highland of course has many existing options for supply of chemicals.

Disclaimer

This analysis is cursory in nature and is not intended to be relied upon by third parties, who should make their own enquiries. The report does not contain investment advice.

Any views expressed in this report are purely my own unless otherwise indicated.

Disclosure

I have not received any remuneration from any person for this report.

Associated entities own 1.0 million shares in SDV at the time of writing.

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