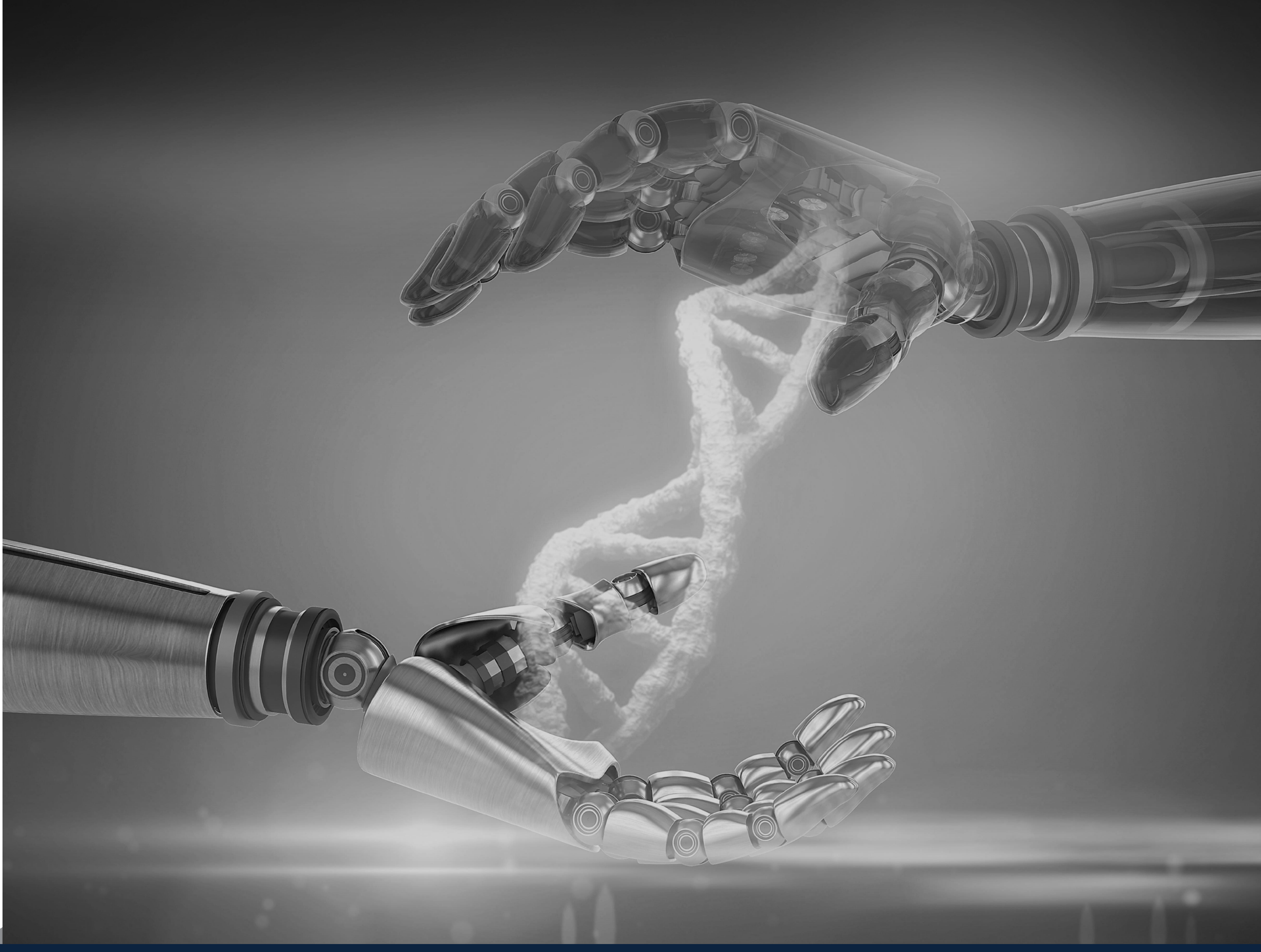
STOCKS DOWN UNDER

31 MAY 2022

Emerging Stocks Down Under

> *Gold and silver are money. Everything else is credit.*
>
> - J.P. Morgan (1837-1913), founder of J.P. Morgan



CHRYSOS

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Stocks Down Under rating: ★★★★

ASX: C79
Market cap: A$510.0M

52-week range: A$3.77 / A$6.50
Share price: A$5.15

Every now and then, one of the CSIRO's inventions gets spun out of the public service and onto the public markets. While typically these are medical or agriculture-focused spin outs, Chrysos' technology focuses on the resources sector. Its PhotonAssay units are essentially high-powered X-rays that process rock samples for gold and other metals. Mr. Market has not been a fan of the company since it listed a few weeks ago sending it down from $6.50 to as low as $3.77. But did the company just time its ASX listing poorly, or should investors genuinely be concerned about the company?

Share price chart

Source: Tradingview

Who said mining couldn't be ESG friendly?

For centuries, gold samples have been processed by fire assays. This method involves the melting of rock samples in a clay crucible allowing the metals to be separated from other rock residue. Unfortunately, this process is not environmentally friendly because it causes carbon emissions and hazardous waste. Additionally, fire assays are slow (taking several hours) and often result in the sample being destroyed.

Chrysos' PhotonAssay units can analyse the samples without any environmental drawbacks, but can also do the job faster, in just 2-3 minutes. Although the units are the size of three shipping containers side by side, they can process large samples of up to 500g and up to 72 samples an hour. At the time of Chrysos' listing, it had 33 PhotonAssay units deployed or committed under executed lease agreements. Its client list includes major miners such as Barrick and Kirkland Lake Gold as well as TIC companies including Intertek, SGS and ALS.

A big opportunity

The company thinks there is a Total Addressable Market (TAM) for 610 machines. This is considering that there are 410 operating gold mines globally producing at least 1.25t or more annually and with onsite laboratories and a further 200 off-site laboratories providing fire assay services.

With 33 units deployed or committed, Chrysos only has 5.4% market penetration right now. But since listing it has won contracts to deliver an extra 25 of its machines out to 2024. Assuming an average annual revenue per unit of $1.6m, including existing deployed and committed units, the company thinks there is a Total Contract Value of $559.8m. It's pricing model includes upfront capital costs and monthly payments based on the level of utilisation, typically $3.65m upfront and ~$134,000 monthly.

These prices may not seem cheap, but when you consider these machines process up to 40,000 assays a month, the weighted average rate per assay is just over $6. And bear in mind these machines also add sustainability, efficiency and accuracy benefits for clients. The machines are not sold outright but are leased in five-year deals that include regular maintenance and service.

A risk, but one that could pay off

Given that Chrysos' market cap is less than its TCV and its growth potential, you might think you could be getting in cheap right now. But on an FY23 EV/EBITDA basis, the stock is trading at ~127.5x with only $3.2m expected in FY23 (and a current EV of $408.0m). And that is even with the share price drop since listing. The company has not issued guidance from FY24 onwards, but consensus estimates suggest a period of strong growth with $17.6m in EBITDA in FY24 (up 433%), $39.3m in FY25 (up 123%) and $66.0m in FY26 (up 68%). Consensus estimates expect profitability in FY25, and the company's P/E for that year's earnings is 47.7x.

However, investors may retain some scepticism towards this company for several reasons, particularly the fact that existing shareholders exploited the IPO to exit the business. Surely investors would not be selling if they saw further growth on the horizon. Most notably, mining services firm Perenti cashed out its 8% stake despite telling its shareholders only two months earlier (in its 1HY22 report) that it was retaining its stake 'given the significant future value proposition'. There are three other factors investors may be cautious towards this company.

First, as we noted above, the company will be investing for growth and will not be profitable for some time, forecasting a $2.9m loss in FY22 and a $4.7m loss in FY23. Although it's FY22 FCF before financing and dividends was $27.6m, this number was only positive due to the IPO and is forecast to be in the red by $50m in FY23.

Second, the company relies heavily on suppliers in China for the manufacturing of machines. Chinese state-owned enterprise Nuctech makes 80% of the parts, structure and framework of the machines, although it does not have access to the core black box IP. The market has been hostile to companies with anything to do with China for the best part of two years now given frosty diplomatic and trade relations between China on the one hand and several western countries on the other, including Australia. Investor sentiment has become even worse this year due to China's persistence with COVID-zero and lockdowns aimed to achieve that. But manufacturing in China is beneficial for the company, because it lowers overall costs and more importantly because China is one of the world's top gold producers along with Russia.

Third, Chrysos is reliant on the gold market. It does have capabilities to process other metals, but gold is its primary revenue driver. Although gold will always be an important metal, its prices inevitably fluctuate, and gold does not have the long-term demand story that battery metals have. It is true that there is more gold to be discovered – Wood Mackenzie estimates there are over 25,000t in undeveloped gold reserves, which is ~80% of the world's current gold reserves. But there won't be the same scramble to develop these reserves as with other metals, particularly lithium.

Notwithstanding these factors, we're going to give Chrysos four stars for now, assuming it can meet its forecasts. At the same time, we acknowledge more cautious investors may want to wait for its FY22 results in August to see if it is on the right path. This is because have been too many IPOs in the past couple of years to show a company's first results are typically make or break for its future as a listed company.

Pitt Street Research Pty Ltd

3 Spring Street, Sydney, NSW 2000, Australia

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