

## 4Q20: Positive operating CF

4Q20 trading update saw De.mem (ASX:DEM) delivered its first positive quarterly operating cashflow of c.\$0.5M. Cash receipts from customers rose by an impressive +36% YoY to \$16M for CY20. Growth is enhanced by a full year of consolidation and integration of two acquisitions completed in 2H19. Backing out the acquisitive growth component, we derive DEM' underlying organic cash receipts still grew at an impressive 12%, which underscores the steady continued performance in DEM's BOO and O&M recurring revenue segments driven by strong orders from both existing and new customers.

### Growth momentum continuing into CY21

We are encouraged by the recent contract wins such as the \$2.6M seawater desalination project (signed in 4Q20) and the \$0.8M BOO project (signed in 3Q20) and believe these wins will not only cement DEM's market leading position in the water treatment industry but also increase awareness of its unique membrane technology and its strong branding amongst both existing and potential customers across the globe. As such, we believe the growth momentum in customer wins will continue to build into CY21 and over the medium term.

### Valuation revised to \$0.64 per share

We have arrived at a revised valuation range of \$0.64 – \$0.74 per share (previous: \$0.62 – \$0.72), which is equally weighted between EV/Sales and DCF of future cashflows. This marginal increase is a function of us raising our revenue forecasts for the Pumptech business due to a higher than expected cash receipts in CY20. Key risks we see include: (1) competitors bringing superior products; (2) ability to the business scale profitably and (3) execution in product innovation and implementation.

Year to Dec (AUD)	2019A	2020F	2021F	2022F	2023F
Revenue (m)	10.1	16.2	26.3	32.2	37.7
EBITDA (m)	(3.2)	(1.3)	1.2	3.3	5.2
Net Profit (m)	(3.5)	(1.7)	0.7	2.7	4.5
EPS	(2.6)	(1.0)	0.4	1.6	2.5
EBITDA Margin (%)	NM	NM	4.6%	10.3%	13.7%
RoA (%)	NM	NM	4.8%	15.2%	19.7%
EV/Sales	2.8x	3.4x	2.1x	1.7x	1.4x
EV/EBITDA	NM	NM	46.6x	16.6x	10.1x
P/E	NM	NM	78.7x	21.1x	13.0x

Source: Company, Pitt Street Research

Share Price: A\$0.33

ASX: DEM

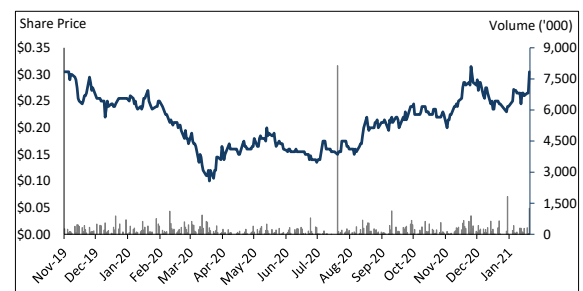
Sector: Utilities

22 January 2021

Market Cap. (A\$ m)	57.9
# shares outstanding (m)	175.6
# shares fully diluted (m)	185.1
Market Cap Ful. Dil. (A\$ m)	61.1
Free Float	61.8%
52-week high/low (A\$)	0.34 / 0.10
Avg. 12M daily volume ('000)	238.1
Website	<a href="http://www.demembranes.com">www.demembranes.com</a>

Source: Company, Pitt Street Research

### Share price (A\$) and avg. daily volume (k, r.h.s.)



Source: Refinitiv Eikon, Pitt Street Research

Valuation metrics	
Blended valuation range (A\$)	0.64 – 0.74
WACC	11.2%
Assumed terminal growth rate	2%

Source: Pitt Street Research

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Disclosure: Pitt Street Research directors own shares in De.mem Ltd.



Profit & Loss (A\$M)	2017a	2018a	2019a	2020e	2021e	2022e	2023e	2024e
<b>Sales Revenue</b>	<b>2.9</b>	<b>10.5</b>	<b>10.1</b>	<b>16.2</b>	<b>26.3</b>	<b>32.2</b>	<b>37.7</b>	<b>43.2</b>
Operating expenses	(9.2)	(12.3)	(13.4)	(17.5)	(25.1)	(28.9)	(32.5)	(36.3)
<b>EBITDA</b>	<b>(6.3)</b>	<b>(1.7)</b>	<b>(3.3)</b>	<b>(1.3)</b>	<b>1.2</b>	<b>3.3</b>	<b>5.2</b>	<b>6.9</b>
Depn & Amort	(0.1)	(0.2)	(0.3)	(0.2)	(0.4)	(0.5)	(0.6)	(0.8)
<b>EBIT</b>	<b>(6.4)</b>	<b>(1.9)</b>	<b>(3.6)</b>	<b>(1.6)</b>	<b>0.8</b>	<b>2.8</b>	<b>4.5</b>	<b>6.1</b>
Net Interest	(0.0)	(0.0)	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)
<b>Profit before tax</b>	<b>(6.4)</b>	<b>(1.9)</b>	<b>(3.5)</b>	<b>(1.7)</b>	<b>0.7</b>	<b>2.7</b>	<b>4.5</b>	<b>6.0</b>
Tax expense	0.0	-	(0.0)	-	-	-	-	(1.0)
<b>NPAT</b>	<b>(6.3)</b>	<b>(1.9)</b>	<b>(3.5)</b>	<b>(1.7)</b>	<b>0.7</b>	<b>2.7</b>	<b>4.5</b>	<b>5.0</b>
Cash Flow (A\$M)	2017a	2018a	2019a	2020e	2021e	2022e	2023e	2024e
Profit after tax	(6.3)	(1.9)	(3.5)	(1.7)	0.7	2.7	4.5	5.0
Depreciation	0.1	0.2	0.3	0.2	0.4	0.5	0.6	0.8
Change in trade and other receivables	0.2	(0.4)	0.4	(1.0)	(1.6)	(0.8)	(0.7)	(0.7)
Change in trade payables	(0.4)	0.2	1.5	0.5	0.8	(0.1)	(0.1)	(0.0)
Other operating activities	4.1	0.4	(0.4)	0.4	0.0	0.2	0.2	0.3
<b>Operating cashflow</b>	<b>(2.4)</b>	<b>(1.5)</b>	<b>(1.7)</b>	<b>(1.5)</b>	<b>0.4</b>	<b>2.6</b>	<b>4.6</b>	<b>5.3</b>
Capex	0.1	(0.5)	(0.2)	(0.8)	(0.8)	(1.0)	(1.1)	(1.3)
Other investing activities	(0.8)	(0.2)	(2.0)	(0.6)	(0.1)	(0.1)	(0.1)	(0.1)
<b>Investing cashflow</b>	<b>(0.6)</b>	<b>(0.7)</b>	<b>(2.2)</b>	<b>(1.4)</b>	<b>(0.9)</b>	<b>(1.1)</b>	<b>(1.2)</b>	<b>(1.4)</b>
Dividends	-	-	-	-	-	-	-	-
Equity raised	6.3	0.6	10.2	-	-	-	-	-
Debt drawdown (repaid)	(0.2)	0.1	(0.0)	(0.2)	-	-	-	-
Other financing activities	-	-	(0.2)	-	-	-	-	-
<b>Financing cashflow</b>	<b>6.1</b>	<b>0.7</b>	<b>10.0</b>	<b>(0.2)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Net change in cash</b>	<b>3.1</b>	<b>(1.5)</b>	<b>6.1</b>	<b>(3.1)</b>	<b>(0.5)</b>	<b>1.6</b>	<b>3.3</b>	<b>3.9</b>
Cash at End Period	3.3	1.8	7.9	5.0	4.5	6.1	9.4	13.4
Net Debt (Cash)	(2.8)	(1.2)	(6.3)	(3.9)	(3.3)	(4.9)	(8.2)	(12.2)
Balance Sheet (A\$M)	2017a	2018a	2019a	2020e	2021e	2022e	2023e	2024e
Cash	3.3	1.7	7.8	5.0	4.5	6.1	9.4	13.4
Total Assets	6.3	5.3	14.6	13.5	15.2	18.1	22.7	28.0
Total Debt	0.5	0.5	1.4	1.2	1.2	1.2	1.2	1.2
Total Liabilities	3.1	3.4	5.1	5.5	6.4	6.3	6.2	6.2
Shareholders' Funds	3.2	1.9	9.5	8.0	8.9	11.8	16.5	21.8
Ratios	2017a	2018a	2019a	2020e	2021e	2022e	2023e	2024e
Net Debt/Equity (%)	-87.3%	-63.0%	-66.3%	-48.5%	-37.6%	-41.4%	-49.8%	-55.8%
Return on Equity (%)	nm	nm	nm	nm	8.3%	23.2%	27.0%	23.0%



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### 4Q20: Positive operating cashflow achieved

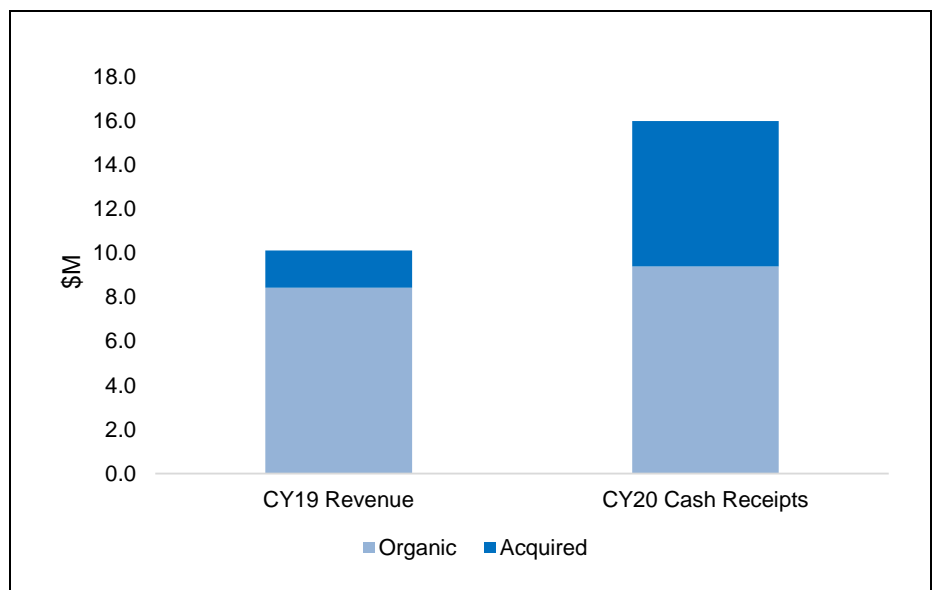
For the 12 months ending December 2020, DEM has delivered on its guidance and impressively grown its cash receipts from customers by +36% YoY to \$16M. This was achieved through a combination of organic and acquisitive growth. With the CY19 acquired revenues available, we can dissect the full year revenue into organic and acquisitive components (Figure 1). Using CY19 revenue as a proxy for the same year’s cash receipts from customers, we can derive an increase of 12% YoY in organic growth for CY20, underscoring the steady continued performance in DEM’s BOO and O&M recurring revenue segments driven by strong orders from both existing and new customers.

Inside the acquisitive growth are strong turnovers generated by the two cash generative businesses, Pumptech (Tasmania) and Geutec (Germany), both of which DEM acquired in 2H19. Accordingly, DEM’s CY20 acquired cashflows of \$6.6M included a full year of cash receipts from both Pumptech and Geutec. Moreover, the successful integration of both businesses into DEM’s group has provided synergies to the merged group, as reflected in the +67% YoY growth in cash receipts delivered by Pumptech for CY20, which was in part driven by the cross and up-selling of DEM’s product offerings to Pumptech’s customers.

As a result of disciplined management execution, DEM consistently improved its quarterly operating cashflows throughout CY20 and at 4Q20 achieved its first positive operating cashflow of c.\$0.5M. As at CY20 year end, DEM had \$5M in cash, with debt sitting at c.\$0.7M based on our forecast.

*DEM achieved its first positive quarterly operating cashflows in 4Q20*

Figure 1: DEM’s revenues and cash receipts split YoY



Source: Pitt Street Research, Company Reports

### Growth momentum continuing for CY21

We believe the recent new contract wins by DEM such as the \$2.6M seawater desalination project (signed in 4Q20) as well as the \$0.8M BOO project (signed in 3Q20) will not only cement its market leading position in industrial water treatment but also increase awareness of its unique membrane technology and its strong branding amongst both existing and potential customers across the globe. As such, we believe the growth momentum in customer wins will continue to build into CY21 and over the medium term.

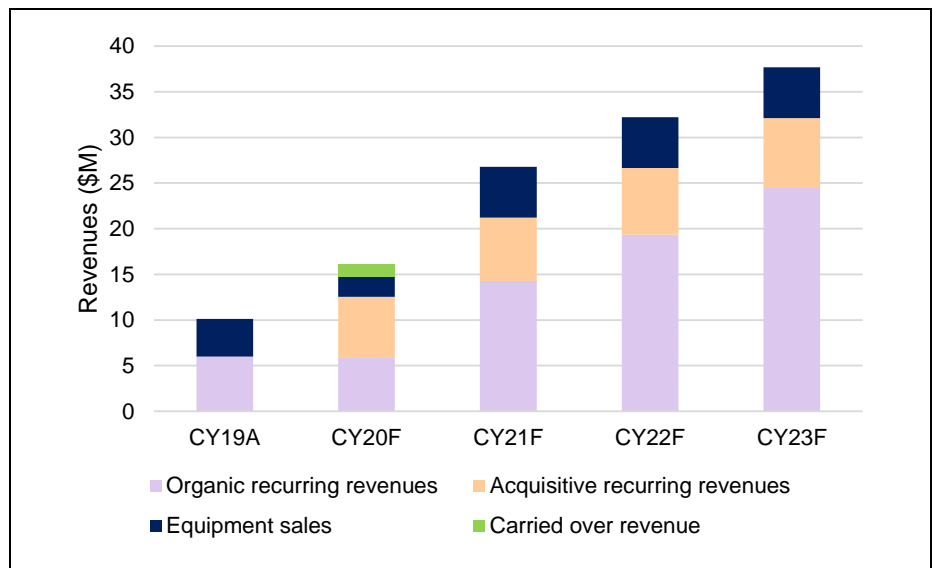
*Recent customer wins are encouraging and reflect DEM’s market leading position in the water treatment industry*



### Continuing structural shift to recurring revenues

Figure 2 shows the breakdown of our group revenue forecasts from CY21F to CY23F. The recurring revenue segment, which we view as pivotal to DEM, should continue to grow strongly on the back of its robust sales pipeline and on the assumption that existing customers will continue their renewals upon contract expiry. Given the structural shift from low margin one-off equipment sales to high margin BOO and O&M services, we expect group gross margins to progressively increase from 32% in CY20F to 37% in CY23F.

Figure 2: DEM's revenue forecasts

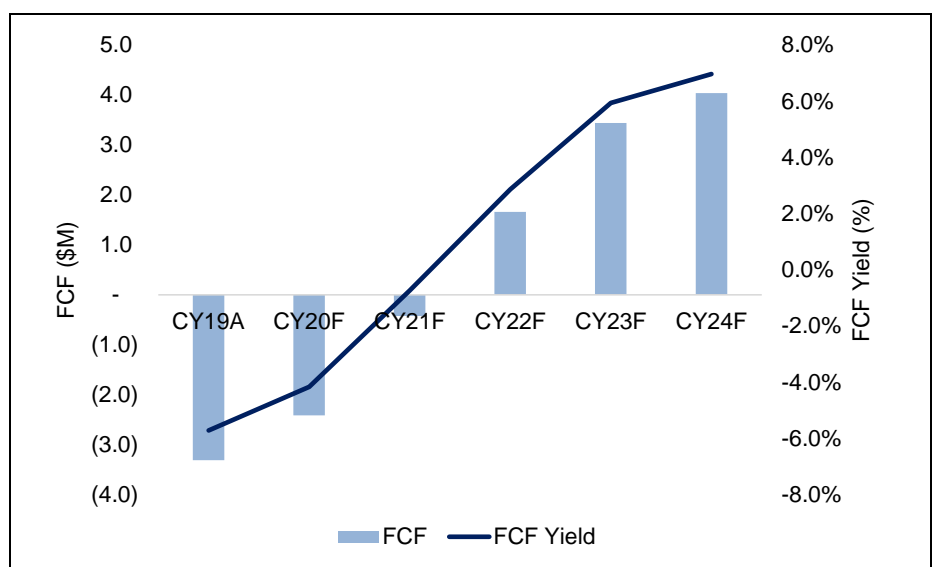


Strong and growing sales pipeline should underpin continued expansion in recurring revenue base

Source: Pitt Street Research, Company Reports

Our base case modelling expects DEM to achieve FCF breakeven around 1H22, driven by continued sales growth and operating leverage (Figure 3). On a CY23 FCF yield of 5.9% with relatively high earnings certainty due to the structural shift to recurring revenues, DEM looks attractive in our view.

Figure 3: DEM's FCF and FCF yield forecasts



We expect DEM to achieve FCF breakeven by 1H22

Source: Pitt Street Research, Company Reports



## Valuation

### Forecast changes

With 4Q20 cashflow results, we have updated and re-worked our cashflow model to better reflect DEM's current financial position. Our adjustments are:

- On Pumptech, its CY20 full year cash receipts of \$4M have exceeded our expectations by \$0.7M, which we think was due to our underestimation of the synergies that have been realised post-acquisition. Based on this revised higher cash receipts and the same growth assumptions we had earlier, we have therefore marginally increased our forward revenues for Pumptech over our forecast horizon.
- Net borrowings for CY20 resulted in cash outflow of \$0.2M. Given DEM had \$0.9M debt at CY19 year end, we update debt level to \$0.7M as at CY20 year end.

### Valuation revised to \$0.64 per share

We have arrived at a revised valuation range of \$0.64 – \$0.74 per share (previous: \$0.62 – \$0.72), which is equally weighted between CY21 EV/Sales peer multiple and DCF of future cashflows (Figure 4). This marginal increase is a function of us raising our revenue forecasts for the Pumptech business due to a higher than expected cash receipts in CY20 as described above.

On our forecasts, DEM is currently trading on EV/Revenue of 3.4x, falling to 2.1x and 1.7x for CY21 and CY22 respectively.

We see the catalysts for a re-rating of the stock include new customer wins, existing customer renewals, accretive acquisitions and continued expansion in recurring revenue base.

Figure 4: Blended valuation summary

Base Case	Weights (%)	Share price (AUD)	Bull Case	Weights (%)	Share price (AUD)
DCF	50.0%	0.59	DCF	50.0%	0.72
Relative valuation	50.0%	0.69	Relative valuation	50.0%	0.76
<b>Composite Value (AUD)</b>		<b>0.64</b>	<b>Composite Value (AUD)</b>		<b>0.74</b>
Current Price (AUD)		0.33	Current Price (AUD)		0.33
<b>Upside/Downside (%)</b>		<b>94.1%</b>	<b>Upside/Downside (%)</b>		<b>124.0%</b>

Source: Pitt Street Research

Please refer to [www.pittstreetresearch.com](http://www.pittstreetresearch.com) for our initiating coverage report on DEM.



## Appendix – Analyst Qualifications

Cheng Ge is an equities research analyst at Pitt Street Research.

- Cheng obtained a B.Com in Finance and LL.B from University of New South Wales, in 2013, and has passed all three levels of the CFA Program.
- Before joining Pitt Street Research, he has worked for several financial services firms in Sydney, where his focus was on financial advice.
- He joined Pitt Street Research in January 2020.

Marc Kennis has been covering a range of sectors as an analyst since 1997.

- Marc obtained an MSc in Economics from Tilburg University, Netherlands, in 1996 and a post graduate degree in investment analysis in 2001.
- Since 1996, he has worked for a variety of brokers and banks in the Netherlands, including ING and Rabobank, where his main focus has been on the Technology and Industrials sectors, including the Semiconductor sector.
- After moving to Sydney in 2014, he worked for several Sydney-based brokers before setting up TMT Analytics Pty Ltd, an issuer-sponsored equities research firm.
- In July 2016, with Stuart Roberts, Marc co-founded Pitt Street Research Pty Ltd, which provides issuer-sponsored research on ASX-listed companies across the entire market, including Technology companies.
- In 2020 Pitt Street Research launched Stocks Down Under, a subscription-based investment publication.

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