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Ellex Medical Lasers Limited

Hold

Awaiting Evidence of Improved Working Capital Position and Re-aligned Cost Base

\$0.10

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Key Points from 1H09 Result

1H09 EBITDA increased 10.3% to \$2.5 million, on sales up 16.3% to \$30.2 million.

Uncertainty and challenges remain, both in terms of Ellex's balance sheet and broader market conditions.

Awaiting clear signs of working capital improvements before turning positive on the story.

Summary

Market capitalisation	\$8.2M
Share price	\$0.10
52 week low	\$0.08
52 week high	\$0.69
Ave Monthly Vol (year rolling)	1.427M

Key Statistics

Year End (\$'000)	FY08 Actual	1H09 Actual	FY09 Est.
Revenue	51,804	30,207	56,447
EBITDA	4,385	2,540	4,551
Reported NPAT*	4,745	(23,132)	(22,658)
NPAT Adj.	1,579	967	1,654
EPS Adj. (c)	2.3	1.4	2.2
Growth	-23%	4%	-6%
PE Ratio Adj. (x)	4.3	n/a	4.6
DPS (c)	0.0	0.0	0.0
Div Yield	0.0%	n/a	0.0%
Franking	0.0%	0.0%	0.0%
EV/EBITDA (x)	4.1	n/a	3.7
ROE	5.0%	n/a	5.7%
EBITDA Margin	8.5%	8.4%	8.1%

*FY08 and 1H09 included one-off tax benefits

Share Price Graph (A\$)



Our View

- Earnings growth yet to reflect sales momentum** – Ellex reported a 3.4% NPAT increase to \$1.0 million, after adjusting for abnormal items and assuming full corporate tax rates. Abnormal items included the write down of goodwill (\$21.7 million), impairment of capitalised development expenditure (\$0.7 million), income tax benefits (\$1.5 million), and unrealised losses on outstanding foreign exchange positions (\$3.6 million). At the EBITDA level, earnings increased 10.3% to \$2.5 million, but on sales up 16.3% to \$30.2 million. As a result, EBITDA margins declined from 8.9% to 8.4%. This disappointing translation of sales to earnings has become a recurring feature of Ellex's results of late, with current deteriorating market conditions likely to continue that theme through the remainder of FY09.
- Worsening economic conditions a challenge for 2H09** – Ellex's ability to report double digit sales growth despite global turmoil, gives an indication as to the quality and appeal of its product range. It is the inability to deliver meaningful earnings growth from this solid base that is so disheartening. Despite an increasing focus on the cost base with an 18% reduction in headcount since October, we have reduced our FY09 and FY10 EPS forecasts by 18.5% and 11.1% respectively, given the worsening economic conditions expected in 2H09.
- Working capital improvements yet to take effect** – A crucial aspect of Ellex's performance over recent years has been its deteriorating working capital position. We understand this has been a major focus for management but with 1H09 showing limited initial benefits. The growth in stock levels of 22.8% was down on the 26.5% increase of pcp, but still results in inventories representing a sizeable 36.6% of our FY09 sales forecast. 1H09 receivables also spiked 42.6% higher, and whilst we acknowledge Ellex typically suffers from some 1H debtor seasonality, the magnitude of the rise is concerning. We will continue to monitor working capital demands throughout 2H09, and see this as critical before turning positive on the story.
- Uncertainty remains** – Limited headway has been made in the key areas of cost re-alignment and working capital management during 1H09. We acknowledge a lag exists between the targeting of improvements and delivering on them. However, given product deferrals and pricing irrationality remain short term risks, we maintain our Hold recommendation despite Ellex trading on a lowly 4.6 and 4.0 times our FY09 and FY10 adjusted EPS forecasts.

ELLEX MEDICAL LASERS LIMITED - Summary of Forecasts

ELX \$ 0.10

PROFIT & LOSS SUMMARY (A\$'000s)				
Period	FY08A	1H09A	FY09E	FY10E
Total Revenue	51,804	30,207	56,447	52,403
<i>Growth (pcp)</i>	12.7%	16.3%	9.0%	-7.2%
EBITDA	4,385	2,540	4,551	4,797
Dep'n/Other Amort'n	(813)	(456)	(982)	(1,012)
Amort'n of Capitalised R&D	(592)	(328)	(617)	(241)
EBIT	2,980	1,756	2,952	3,545
Net Interest	(597)	(400)	(640)	(591)
Pre-Tax Profit	2,383	1,356	2,312	2,954
Tax Expense	(911)	(407)	(694)	(886)
Minorities	(89)	18	36	36
NPAT nil tax pre one-offs	2,294	1,374	2,348	2,990
<i>Growth (pcp)</i>	-15.8%	1.3%	2.4%	27.3%
NPAT full corp. tax pre one-offs	1,579	967	1,654	2,104
<i>Growth (pcp)</i>	-15.8%	3.5%	4.8%	27.2%
Adjustments*	3,362	(24,506)	(25,006)	886
NPAT Reported	4,745	(23,132)	(22,658)	2,990

PER SHARE DATA				
Period	FY08A	1H09A	FY09E	FY10E
EPS (c) nil tax pre one-offs	3.4	2.0	3.1	3.5
<i>Growth (pcp)</i>	-23.3%	1.9%	-8.6%	15.0%
EPS (c) full corp. tax pre one-offs	2.3	1.4	2.2	2.5
<i>Growth (pcp)</i>	-23.3%	4.1%	-6.4%	14.9%
Dividend (c)	0.0	0.0	0.0	0.0
Franking	0%	0%	0%	0%

KEY RATIOS				
Period	FY08A	1H09A	FY09E	FY10E
EBITDA/Sales Margin %	8.5%	8.4%	8.1%	9.2%
EBIT/Sales Margin %	5.8%	5.8%	5.2%	6.8%
EBIT Interest cover (x)	4.6	4.3	4.1	5.0
Current ratio (x)	1.7	1.5	1.7	1.8
Net Debt : Equity (%)	20.3%	40.5%	25.7%	21.3%
ROE (%)	5.0%	n/a	5.7%	8.6%
Dividend Payout Ratio (%)	0.0%	0.0%	0.0%	0.0%

VALUATION MULTIPLES				
Period	FY08A	1H09A	FY09E	FY10E
PER (x) nil tax rate	3.0	n/a	3.3	2.8
PER (x) full corp. tax rate	4.3	n/a	4.6	4.0
Dividend Yield (%)	0.0%	n/a	0.0%	0.0%
EV/EBITDA (x)	4.1	n/a	3.7	3.3
EV/EBIT (x)	6.0	n/a	5.7	4.5

BALANCE SHEET SUMMARY				
Period	FY08A	1H09A	FY09E	FY10E
Cash	830	1,468	1,579	1,647
Receivables	13,038	17,434	16,274	18,197
Inventories	17,745	20,667	21,227	20,796
Other	1,529	1,891	1,891	1,891
Total Current Assets	33,142	41,460	40,970	42,531
Investments	0	0	0	0
Inventories	0	0	0	0
Property Plant & Equip	3,761	3,735	3,679	3,568
Intangibles	21,680	0	0	0
Capitalised R&D Intang.	6,952	6,263	6,267	6,017
Other	6,238	8,396	8,396	8,396
Total Non-Current Assets	38,799	18,691	18,343	17,980
TOTAL ASSETS	71,941	60,151	59,313	60,512
Accounts Payable	8,085	8,355	8,660	9,098
Borrowings	9,175	14,025	10,281	9,274
Provisions	1,736	1,790	1,500	1,222
Other	666	3,684	3,684	3,684
Total Current Liab	19,662	27,854	24,125	23,278
Borrowings	1,380	0	0	0
Provisions	218	178	283	260
Other	2,740	1,092	1,092	1,092
Total Non-Current Liab	4,338	1,270	1,375	1,352
TOTAL LIABILITIES	24,000	29,124	25,500	24,630
TOTAL EQUITY	47,941	31,027	33,813	35,881

CASH FLOW SUMMARY				
Period	FY08A	1H09A	FY09E	FY10E
EBIT (excl Abs/Extr)	2,980	1,756	2,952	3,545
Add: Depreciation	813	456	982	1,012
Amort'n Cap R&D	592	328	617	241
Change in Pay.	(296)	270	575	438
Less: Tax paid	(911)	(407)	(694)	(886)
Net Interest	(597)	(400)	(640)	(591)
Change in Rec.	(1,290)	(4,525)	(3,068)	(1,923)
Change in Inv.	(3,016)	(2,922)	(3,482)	430
Gross Cashflows	(1,725)	(5,444)	(2,757)	2,265
Capex	(1,820)	(430)	(900)	(900)
Free Cashflows	(3,545)	(5,874)	(3,657)	1,365
Dividends Paid	0	0	0	0
Net Cash Flow	(3,545)	(5,874)	(3,657)	1,365

* Adjusted for FY07, FY08 and 1H09 tax benefits. Normalised for full corporate tax rate going forward. Nil tax rate also shown.

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