

# HARDIDE CHEMICALS

**HDD.L**

1.83p

Market Cap: £28m

## SHARE PRICE (p)



12m high/low

2.2p/0.7p

Source: LSE Data

## KEY INFORMATION

Enterprise value	£26.8m
Index/market	FTSE AIM
Next news	11 December – prelims
Gearing	0%
Interest cover	N/A

**HARDIDE IS A RESEARCH CLIENT OF  
PROGRESSIVE**

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## Preparing for a bright future Creating a solid platform for growth

On 27 October, Hardide announced an oversubscribed fundraising of £2.54m, in two tranches, at 1.7p per share to fund additional capacity in anticipation of future demand, creating a solid platform for growth. The group also provided a trading update within the announcement highlighting that FY 2018E has started positively, with Hardide signing a framework supply agreement with a major international O&G (Oil & Gas) operator and is in the process of finalising a second with a different O&G customer, suggesting a positive outlook ahead. We make changes to estimates to reflect the placing, the anticipated increase in capex and more positive margin assumptions. The result is an increase to Adj EBITDA in FY2019E and FY 2020E together with higher cash balances.

- The oversubscribed £2.54m fundraising, £1.7m initially and a further £0.8m subject to receipt of EIS and VCT eligibility from HMRC, comprises a placing and a subscription by certain Directors. Proceeds will be primarily used to fund further coating reactor capacity in the US, to upgrade one coating reactors in the UK and the US facility to an aerospace standard and will strengthen the balance sheet creating a solid platform for future growth.
- Hardide's current management has a positive history of anticipating and managing the need for greater capacity to support future growth and enable further development work. Since its previous placing in September 2016, Hardide's share price has increased by 135%.
- Management expects to report preliminary year end results in-line with market expectations. We are currently forecasting revenue of £3.2m for FY2017E suggesting Hardide is on track to deliver revenue 58% higher than in FY2016.
- Post close, it has signed a 3-year framework supply agreement with a major operator in the O&G sector. A second agreement with a land based manufacturer of drilling and production tools is in the process of being finalised. The two agreements could be worth up to £1m and underpin current market revenue growth estimates.
- In September, Hardide announced the appointment of Neil Jeskins as Quality Assurance Manager within Hardide's management team to support its aerospace development. The trading update highlighted the development and trialling of safety critical parts for customers is well advanced. This underscores the group's confidence in securing material future aerospace sales.

FY SEPT (£M)	2016	2017E	2018E	2019E	2020E
Revenue	2.1	3.2	4.1	5.0	6.0
Adjusted EBITDA	(1.3)	(0.7)	(0.4)	0.2	0.8
Adjusted EBIT	(1.7)	(1.2)	(0.9)	(0.2)	0.3
Fully Adjusted PBT	(1.7)	(1.2)	(0.9)	(0.2)	0.3
Free Cash Flow	(1.9)	(0.8)	(1.5)	(0.9)	0.5
EV/Sales	12.5x	8.3x	6.6x	5.4x	4.5x

Source: Company Information and Progressive Equity Research estimates

## Trading Update and Fundraising

On 27 October, Hardide announced an oversubscribed fundraising of £2.54m (net £2.43m) comprising a Placing and a Subscription by individuals (including Directors). Incorporated into the announcement was Hardide's FY2017E trading update. The fundraising will comprise two tranches. The first tranche will raise £1.7m, with net proceeds of £1.6m, issuing 100,941,175 new shares at 1.7p. The second will raise a further £0.82m at 1.7p, subject to the assurance from HM Revenue & Customs that this additional fundraising will be eligible for Enterprise Investment Scheme (EIS) and/or Venture Capital Trust (VCT) tax relief. Of the funds raised, £1.6m will be eligible for EIS and VCT relief as confirmed by Her Majesty's Revenue and Customs. The group will apply for the remaining funds raised to receive the same tax eligibility. Such assurances were granted in the 2016 raise, which was undertaken in the same manner.

The trading update indicated that management expects to announce preliminary year end results that are in line with current market expectations. The positive trends in market conditions the company experienced in 1H17 with a continued recovery in the oil & gas market (O&G) and new business wins in precision engineering have continued through the second half. We are currently forecasting revenue of £3.2m for 2017E suggesting that Hardide, based on our estimates, is on track to deliver revenue 58% higher than in 2016.

- **The positive trends in market conditions experienced in 1H17 have continued through the 2H17.**

The outlook for the group is positive as, post the September year end, Hardide has signed a 3-year supply agreement with a major international O&G operator based in North America. The agreement outlines a framework for future orders for the coating of downhole components. The first orders under this framework are expected in early 2018. An additional agreement with a North American land-based drilling and production tools manufacturer is currently being finalised. The combined initial sales under these two agreements are expected to be worth up to £1m per annum and have positive future growth potential. Management believes the growth shown in consensus forecasts is underpinned by these two agreements. (See page 6 – Financial Summary)

The company reiterated that prospects for increasing aerospace business, post its Airbus approval and Nadcap accreditation, remain robust. In September, Hardide created the role of Quality Assurance Manager within its management team to support its aerospace business and announced the appointment of Neil Jeskins to the role. Jeskins comes from Bureau Vertias, where he was an aerospace lead auditor for AS 9100 and associated standards. He was in the Royal Air Force for 27 years where he was responsible for many aspects of aircraft maintenance and engineering. At Hardide, he will be responsible for its quality organisation and quality assurance accreditations including Nadcap, AS9100 as well as the group's ISO qualifications across both the US and UK facilities. As announced at the 1H17 interim results, Hardide remains in commercial and technical negotiations with Airbus and its supply chain. It is currently developing and trialling safety critical parts for aerospace customers, which the company believe will translate into future sales.

As indicated in its trading statement, the US coating facility is performing well, with demand expected to reach the capacity of the two operating reactors during CY2018. Given the increased demand the company is benefitting from and in anticipation of future demand, Hardide has announced this £2.54m fundraising to fund its expansion.

## Use of Proceeds

The proceeds of the fundraising will primarily be used to fund two new coating reactors in the US facility, an upgrade to one of the UK reactors and the whole US facility to an aerospace standard in anticipation of future demand and further strengthen the balance sheet. Hardide intends to place an order for the first reactor before the end of 2017 at a cost of approximately £0.6m. The lead time for a reactor is c.10 months, so the company expects the first reactor to be commissioned by Autumn 2018, therefore benefitting revenue in 2019. The company expects to place an order for the second reactor, at a cost of £0.85m, during the course of 2018 with the expectation it will be commission toward year end 2019, benefitting revenue in 2020. The second reactor is to have greater volume than the other reactors allowing for larger items to be coated as well as increasing the efficiency of the reactor. Hardide will spend £0.25m to expand the size of its pre-treatment facility to accommodate larger parts. The group will also be seeking aerospace accreditation for its US facility.

The US facility became fully operational in March 2016 and currently houses two large coating reactors. As the North American region was expected to be a high growth area, the 26,000-foot facility was chosen to allow for considerable expansion of capacity and was designed to accommodate more than 5 reactors, therefore the now planned 4 reactors leave the group with opportunity for further expansion beyond 2020. A further endorsement of the US operations, is the indication from the local economic development corporation in Martinsville, Virginia that it intends, to provide a US\$240,000 loan, at an attractive 2% annual rate, to support Hardide's expansion plans.

The UK facility in Bicester houses three large coating reactors and one small reactor. Currently only one of the large reactors operates at the required aerospace standard. In anticipation of material aerospace volumes, the company will use a portion of the placing proceeds to upgrade an additional large reactor and other processing equipment to an aerospace standard. It will also make an investment in further analytical equipment to further improve the company's operations.

- Spare capacity is crucial for development work

The increase in capacity across the two facilities will leave Hardide with some spare capacity. Spare capacity is crucial for the development process and to maintain lead times during periods of high activity. Hardide is continually making advances and developing additional technologies to broaden its application and end market prospects. Hardide has a board level Intellectual Property committee which guides the process and underpins the strategic future of the group.

The management of Hardide has a good track record of anticipating the need for and managing capacity. Given the capex intensive nature of its technologies, since its initial public offering Hardide has periodically raised capital to fund its growth. The exhibit below outlines Hardide's equity issuance since its reorganisation in 2009 and the increase in share price from point of issue to today.

### Hardide plc Equity Issuance since 2009

Year	Gross amount raised	Issue Price	Increase in share price
June 2009	£1.56m	0.3p	510%
November 2011	£0.75m	0.6p	205%
August 2014	£2.7m	1.6p	14%
September 2016	£1.6m	0.8p	129%
October 2017	£2.54m	1.7p	

Source: Progressive Research – Reference price 1.83p

- The Hardide share price is up 135% since the last raise in 2016.

The share price performance after an equity raise is an indicator of the ability of the management to create shareholder value. The exhibit above clearly indicates how the share price improved on an absolute basis. Since its previous raise of £1.6m in September 2016 at 0.8p, the share price of Hardide is up 135%.

## New Financials

Post the trading update and successful placement, we have made several changes to our estimates which are summarised in the table below. We have materially increased our capex assumptions in 2018E to £1.0m from £0.7m and in 2019E to £1.1 from £0.1m to reflect the increased investment in both the UK and US plants. We have increased our gross margin assumptions in 2019E to 56% from 55% and 2020E to 58% from 57% as we believe Hardide should benefit from a more favourable mix than we were previously assuming. The funds raised through the placing and the Martinsville loan also result in an increased cash balance, where we now estimate £1.6m in 2018E, £0.6m in 2019E and £1.1m in 2020E versus a flat position in 2018 and 2019E and £0.5m 2020E previously. The cash balance will increase by materially post the finalisation of the second tranche of the placing, which we have yet to include in our estimates.

### Changes to Estimates (Year End September)

£m unless stated	FY18E			FY19E			FY20E		
	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)
Revenue	4.1	4.1	0%	5.0	5.0	0%	6.0	6.0	0%
Adj EBITDA	(0.4)	(0.4)	n.a.	0.1	0.2	100%	0.7	0.8	14%
Reported PBT	(0.9)	(0.9)	n.a.	(0.2)	(0.2)	n.a.	0.3	0.3	n.a.
Capital Expenditure	0.7	1.0	43%	0.1	1.1	1000%	0.2	0.2	n.a.
Cash	0.0	1.6		0.0	0.6		0.5	1.1	127%

Source: Progressive Research

Our revenue estimates have not changed, but we believe they are prudent given the O&G framework agreement signed post year end and the advanced discussion stage of a second, which underpin estimates. Adjusted EBITDA has increased in 2019E and 2020E because of our more positive gross margin assumptions. Adjusted PBT remains unchanged given the increased depreciation and amortisation costs resulting from the increased capital expenditure.

## Conclusion

Hardide has been benefitting from an improving outlook across its largest key markets which has continued through 2H17 and into the start of the 2018 financial year as outlined in its trading update. The successful £2.54m fundraising undertaken creates a solid platform for future growth. A strengthening of the balance sheet will allow for greater customer confidence when entering into long term contracts with Hardide. We believe our estimates are prudent, underpinned by the O&G framework signed post the FYE 2017 and the advanced stage of a second framework. We continue to expect that material A&D volumes should to emerge over the next 12-18 months, which could put further upward pressure on estimates.

Our more in-depth research review can be seen here in our recent initiation: *Ready for Take Off* (September 2017).

- B/S strength allow for greater customer confidence on LT contracts.

## SUMMARY FINANCIALS

PROFIT & LOSS	FY-15A	FY-16A	FY-17E	FY-18E	FY-19E	FY-20E
<b>Revenue</b>	<b>3.0</b>	<b>2.1</b>	<b>3.2</b>	<b>4.1</b>	<b>5.0</b>	<b>6.0</b>
Adj EBITDA	(0.3)	(1.3)	(0.7)	(0.4)	0.2	0.8
<b>Adj EBIT</b>	<b>(0.5)</b>	<b>(1.7)</b>	<b>(1.2)</b>	<b>(0.9)</b>	<b>(0.2)</b>	<b>0.3</b>
Reported PBT	(0.2)	(1.5)	(1.2)	(0.9)	(0.2)	0.3
<b>Fully adj PBT</b>	<b>(0.5)</b>	<b>(1.7)</b>	<b>(1.2)</b>	<b>(0.9)</b>	<b>(0.2)</b>	<b>0.3</b>
NOPAT	(0.5)	(1.7)	(1.2)	(0.9)	(0.2)	0.3
Reported EPS (p)	(0.0)	(0.1)	(0.1)	(0.1)	(0.0)	0.0
<b>Fully adj EPS (p)</b>	<b>(0.0)</b>	<b>(0.1)</b>	<b>(0.1)</b>	<b>(0.1)</b>	<b>(0.0)</b>	<b>0.0</b>
Dividend per share (p)	0.0	0.0	0.0	0.0	0.0	0.0

CASH FLOW & BALANCE SHEET	FY-15A	FY-16A	FY-17E	FY-18E	FY-19E	FY-20E
Operating cash flow	(0.2)	(1.4)	(0.6)	(0.5)	0.1	0.7
Free Cash flow (£m)	(1.1)	(1.9)	(0.8)	(1.5)	(0.9)	0.5
FCF per share (p)	(0.1)	(0.1)	(0.0)	(0.1)	(0.1)	0.0
Acquisitions	0.0	0.0	0.0	0.0	0.0	0.0
Disposals	0.0	0.0	0.0	0.0	0.0	0.0
Shares issued	0.0	1.6	0.0	1.6	0.0	0.0
<b>Net cash flow</b>	<b>(1.1)</b>	<b>(0.4)</b>	<b>(0.8)</b>	<b>0.4</b>	<b>(0.9)</b>	<b>0.5</b>
Overdrafts / borrowings	0.0	0.0	0.0	(0.2)	(0.2)	(0.2)
Cash & equivalents	2.3	2.0	1.2	1.6	0.6	1.1
<b>Net (Debt)/Cash</b>	<b>2.3</b>	<b>2.0</b>	<b>1.2</b>	<b>1.4</b>	<b>0.4</b>	<b>1.0</b>

NAV AND RETURNS	FY-15A	FY-16A	FY-17E	FY-18E	FY-19E	FY-20E
Net asset value	3.9	4.4	3.2	4.1	3.8	4.2
<b>NAV/share (p)</b>	<b>0.3</b>	<b>0.3</b>	<b>0.2</b>	<b>0.3</b>	<b>0.3</b>	<b>0.3</b>
Net Tangible Asset Value	3.8	4.3	3.1	4.0	3.8	4.1
<b>NTAV/share (p)</b>	<b>0.3</b>	<b>0.3</b>	<b>0.2</b>	<b>0.3</b>	<b>0.3</b>	<b>0.3</b>
Average equity	3.9	4.1	3.8	3.6	3.9	4.0
<b>Post-tax ROE (%)</b>	<b>-3.0%</b>	<b>-32.6%</b>	<b>-32.4%</b>	<b>-24.1%</b>	<b>-5.9%</b>	<b>7.5%</b>

METRICS	FY-15A	FY-16A	FY-17E	FY-18E	FY-19E	FY-20E
Revenue grow th	-1%	-29%	50%	26%	22%	20%
Adj EBITDA grow th	-366%	301%	-46%	-47%	-151%	307%
Adj EBIT grow th	-48700%	254%	-29%	-29%	-73%	-225%
Adj PBT grow th	642%	264%	-30%	-29%	-73%	-229%
Adj EPS grow th	640%	211%	-24%	-33%	-73%	-229%
Dividend grow th	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Adj EBIT margins	-16%	-80%	-38%	-22%	-5%	5%

VALUATION	FY-15A	FY-16A	FY-17E	FY-18E	FY-19E	FY-20E
EV/Sales	8.9	12.5	8.3	6.6	5.4	4.5
EV/EBITDA	(82.5)	(20.6)	(38.3)	(72.8)	141.7	34.8
EV/NOPAT	(55.3)	(15.4)	(21.9)	(30.7)	(112.7)	90.1
PER	n.a.	n.a.	n.a.	n.a.	n.a.	99.0
Dividend yield	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
FCF yield	-4.4%	-6.3%	-2.7%	-4.9%	-3.2%	1.8%

Source: Company information, Progressive Equity Research estimates

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