

# Phoslock Environmental Technologies Limited (ASX: PET)

## Environmental and Facilities Services Industry

Date

December 2023

Overview

Executive Summary

Details

Phoslock Environmental Technologies Limited designs, engineers, and implements solutions for water related projects and water treatment products.

Products

The Group offers two products. Phoslock, is a water treatment product that removes excess phosphate from the water by bentonite lanthanum. Phosflow, is a solution for flowing water remediation. The products are used to clean up lakes, rivers, canals, wetlands, and drinking water reservoirs.

Key Takeaways

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Phoslock's rapid expansion into China, led to poor risk control, bribes, fraudulent activities perpetrated by the Directors of their Chinese subsidiary. This led to accounting irregularities and substantial financial losses.

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Revenues have decreased by 52.0% from \$6.3m in FY21 to \$3.0m in FY22 because of project delays and restructures in Europe and China.

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Despite ongoing efforts to raise funds, the Group currently has no debt. At the current rate of net cash outflows from operations (\$5.6m) 9 months YTD, there is an estimated 5 quarters of funding remaining.

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The Group has recovered \$5.3m AUD from a Chinese creditor, this was paid to Phoslock's Beijing based subsidiary BEST. If the funds are repatriated back to Australia, it should provide an additional 3 quarters of runway.

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An Extraordinary General Meeting (EGM) will be held on 18 January 2024 to consider a proposed business sale to SePRO Corporation and de-listing. In the event this occurs, there is no necessary involvement from KordaMentha.

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Should the vote fail, the Board expects to appoint voluntary administrators.

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An alternate resolution will be considered in the EGM for a continuation of the business under a new Board. This does not change the distressed nature of the Group. The Group should be monitored by KordaMentha.

R/Office

The Commons, 10-20 Gwynne Street, Cremorne, Victoria, 3000, Australia

Website

<http://www.phoslock.com.au/>

Market Cap

\$15.6m (9 August 2023)

Business Model

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Phoslock has implemented a distribution-led go-to-market model.

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The Business is highly seasonal as Phoslock is in higher demand in warmer months. Phoslock is used to trap phosphorus, a main nutrient source for algae.

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Approximately 75% of the Group's external revenue was derived from the sales to 3 customers.

159

223

2,578

62

■ Australasia

■ Europe

■ Americas

■ China

\$'000 Revenue by geographical region

Health Scorecard

Profitability

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The Group continues to make losses across FY22 (\$11.2m) and FY21 (\$3.9m), as fixed costs remain high despite falling revenues.

Cash flow

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Net operating cashflows remain negative. Operating cash flows for 9 months YTD was (\$5.6m), representing an annualised decrease of 4.6%. With the current cash on hand, 5 quarters of funding remains.

Debt

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The Group has no external loan facilities, despite efforts to raise funds. It is unclear how the Group will meet its financial obligations under current circumstances.

Advisers

Stockbroker

Lawyers

Auditors

Consultants

Forensics

BW Equities

Arnold Bloch Leibler

SW Audit

Resolute Advisory

FTI and KPMG

Management

David Krasnostein

Lachlan McKinnon

Matthew Parker

Simon Greaves

Kate Waters-Hart

Chairman of the Board

MD

Company Secretary

Executive - Operations

Manager - Aquatic Science

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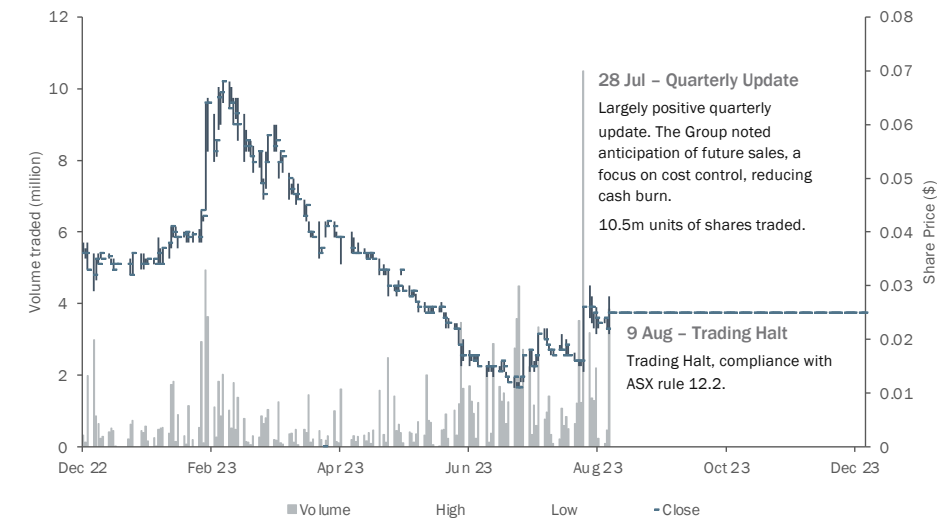
Leads					
Financials					
Profit and Loss					
FY-end 30 June AUD \$'000	12 months to:			6 months to:	
	FY20	FY21	FY22	1HFY22	1HFY23
Sales Revenue	6,878	6,297	3,022	1,258	1,002
Gross Profit	4,103	3,586	1,396	715	531
Underlying EBITDA	(18,463)	(6,234)	(9,975)	(6,022)	(3,635)
Underlying EBIT	(18,650)	(6,295)	(9,988)	(6,035)	(3,797)
Interest Received	(98)	31	76	11	38
Profit Before tax	(25,764)	(3,937)	(11,212)	(6,507)	(5,165)
NPAT	(25,492)	(3,937)	(11,212)	(6,507)	(5,165)
Balance Sheet					
Cash and Cash Equivalents	30,441	22,991	14,456	14,456	10,305
Total Receivables	2,726	2,781	681	681	975
Borrowings (ST + LT)	310	NA	NA	NA	NA
Net Assets	29,647	25,817	14,641	14,641	9,536
Net Debt	(26,605)	(21,699)	(13,501)	(16,664)	(9,792)
Cash Flow					
Net CF – Operating Activities	(12,554)	(6,926)	(7,070)	(4,507)	(3,499)
Net CF – Investing Activities	(52)	(141)	(628)	(245)	(374)
Net CF – Financing Activities	27,959	(480)	(687)	(510)	(331)
Net CF for the Period	15,353	(7,547)	(8,385)	(5,262)	(4,204)
Working Capital					
Receivables	2,726	2,781	681	681	975
Inventory	3,959	3,305	2,420	2,420	1,821
Payables	3,815	2,935	2,104	2,104	1,618
Net Working Capital	4,469	4,412	1,638	2,241	1,268
Ratios					
Gross Margin %	59.7	56.9	46.2	56.5	52.9
EBIT Margin %	(271.2)	(99.9)	(330.5)	(479.7)	(378.9)
Return on Assets %	(86.0)	(15.3)	(76.6)	(22.2)	(27.1)
Current Ratio	7.6x	7.8x	6.5x	NA	NA
Estimated Cash for Future Operating Activities					
Net cash from/ (used in) operating activities in Q3 23 <sup>(1)</sup>				(1,726)	
Cash and cash equivalents at quarter end <sup>(2)</sup>				8,452	
Estimated quarters of funding available <sup>(2/4)</sup>				5	

Status	Monitor
Issues	
Profitability	
Revenue	<ul style="list-style-type: none"><li>The Group has posted revenues of \$3.0m in FY22 (52.0% decreased from FY21). This was owing to steep declines in revenues from China (\$756,000) and Europe (\$3.8m). Government authorities have prioritised immediate health COVID funding over lake restoration projects.</li><li>Revenues are also highly concentrated, as 75.0% of revenues were derived from 3 customers in FY22, down from 72.0% of revenues concentrated between 4 customers in FY21.</li><li>Phoslock achieved healthy gross margins of 46.2% in FY22, albeit lower than historical gross margins above 50.0%. Caused by higher freight costs, gross margin declined (10.7%) in FY22.</li></ul>
Expenses	<ul style="list-style-type: none"><li>While cost of sales across FY22 was slightly down, other expenses also materially increased, resulting in poorer profitability. The largest expense increases are as follows:<ul style="list-style-type: none"><li>Occupancy expenses increased by 312.5% to (\$332,000).</li><li>Impairment costs increased by 35.7% to (\$2.2m).</li><li>Administration expenses increased by 3.1% to (\$5.5m).</li></ul></li><li>The Group has implemented cost-cutting procedures in 2023. Occupancy expenses have drastically decreased to (\$29,000) for 1H23, as the Group moved headquarters. Director, listing and professional fees have also decreased by an annualised (38.2%) to (\$1.6m) in 1H23. Lachlan McKinnon and Matthew Parker roles as CEO and CFO have been terminated.</li><li>Additionally, \$5.3m will be reversed for impairment of receivables in Q4 23.</li></ul>
Profitability	<ul style="list-style-type: none"><li>The Group displays poor cost controls. The decrease in revenue by 52.0% is not proportional to the increases in various expenses, which led to a decline in profitability to (\$11.2m) in FY22.</li></ul>
Cash Flow and Balance Sheet	
Cash Flow	<ul style="list-style-type: none"><li>The Group posted an operating cash outflow of (\$5.6m) in 9 months of 2023, which is an annualised (4.6%) decrease from an outflow of (\$7.1m) in FY22. This position indicates that with only \$8.5m in cash and cash equivalents as of 30 September 2023, there is an estimated 5 quarters of funding available in the absence of additional funds.</li><li>The Group has posted significant cash outflows over the past 3 years. Phoslock's cash reserves have decreased from \$30.4m in FY20 to \$8.5m on 30 September 2023, an average of (\$2.0m) cash outflow each quarter.</li></ul>
Balance Sheet	<ul style="list-style-type: none"><li>The Group has struggled to raise additional corporate funds since the \$12.0m equity raise in April 2020. The Company currently has no debt.</li><li>Phoslock's cash and cash equivalents since the last capital raising in FY20 has fallen (72.0%) from \$30.4m to \$8.5m on 30 September 2023.</li><li>Reduced business activity resulted in a (75.5%) decrease in receivables to \$0.7m in FY22. Additionally, inventory held largely exceeded demand. Provisions for impairment were (\$2.1m) in FY22, up (18.5%) from (\$1.8m) in FY21.</li><li>The Group posted large allowances for expected credit losses in FY22 (\$7.9m) and (\$8.1m) in FY21. This was largely related to the amount owing from a Chinese creditor for the XingYun project. 75.0% of the amount owing, equivalent to \$5.3m was recovered in October.</li></ul>
Outlook	
<ul style="list-style-type: none"><li>The key challenge for the Group is to continue to as a going concern due to its high cash burn.</li><li>The Group is considering an asset sale to SePRO Corporation in the January EGM.</li><li>Repatriation of the recovered funds from XingYun Lake project (equivalent to \$5.3m), will provide an approximate 3 quarters of additional funding. These funds will be subject to movements in exchange rates and foreign policy between China and Australia.</li><li>Shareholders have voiced their concern over the competency of the current Board. An alternate resolution to continue the business under a new Board will be considered in the January Extraordinary General Meeting. A class action has also been organised by Levitt Robinson.</li></ul>	

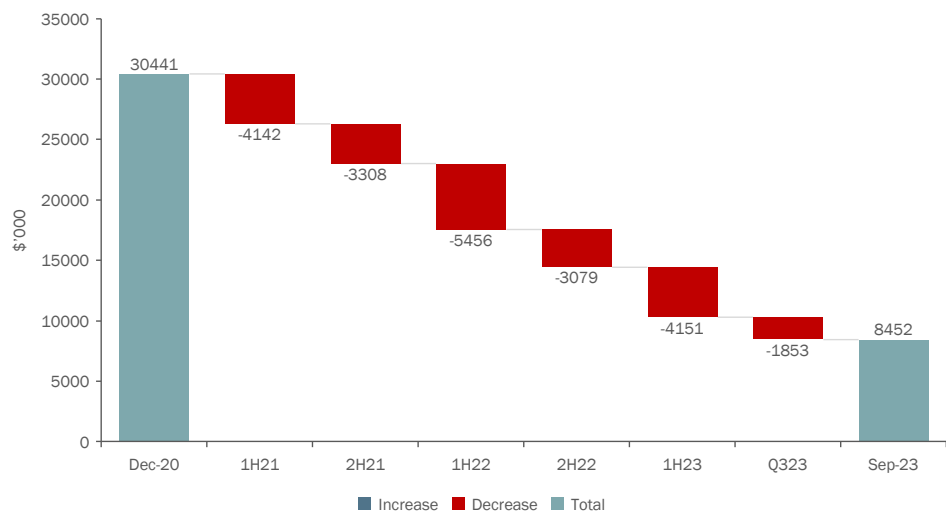
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## Environmental and Facilities Services Industry

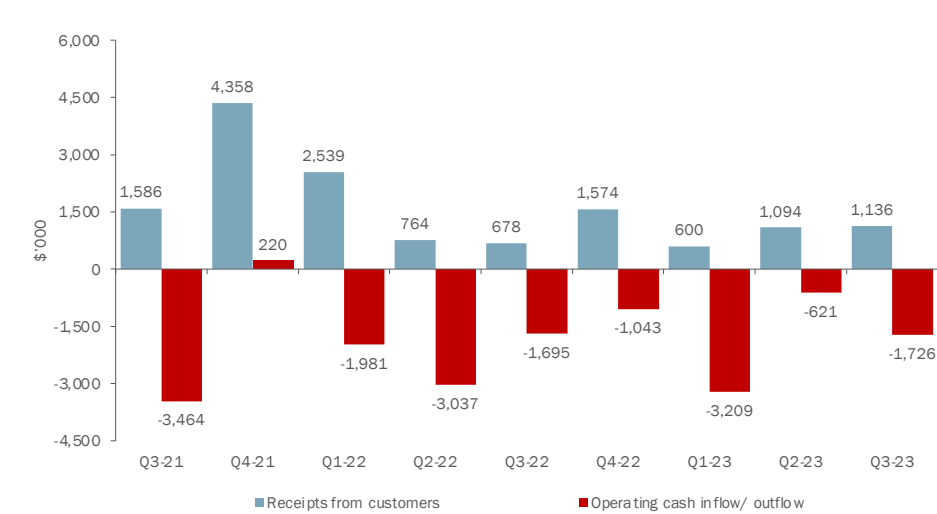
Phoslock Environmental Technologies Limited – share price and volume traded



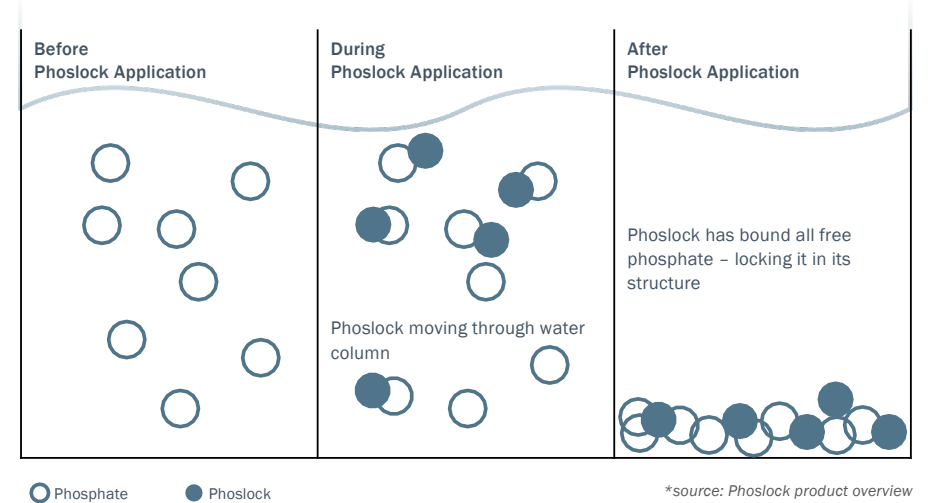
Phoslock Environmental Technologies – Cash and cash equivalents



Phoslock Environmental Technologies – receipts to operating cash flow




Phoslock Environmental Technologies – Phoslock application



Company Overview

The Group’s rapid expansion into China, led to poor risk control, bribes and fraudulent activities



### Cash outflow

Despite ongoing efforts to raise funds, the Group currently has no debt. At the current rate of net cash outflows from operations (\$5.6m) 9 months YTD, there is an estimated 5 quarters of funding remaining.

### Proposed asset sale

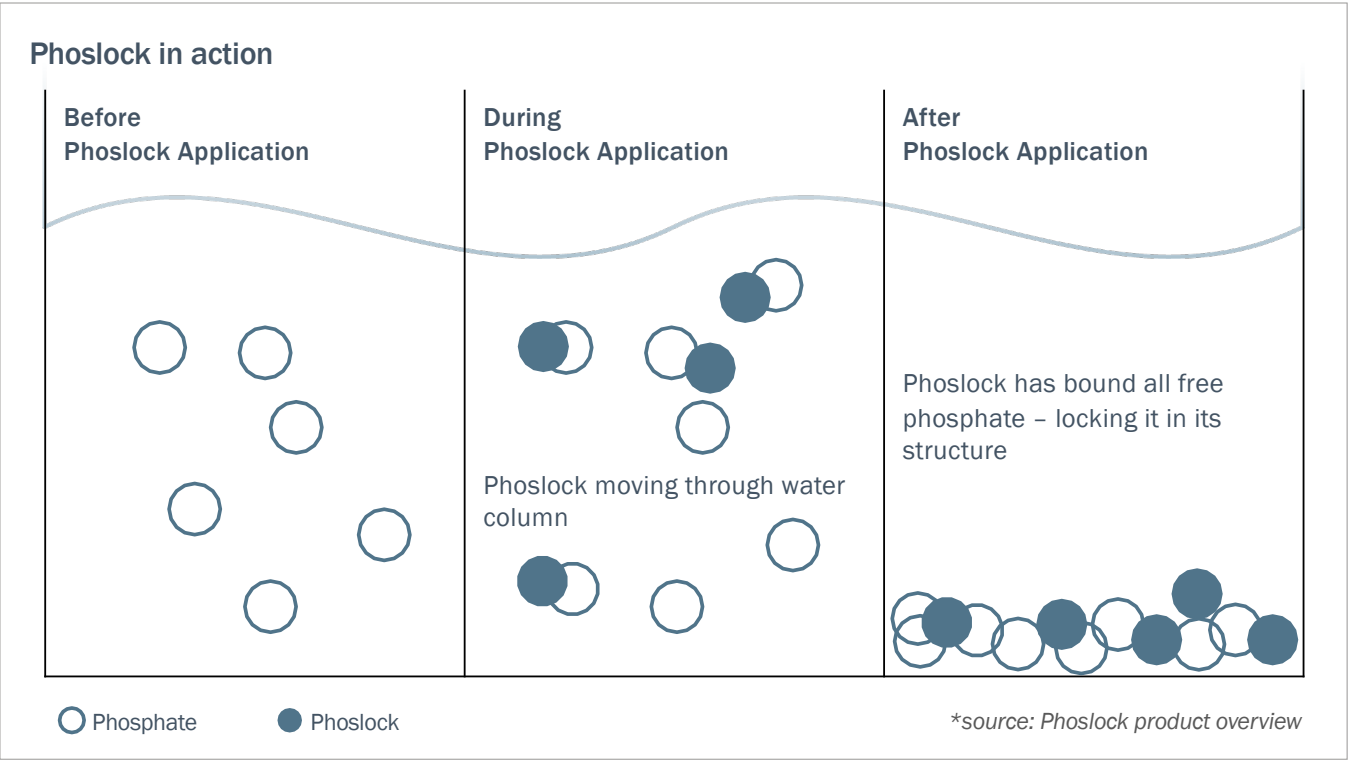
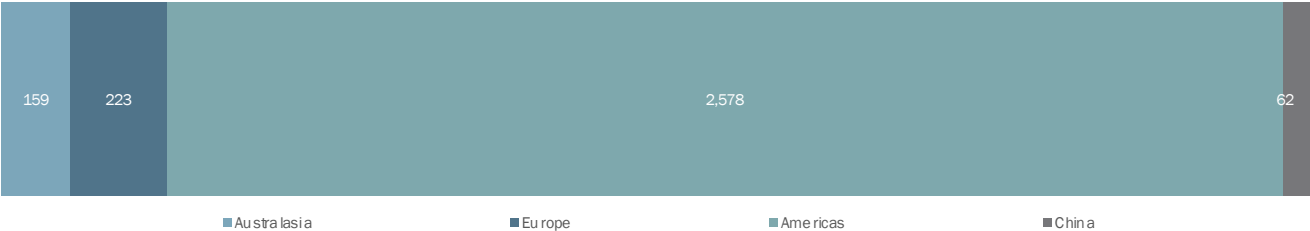
An EGM will be held on 18 January 2024 to consider a proposed sale to SePRO Corporation and de-listing.

Should the vote fail the Board expects to appoint Voluntary Administrators.

### Alternate resolution

An alternate resolution will be considered for a continuation of the business under a new Board. This does not change the distressed nature of the Group.

Revenue by geographical region (“\$000)



## Financials and Cash Flow

### 5 quarters of funding remain due to falling revenues and high operating costs

#### Cash Flow and Balance Sheet

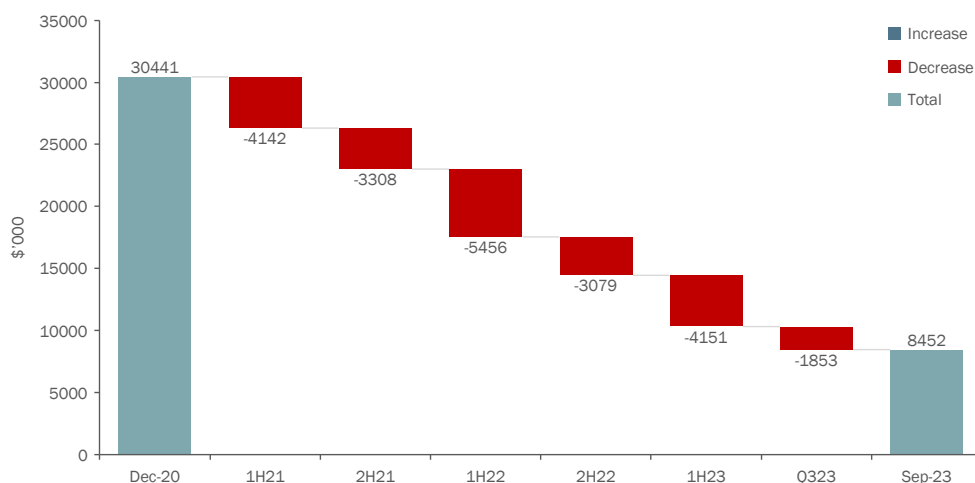
##### Cash Flow

- The Group has posted significant cash outflows over the past 3 years. Phoslock's cash reserves have decreased from \$30.4m in FY20 to \$8.5m on 30 September 2023, an average of (\$2.0m) cash outflow each quarter.
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##### Balance Sheet

- The Group has struggled to raise additional corporate funds since the \$12.0m equity raise in April 2020. The Company currently has no debt.
- \$5.3m has been recovered from a Chinese creditor in October 2023.

##### Cash and cash equivalents



#### Profitability

Revenue - FY22

**\$3.2m**

Down 52.0%

EBIT - FY22

**(\$9.9)m**

Down 58.6%

Cash - Q3 23

**\$8.5m**

Down 55.3% a.

CFO - Q3 23

**(\$1.7)m**

Down 4.6% a.

##### Revenue

- The Group has posted revenues of \$3.0m in FY22 (52.0% decreased from FY21). This was owing to steep declines in revenues from China (\$756,000) and Europe (\$3.8m). Government authorities have prioritised immediate health COVID funding over lake restoration projects.
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  - Occupancy expenses increased by 312.5% to (\$332,000).
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##### Profitability

- The Group displays poor cost controls. The decrease in revenue by 52.0% is not proportional to the increases in various expenses, which led to a decline in profitability to (\$11.2m) in FY22.

#### Estimated Cash for Future Operating Activities

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Cash and cash equivalents at quarter end <sup>(2)</sup>	8,452
<b>Estimated quarters of funding available <sup>(2/1)</sup></b>	<b>5</b>

## Outlook and Next Steps

### Monitor the EGM, Voluntary Administrators may be necessary if a sale does not occur

#### Outlook

##### Sale of Business

- Management expects that upon the completion of the Business Sale, shareholders will receive around 1.7 – 2.0 per share.
- (20.0%) – (32.0%) less than the closing price of the Shares.

##### Funding

- The Board has noted no actionable interest from potential investors to invest directly into the PET entity to date. This is despite the Group's engagement since April 2023 to seek potential investors and industry players to contribute capital or partner with Phoslock.

##### Trading

- If the Group continues to trade, the key challenge is for Phoslock to remain a going concern due to its high cash burn.
- Repatriation of the recovered funds from China will extend the estimated amount of funding available to 8 quarters.

Phoslock Environmental Technologies Limited – share price and volume traded



#### Resolutions/ Outcomes of January's EGM

01

No involvement

Sale of all business and intellectual business to SePRO. Delist off the ASX.

No involvement if a sale occurs.

02

Monitor

Continuation under a new Board and management

This does not change the distressed nature of the business. An informal engagement, to provide Safe Harbour Advice in the future.

03

Pursuit

Neither outcomes occur, and current management retains control.

The current Board has noted that it would be necessary to appoint Voluntary Administrators.

# Timeline of Events

## Phoslock Environmental Technologies Limited (ASX:PET)

