Vysarn Limited *ASX: VYS*

Vysarn Limited (VYS) is the holding company of Pentium Hydro Pty Ltd, a hydrogeological, dewatering service and equipment provider mainly targeting tier 1 and 2 mining operators based in the Pilbara region, Perth, WA.

SP as of 16/09/2020: 0.078c
SOI: 386.96m
Market Cap: 27.03m
Current P/E ratio: 3.93
Industry: Materials

A Story Starting with a Bargain

On 29 August 2019, Vysarn completed the acquisition of the drilling assets from Ausdrill. These assets were originally part of Ausdrill's hydrogeological drilling business known as 'Connector Drilling', comprising of 10 drill rigs and supporting ancillary equipment and inventory. The consideration paid was $16 million. After independent valuation, it was determined the net assets at acquisition date fair value was 23.6 million. It is interesting to note that back in 2011, Ausdrill acquired these assets for around 30 million, the reason for the sale was with it no longer fit within the new strategic direction of Ausdrill.

This acquisition kicked off the first chapter of Vysarn's story, with the Company aiming to become a significant production critical services and solutions provider to the mining industry. Following this acquisition, Vysarn has been quick to attempt to establish itself a reputation to execute challenging scopes of work with Tier-1 and 2 mining companies, growing mainly organically but also with a view to acquire complementary bolt-on acquisitions to cross-selling and become a full-service specialised whole of water provider.

> Exclusive to drilling, the board has ascertained that there is a genuine business case for developing the current business into a vertically integrated whole of life water service provider. The board is currently reviewing several opportunities both organically and via acquisition. These opportunities encompass minor bolt-on services through to company transformational acquisitions.

Source: Vysarn Limited FY2020 Results Commentary

The Business Model

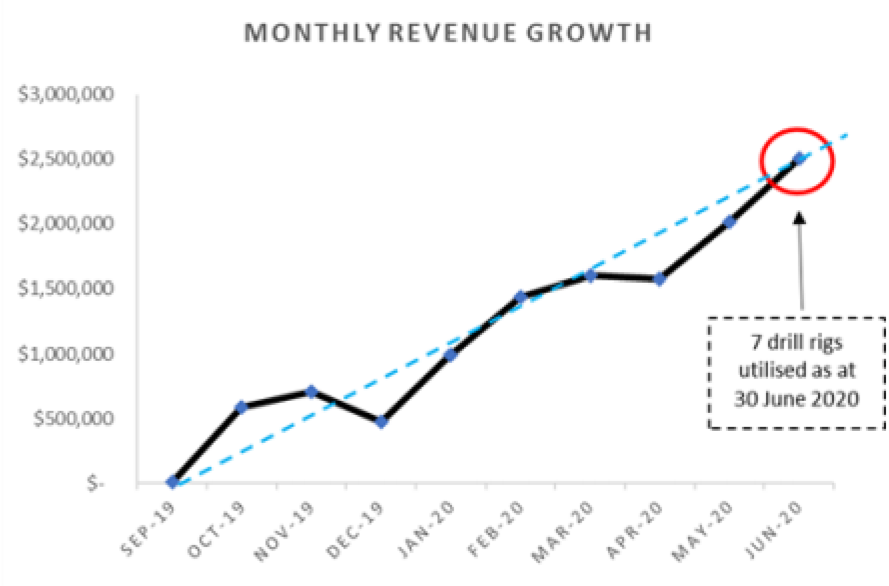
Vysam currently operates in WA in the Pilbara region. The company owns 12 drill rigs and has over 55 employees mainly comprised of hydrogeologists, drilling assistants and contractors to service their tier 1 and 2 mining customers (Fortescue, Iluka Resources, AngloGold Ashanti and more). Customers generally enter into fixed term contracts with their subsidiary Pentium Hydro to access dewatering services and drill rigs machineries, signing agreements to solve their existing problems where a high level of ground water is a major impediment to their production, particularly iron ore.

> The Company drills holes in the ground that will enable mining companies to "de-water" areas where high water table issues prevent mining companies from accessing ore bodies and efficiently mining them.

Source: https://spokecorporate.com/news-item/perth-company-finds-success-by-tapping-into-the-water-table/324e40f9-9af6-5e67-07a4-5f32093700fa

The incentive here for mining operators to extract and dewater going deeper into the ground is of great value, as most of the Pilbara iron ore mines have a large amount of ore below the ground water level. In some reserves, 35% of iron ore is found above these water levels, while a further 65% can be found below. Out of the 12 drills rigs (with two additional rigs recently purchased arriving in September 2020), 8 are deployed as of 16/09/2020, bringing in a total revenue of $11.91 million from operations, an EBITDA of $6.03 million and NPAT of $4.84 million.

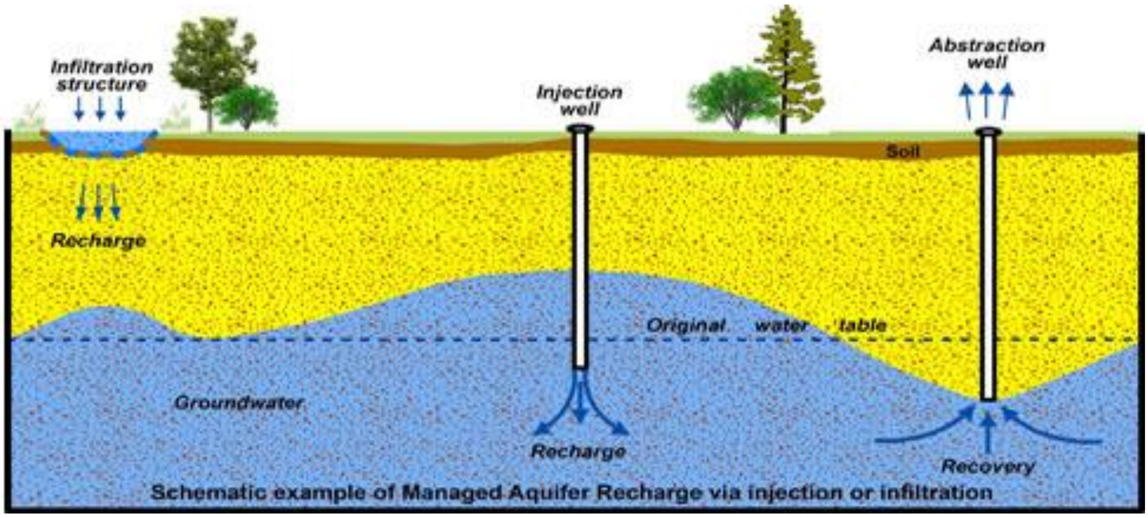
Perhaps the most important thing to note here is that monthly revenue continues to grow as more rigs are deployed, while management is confident that should they maintain the current contracts while securing a number of upcoming earmarked multi-rig, multi-year contracts leading into June half of 2021, they will be able to exceed last year's EBITDA. This provides validation that the demand for drill rigs has not slowed down. With the price for iron ore continuing to trend higher, sitting at $124.5 USD per tonne (as of 16/09/2020), the Pilbara region accounting for ~450 gigalitres (GL) of extracted water last year, which is set to increase to ~580GL forecasted by 2024 as companies mine further below to locate iron ore, Vysarn's growing reputation and the amount of groundwater should provide enough tailwinds required for business continuity and growth.



Source: Visaryn Limited FY2020 Results Commentary

As Vysarn continues its growth, it worth mentioning the moat here. Firstly, in a recent call with management, it is noted a brand new drill-rig along with necessary equipment for operational purposes can cost upwards of $5 million USD. A large amount of this is involved in the packaging, shipping and delivery process from overseas which could take a considerable time of time to arrive domestically. Secondly, Tier 1 and 2 mining operators require at least 2 or more drilling rigs to be available at any given time. This is because if one is broken, then the other one can be supplemented and operations can continue. The high cost of entry here should provide a strong insulant against competitors or any start-ups for Vysarn to operate sustainably. Any entrants will need to have a significant amount of capital, contractors and industry expertise to be able to compete.

Another interesting point noted during the management call was the WA Government's [Managed Aquifer Recharge Policy], which essentially states that water derived from the ground will need to 'recharged', which means be put back into the ground in the region. The recharge of aquifers provides certain environmental benefits including the reduce for salt-water intrusion, maintaining wetlands in groundwater constraint areas and the storage of recharged water as supplies of drinking water. Mining companies must oblige to these regulatory guidelines. The effects of this cyclical activity of dewatering and recharging should mean that the business's services are sustainable over the long run, as long as mining activities continues.



Source: https://www.water.wa.gov.au/urban-water/water-recycling-efficiencies/managed-aquifer-recharge

Digging into the numbers

FY20 revenue figure stands at 11.91m from operating income, an improvement of 7,188% compared to FY19 not accounting for the $7.18 million gain on bargain purchase, resulting from the difference between the price paid for the assets and the independent market value of the assets acquired. The current business model delivered a Return on Equity (ROE) of 28.4% for FY20, a substantial improvement on 2.4% in FY19, along with an EBITDA of $6.03 million and NPAT of $4.84 million.

It is important to note here, 1H20 revenue was $1.78 million, which reflected costs involving the start-up phrase, while 2H20 produced $10.13 million as the revenues from won tenders and contracts begun to trickle in (contracts announced are in the table below). With a solid NTA backing of $24.33 million and $7.10 million in current assets which represents 6.29 cents per share, this is significant compared to the current market cap of ~27 million with shares currently trading at 7.8 cents (as of 16/09/2020). The Earnings Per Share (EPS) based off NPAT/SOI for FY20 is 0.0125 cents (as of 16/09/2020). From an overtly pessimistic point of view, one can arguably say in the extremely unlikely scenario that the Company fold with administrators called in, NTA backing should still be able to return at least 5-6 cents per share from the sale of assets.

Debt currently stands at $9.78 million and is separated into two classes, one which is an asset finance facility accounting for approximately $1.70 million at 3.3-4% fixed interest rate, while the other is a $8.00 million long-term bank loan repayable in monthly instalments at 4.41% interest p.a. until expiry in July 2023. The main thing to note here is that the bank loan was used strategically as part of the funding to purchase the assets from Ausdrill, rather than funding existing services or existing operational requirements.

Cash currently stands at $9.71 million, with the most recent equity raise occurring in May raising $4.02 million at 0.045 cents for up to 89,297,618 shares. Existing shareholders here subscribed for 57,368,435 shares for a subscribed amount of $2.58 million (65% of the offer), while pleasingly, when given the opportunity for existing holders and management to subscribe to the shortfall of 31,929,182 shares, the full amount was subsequently met and raised with management subscribing to approximately $1.25 million worth of shortfall shares. The dispatching was completed on 1 July 2020.

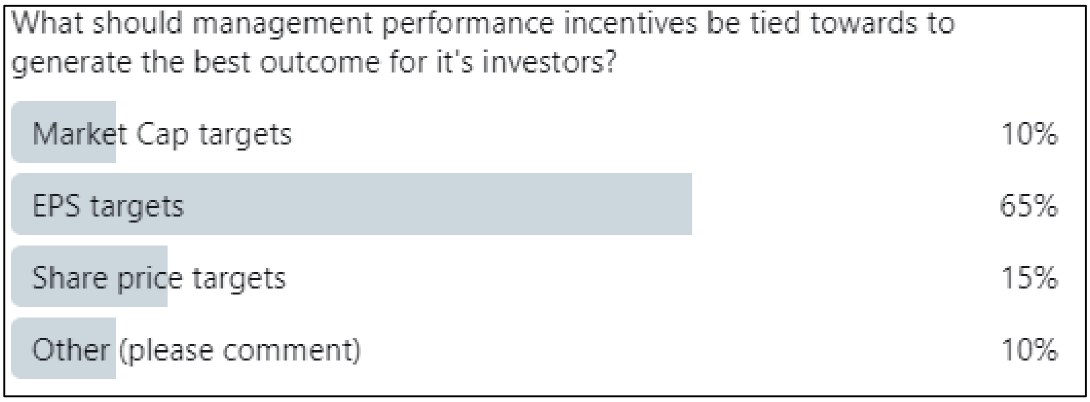
The main reason for the raise here as stated by management was to strengthen the balance sheet. It was a prudent and smart approach mainly due to the uncertainty across any potential COVID-19 impacts and to keep a strong grip on the debt should there be a need to rapidly repay it down.

Customer	**Announcement date**	**Rigs deployed**	**Revenue**	**Contract length**
Easternwell WA Pty Ltd	19 August 2019 and 20 March 2020 (extension).	2	$4,500 per shift	4 months
Chichester Metals Pty Ltd (subsidiary of FMG)	16 September 2019	1	$800,000	2 months
AngloGold Ashani Australia	27 September 2019	1	$541,000	3 months
Roy Hill Iron Ore Pty Ltd	1 November 2019	1	$2,000,000	7 months
Chichester Metals Pty Ltd + FMG Solomon Pty Ltd	28 November 2019	2	$13,300,000	2 years with 1 year extension option
Roy Hill Iron Ore Pty Ltd	08 January 2020	1	$1,300,000	3-4 months
Iluka Resources Limited	16 January 2020	1	$1,875,000	9 months
Roy Hill Iron Ore Pty Ltd	30 March 2020	1	Unspecified	4-5 months
Total **8**	**N/A**	**10 (incl. redeployment)**	**$19,816,000 (excl. revenue for Easternwell WA and 3rd Roy Hill Iron Ore Pty Ltd order as total revenue is unknown).**	**N/A**

Management ownership

The main management consists of Peter Hutchinson (NEC), James Clement (MD and CEO) and Sheldon Burt (ED and MD Pentium Hydro) and Christopher Brophy (NED). Together management owns over 75,483,630 shares which currently accounts for roughly 19.5% of the total register.

A really positive note here is that management has 15,000,000 performance rights tied towards longevity in management and cumulative EPS appreciation, which conditions compound annual growth in the Company's EPS of 15% per annum. EPS is generally the preferable performance incentive for management among investors, as set out recent in a recent Twitter poll below conducted.



Source: https://twitter.com/1Shangwlux

Additionally, Peter Hutchinson is well known for his time at ASX listed Forge Group, founding the company where he floated it in 2007 and growing the market cap from $12.00m to over $450m where he exited in July 2012. It is important to note he was not involved in the collapse of Forge in 2014. Peter Hutchinson along with James Clement also founded Maraterram Limited $MTM, which was taken over at a 31% premium to the 30-day volume.

With the Chairman owning approximately 56,000,000 out of the total 75,483,630 shares (74%) by management, one can imagine that Peter has the big plans to continue to grow the business and replicate the success similar success in the early days of Forge.

Outlook and thoughts

Although the majority of the contracts are of less than a year, it is important to note that future contracts, if won, are more likely to be multi-year, multi-rig contracts. Management has also plans to become a back to back full service specialised provider, as the industry is currently fragmented with a number of smaller water solution providers to Tier-1 and 2 mining companies. Bolt-on acquisitions are on the table where they make sense, which will likely enable cross-selling opportunities. This feeds well into Management's expectation that the majority of the rigs fleet is expected to be deployed in FY21, with the recent purchasing of 2 additional rigs arriving from New Zealand in September 2020 adding extra back-up and strengthening their fleet.

With management having skin in the game, should the company continue to position itself as a high quality service and equipment provider by winning further tenders, this may be a story whereas management executes, the share price follows, as investors looks for excellent fundamentals alongside value. The current P/E ratio at 3.93 seems a little low as it seems to not factor in the potentiality of further multi-year contracts, dividend and bolt on acquisitions. If management can execute, one can think that the share price can easily go multiple folds with a small market cap and SOI.