Evolva

Capital restructuring

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Food & beverages

On 2 October, Evolva announced equity financing plans with the aim of raising CHF80m (gross) proceeds in two separate transactions in October and November 2017. The funds will be used to continue investing in R&D, and in commercialisation of the products. The company has not ruled out further debt financing in the coming months to meet its contractual obligations to its partner, Cargill. The new equity financing plans should have raised enough cash (CHF86m) to allow the company to reach break-even, expected around FY21. Our fair value is CHF0.65 per share (previously CHF0.69) and we believe this remains an attractive investment.

Year end	Revenue (CHFm)	PBT* (CHFm)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
12/16	9.5	(36.0)	(6.9)	0.0	N/A	N/A
12/17e	7.4	(30.9)	(5.5)	0.0	N/A	N/A
12/18e	11.3	(28.9)	(3.7)	0.0	N/A	N/A
12/19e	25.2	(19.6)	(2.5)	0.0	N/A	N/A

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

Increased focus

Management has undertaken a strategic review and, as a result, has decided to improve the focus of the company. Evolva will concentrate on three existing products: EverSweet, its stevia sweetener that is partnered with Cargill, resveratrol and nootkatone. Milestone-based R&D partnerships will be wound down to reduce cash burn and to allow better focus on existing products, as the company moves from an R&D and technology platform with a number of products with potential, to an innovative ingredients company with a number of commercialised products.

Making the transformation

The new focus of the company is on commercialising existing products and reaching profitability. The launch of EverSweet remains on track for 2018 and we expect nootkatone to be approved as an insect repellent by the US Environmental Protection Agency (EPA) during 2018, thus paving the way for its large-scale commercialisation. We expect resveratrol to take more time until its full commercialisation potential is achieved; we expect sales to ramp up significantly in FY21 and peak sales to be achieved in FY25. Overall, we expect cost control to increase in importance as Evolva gives its R&D platform a much narrower focus. Revenues from R&D partnerships will also fall as fewer of these are undertaken.

Valuation: Fair value of CHF0.65 per share

Our fair value is CHF0.65/share (previously CHF0.69). We have updated our model to reflect the new guidance and equity financing. We continue to value Evolva on a DCF basis with a 25-year model. According to our model, the equity financing has raised enough cash to take the company through to break-even in FY21 (management guidance: four to six years), although management has indicated that it will be looking to secure additional project financing relating to its Cargill agreement.

5 January 2018

Price	**CHF0.35**
Market cap	**CHF270m**

Net cash (CHFm) at 30 June 2017	33.8
Shares in issue	770.6m
Free float	76%
Code	EVE
Primary exchange	SIX Swiss Ex
Secondary exchange	OTC US

Share price performance

%	1m	3m	12m
Abs	12.9	19.3	(44.3)
Rel (local)	10.8	16.5	(51.1)
52-week high/low		CHF0.6	CHF0.3

Business description

Evolva is a Swiss high-tech fermentation company. It has a proprietary yeast technology platform, which it uses to create and manufacture high-value speciality molecules for nutritional and consumer products.

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Valuation

We detail our valuation in **Error! Reference source not found.** Our fair value falls slightly to CHF0.65/share from CHF0.69/share previously. We have updated our model in light of the strategic review and equity financing discussed above. Our valuation now purely reflects the products on which Evolva has chosen to concentrate, and we ascribe a value of zero to all other alliances/collaborations and other projects. We recognise that the latter do retain some residual value, but for the sake of conservatism we err on the side of caution. Management has stated that if commercial partners were to express an interest in these existing projects (for example saffron or santalol), it would consider them.

Exhibit 1: Summary of DCF valuation

Product	Value (CHFm)	Value/share (CHF)	Notes
Stevia	167.9	0.22	Launch date: 2018; peak sales: $600m; likelihood of success 90%; operating margin: 30%; profit share: 30%.
Resveratrol	29.8	0.04	Launched; peak sales: $140m; likelihood of success 75%; margin: 30%.
Nootkatone	234.4	0.30	Launched; peak sales: $150m; likelihood of success 75%*; margin: 40%.
Valencene	18.1	0.02	Launched; peak sales: $10m; likelihood of success 90%; margin: 40%.
Capex	(46.9)	(0.06)	Includes investment of $60m for commercialisation of stevia with Cargill
Net cash	99.4	0.13	Forecast net cash at end FY17
Total	**502.7**	**0.65**	**Using FY18 average number of shares throughout**

Source: Edison Investment Research. Note: WACC = 12.5%. *There is no developmental risk associated with nootkatone, but we have applied a risk adjustment due to uncertainty about the use of the product as an insect repellent.

We use a 25-year DCF valuation with a fade. Each product has varying peak sales, margins, ramp-up assumptions and probabilities of success, as detailed above. In each case, we reduce the R&D and operating expenditure after launch to reflect the lower level of investment required once the product is established on the market. We start to fade stevia in 2031 (year 13) and the other products in 2035 (year 17), and we also assume they become commoditised and their operating margins fall to the single digits, which is the level of commoditised food ingredients. Stevia remains a key product, at c 35% of our valuation, after adjusting for tax and capex, but note that we see greater value overall in nootkatone.

We have adjusted our model to better reflect the new focus on existing products. We now charge R&D costs and tax to each product line independently, and hence no longer charge a total R&D and total tax amount. This also aids comparison between stevia and the other products; as stevia will be produced via the JV with Cargill, it will appear as an associate on the P&L.

We have reviewed our peak sales and margin assumptions for each product and have trimmed our resveratrol peak sales assumption from $200m to $140m given management's stated aim of focusing its R&D. Resveratrol initially had a wide range of potential applications, and inevitably over time there will be a narrower focus on the more promising areas, which is likely to be accelerated by management's cost control initiatives. Our peak operating margin also falls from 40% to 30% as the resveratrol end-markets (anti-ageing, dietary supplements, etc) are competitive and Evolva is likely to have to make its pricing attractive to achieve commercial success. We have left our peak sales and margin assumptions unchanged for nootkatone, but now assume sales start to fade in 2035 (year 17) rather than in FY25. As a reminder, Evolva has signed an agreement with the US Centers for Disease Control and Prevention (CDC), which grants it exclusive worldwide rights to develop and commercialise nootkatone for the control of a wide range of disease and virus vectors.

Note that our model implies break-even during FY21, and hence the latest round of financing should be sufficient to see Evolva through until it reaches profitability. We note that the company still needs to raise some project financing relating to the Cargill agreement. Under the terms of the agreement, this financing must be ring-fenced and specific to the Cargill project. Given Evolva has just completed a successful rights issue and its financing position is secure for the foreseeable future, we believe that securing project financing for the Cargill agreement should be straightforward and the risks are low. That said, if Evolva failed to secure the project financing, under the terms of the agreement Cargill could force it into accepting a royalty stream rather than a profit share from the EverSweet JV. Given the need for significant financial contributions in terms of capex over the next few years and also beyond, in order to maintain the share of ownership, a royalty stream would result in a more rapid contribution to profit vis-à-vis owning a share of the JV. In addition, the risks would be lower for a royalty position, and hence a lower WACC for the project. Overall, therefore, the NPV of a royalty position is only somewhat less favourable than a JV.

Given the need for significant financial contributions not only over the next few years, but also beyond in order to keep the ownership share and the risks related to the profit margin management of EverSweet (that any business has), the WACC is different for an ownership share scenario from a WACC for a royalty position. All in all, this makes the NPV of a royalty position only somewhat less favorable.

We have also updated our near-term assumptions to reflect the outcome of the strategic and operational review. As management concentrates its efforts on transforming Evolva into an innovative ingredients company with a number of commercialised products, we believe milestone-based R&D partnerships will be wound down to reduce cash burn and allow better focus on the existing product suite. Therefore, revenue from R&D partnerships is likely to fall materially in the near term. Costs are also likely to be lower as the operational review will lead to a significant reduction in headcount, particularly around R&D.

All in all, we note that our overall valuation moves from CHF297.8m to CHF502.7m. We have updated our model to incorporate R&D expenditure, capex and tax into each product stream, in order to better reflect the multiple strands of the business, and the fact that the success or otherwise of one product stream should have little effect on the others. Our nootkatone value increases (from CHF121m) in light of the fade now occurring later, as described above. Our resveratrol value falls due to the lower peak sales assumption. As we mentioned above, we no longer ascribe a value to any of the alliances/collaborations, and our R&D forecast falls materially as management has indicated that R&D expenditure will be cut significantly. On a per-share basis, however, our valuation falls slightly (from CHF0.69 to CHF0.65) as a result of the equity issuance (the number of shares has risen from 474m to 771m).

Exhibit 2: Financial summary

CHF'000s	2015	2016	2017e	2018e	2019e
Year end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue	13,364	9,530	7,392	11,339	25,223
Cost of Sales	0	(2,951)	(1,855)	(5,096)	(13,186)
Gross Profit	13,364	6,578	5,536	6,242	12,037
EBITDA	(30,305)	(34,011)	(29,803)	(28,689)	(22,441)
Operating Profit (before GW and except.)	(31,947)	(36,124)	(31,947)	(36,124)	(30,856)
Intangible Amortisation	(3,779)	(5,090)	(5,090)	(5,090)	(5,090)
Exceptionals	0	0	0	0	0
Operating Profit	(35,726)	(41,215)	(35,947)	(34,823)	(28,572)
Net Interest	(129)	497	(60)	418	293
Other financial income	0	(338)	0	449	3,595
Profit Before Tax (norm)	(32,076)	(35,965)	(30,916)	(28,866)	(19,593)
Profit Before Tax (FRS 3)	(35,855)	(41,055)	(36,006)	(33,956)	(24,684)
Tax	4,067	5,160	0	0	0
Profit After Tax (norm)	(28,113)	(30,926)	(30,916)	(28,866)	(19,593)
Profit After Tax (FRS 3)	(31,788)	(35,896)	(36,006)	(33,956)	(24,684)
Average Number of Shares Outstanding (m)	401.3	452.8	558.3	770.6	770.6
EPS - normalised (c)	(7.0)	(6.9)	(5.5)	(3.7)	(2.5)
EPS - FRS 3 (c)	(7.9)	(8.0)	(6.4)	(4.4)	(3.2)
Dividend per share (c)	0.0	0.0	0.0	0.0	0.0
Gross Margin (%)	N/A	N/A	N/A	N/A	N/A
EBITDA Margin (%)	N/A	N/A	N/A	N/A	N/A
Operating Margin (before GW and except.) (%)	N/A	N/A	N/A	N/A	N/A
BALANCE SHEET					
Fixed Assets	143,457	141,356	143,243	170,134	170,068
Intangible Assets	131,940	130,256	125,165	120,075	114,985
Tangible Assets	8,431	7,522	7,454	7,435	7,460
Other fixed assets	3,086	3,578	10,624	42,624	47,624
Current Assets	88,780	56,880	109,969	50,939	28,141
Stocks	2,217	5,687	6,608	8,378	10,115
Debtors	2,785	2,139	2,430	2,796	4,146
Cash	83,228	47,517	99,394	38,228	12,342
Other current assets	550	1,537	1,537	1,537	1,537
Current Liabilities	(7,385)	(5,690)	(5,601)	(5,547)	(5,496)
Creditors	(1,182)	(1,174)	(1,086)	(1,032)	(980)
Short term borrowings	0	0	0	0	0
Finance lease obligations	(969)	(978)	(978)	(978)	(978)
Other current liabilities	(5,234)	(3,537)	(3,537)	(3,537)	(3,537)
Long Term Liabilities	(21,437)	(19,489)	(18,511)	(17,532)	(16,554)
Long term borrowings	0	0	0	0	0
Finance lease obligations	(4,134)	(3,564)	(2,586)	(1,607)	(629)
Other long term liabilities	(17,303)	(15,925)	(15,925)	(15,925)	(15,925)
Net Assets	203,416	173,057	229,100	197,994	176,160
CASH FLOW					
Operating Cash Flow	(31,353)	(33,597)	(30,254)	(29,580)	(19,135)
Net Interest	(376)	(301)	(60)	418	293
Tax	0	0	0	0	0
Capex	(1,865)	(947)	(985)	(1,025)	(1,066)
Acquisitions/disposals	3,278	(210)	0	0	0
Financing	59,956	0	89,200	0	0
Dividends	0	0	0	0	0
Other cash flow	(3,975)	(677)	(5,978)	(30,978)	(5,978)
Net Cash Flow	25,666	(35,731)	51,922	(61,165)	(25,886)
Opening net debt/(cash)	(57,191)	(83,228)	(47,471)	(99,394)	(38,228)
HP finance leases initiated	0	0	0	0	0
Other	371	(26)	1	(1)	1
Closing net debt/(cash)	(83,228)	(47,471)	(99,394)	(38,228)	(12,342)

Source: Edison Investment Research, company data

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