EDISON

Evolva

H117 results

Transformation evolving

Food & beverages

Evolva is transforming itself into a product-based company, and the new CEO is evaluating the organisational structure and operational strategy. R&D-based revenue is likely to fall due to the transformation. EverSweet remains on track for 2018 launch, nootkatone is on track for US regulatory approval in pest control in H218, and resveratrol revenues were up strongly. Our fair value falls to CHF0.69 as we cut our sales forecasts, but we continue to believe the current share price offers a good entry point.

Year end	Revenue (CHFm)	PBT* (CHFm)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
12/16	9.5	(36.0)	(7.8)	0.0	N/A	N/A
12/17e	8.4	(30.4)	(7.2)	0.0	N/A	N/A
12/18e	12.1	(28.3)	(6.5)	0.0	N/A	N/A
12/19e	34.2	(18.5)	(4.1)	0.0	N/A	N/A

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

H117 results

Total revenues of CHF3.6m were below our forecast of CHF6.0m and consensus of CHF5.8m, with both product and R&D revenues lower than expected, although the net loss of CHF20.3m was broadly in line with consensus of CHF18.6m. Given the guidance for FY17 product revenues to at least triple vs the CHF1.1m reported in 2016, we have cut our sales assumptions for FY17 from CHF15.3m to CHF8.4m, and we also cut sales forecasts for FY18 and FY19.

Transformation continues

Over the past few years, Evolva has transformed itself 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. Having strategically partnered with Cargill for the production and commercialisation of EverSweet, Evolva is now exploring a commercial strategy to expand product sales, working with market-leading companies to bring products to market. This should lead to faster and greater results, with more details expected in Q3. The plan to build a standalone Evolva facility next to the retrofitted Cargill facility is being reviewed, given the new CEO's intention to remain asset-light. We now expect the standalone facility not to proceed and for the company to seek more Cargill-style strategic partnerships.

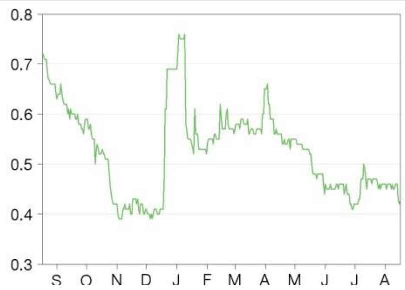
Valuation: Fair value of CHF0.69 per share

Our fair value is CHF0.69/share (previously CHF0.81). We have updated our model to reflect updated guidance, and we have also rolled our DCF forward to start in 2018. We continue to value Evolva on a DCF basis with a 25-year model and a fade beyond year 15. The Standby Equity Distribution Agreement (SEDA) has increased the company's financial flexibility, although management has indicated that it will be looking to secure additional project financing in 2017 relating to its Cargill agreement. We continue to believe that Evolva may eventually need to raise more cash and re-evaluate its balance sheet, most likely during FY18 and almost certainly after the result of its strategy and organisational review.

17 August 2017

Price	**CHF0.43**
Market cap	**CHF186m**
Net cash (CHFm) at 30 June 2017	33.8
Shares in issue	432.8m
Free float	76%
Code	EVE
Primary exchange	SIX Swiss Ex
Secondary exchange	OTC US

Share price performance



%	1m	3m	12m
Abs	(8.5)	(17.3)	(39.4)
Rel (local)	(8.5)	(16.5)	(44.9)
52-week high/low		CHF0.8	CHF0.4

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.

Next events

FY17 results	March 2018

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New CEO: transformation evolves

At the start of July, Evolva announced that its CEO and co-founder, Neil Goldsmith, was stepping down with immediate effect and would be succeeded by Simon Waddington, the COO. The board and Neil Goldsmith had agreed that Evolva's near-term focus needed to be on growing the market for Evolva's existing products and strengthening margins, which did not fit Neil Goldsmith's entrepreneurial skill set. Simon Waddington was previously CEO of Abunda until its acquisition by Evolva in 2011, when he joined the Evolva management team. The board felt that his background and experience are more suited to the next phase of Evolva's growth, as EverSweet nears full-scale production and launch. Simon was in venture capital for over a decade, where he gained experience across a range of subsectors comprising: life-science, advanced materials, medical, agricultural, nutrition and healthcare services. Prior to that, he was product development manager for Zeneca's biopolymers business, which pioneered fermentation-based production of biodegradable polymers from renewable feedstocks.

Over the last 18 months or so, there has been a significant amount of change on Evolva's board, with a new CEO, CFO and chairman. This marks Evolva's transition from a pharmaceutical-oriented biotech start-up to a product-based specialty ingredients business for health, wellness and nutrition.

The strategy and organisational review that was announced with the H117 results suggests Simon Waddington is committed to the transformation of Evolva towards a more focused, product-based company. He highlighted his belief in "focused execution", which leads us to believe that Evolva will increasingly concentrate on the three products that are already on the market, namely stevia, resveratrol and nootkatone. In April, Evolva announced it had reached an agreement with Cargill with regard to its stevia collaboration. This is still on track for launch during 2018, and involves a retrofit of an existing Cargill facility in Blair, Nebraska. Resveratrol and nootkatone are both on the market. Nootkatone remains on track for US regulatory approval in pest control in H218 and Evolva is also continuing to grow the product's customer base in flavour & fragrances. Resveratrol was branded Veri-te in February 2017, and Evolva's commercial pipeline has expanded. The key application is in dietary supplements, with a focus on products for healthy ageing. We await the results of the strategic review (expected in Q3) to learn the fate of the other products in development, such as valencene and saffron.

The CEO believes that Evolva has a unique proposition with its fermentation platform, but it should remain focused on its strengths. As Evolva moves towards commercialisation of its products, the danger is that it could encounter lengthy (and expensive) production delays. The ingredients sector is full of examples of scale-up and production issues, which are extremely common problems. He also believes the best route may be to partner strategically with companies (such as Cargill) that already have the manufacturing assets, capabilities and expertise. The strategy and organisational review instigated by Simon Waddington is already underway and should provide further detail as to how this will be implemented.

H117 results and changes to forecasts

Total H117 revenues of CHF3.6m were below our forecast of CHF6.0m and consensus of CHF5.8m, although the net loss of CHF20.3m was broadly in line with consensus of CHF18.6m. Given the guidance for FY17 product revenues to at least triple versus 2016, we have cut our sales assumptions for FY17 from CHF15.3m to CHF8.4m. We now forecast product sales of CHF3.0m vs CHF6.8m previously. We have also cut our forecast for R&D revenue, as the new CEO has suggested the focus is likely to move to product sales. We note guidance is now for H2 R&D

revenues to be "slightly below" the H1 level. Given the cuts to our product sales forecast for FY17, we have also cut our forecasts for FY18 and FY19, by 48% and 42% respectively, as we assume slower uptake of the key products (stevia, resveratrol, nootkatone and also valencene), and lower R&D revenue as a result of the increased focus on products in the market, as indicated by management. We also cut our assumptions for R&D spend, given the greater focus on these key products.

In terms of cash flow, we have adjusted our forecasts to incorporate a cash outflow of CHF3.9m (split equally between 2017 and 2018) in relation to two contracts with the US Defense Threat Reduction Agency (DTRA) whereby Evolva may be responsible for some of the costs charged to the DTRA (a provision was taken in H117). We have also adjusted our cash flow to reflect our belief that the project to build a new Evolva facility in Blair, Nebraska, next to the retrofitted Cargill facility (detailed here) is no longer likely to go ahead. The final decision is expected in Q317 once the organisational and strategic review is complete. At this juncture we have not altered our peak sales assumptions for the key products, as we await the outcome of the strategic review.

Valuation

We detail our valuation in Exhibit 1 and our updated fair value is CHF0.69/share (from CHF0.81). We have updated our forecasts following the H1 results as discussed above, and we have rolled forward our DCF to start in 2018. Rolling forward the DCF has acted to significantly mitigate the impact on the cut in near-term forecasts on our valuation. Also helping to reduce the impact of the forecast cuts has been the reduction in expected R&D expenditure. We have also trimmed our forecasts for partnership revenues from Evolva's various alliances, in light of CEO Simon Waddington's comments about "focused execution", and hence the potential for these alliances to become less important as a result of the strategic review.

For Evolva, we use a 25-year DCF valuation with a fade. We slightly reduce the R&D and capex in year 6 to reflect our assumption that there will be no new products in the pipeline. In year 11 we reduce these much further as we assume the company will be running on the existing products, and cash flows will then cease. The different products have varying peak sales and ramp-up assumptions as detailed for each above. In 2031 (year 13) we start to fade stevia and vanillin, and from 2035 we start to fade the other products. We assume the stevia and vanillin patents are the first to expire. Stevia remains the key product, at c 45% of our valuation (after adjusting for tax and capex).

We note that we use our estimate for FY18 number of shares for the purpose of our DCF valuation (previously FY17). We forecast an increase in shares through to FY19 as the SEDA is exercised. As discussed in our note, the SEDA is fully flexible and hence will be exercised as necessary, rather than according to a pre-agreed schedule. We note that during H117, Evolva drew CHF3.2m from the SEDA facility, resulting in 7m shares delivered to Yorkville. At the current share price, the total commitment would represent dilution of c10%. We assume the SEDA is drawn down in annual tranches of CHF10m for the purposes of our model. In addition, we continue to assume the additional c CHF30m of financing that Evolva will look to secure for the Blair, Nebraska EverSweet retrofit, is debt-based. Evolva is looking into various funding scenarios.

Exhibit 1: Summary of DCF valuation

Product	Value (CHFm)	Value per share (CHF)	Notes
Stevia royalties	219.1	0.51	Launch date: 2018; peak sales: $600m; likelihood of success 90%; operating margin: 30%; profit share: 30%.
Saffron royalties	13.8	0.03	Launch date: 2018; peak sales: $50m; likelihood of success 60%; royalty: 10%.
Resveratrol	78.5	0.18	Launched; peak sales: $200m; likelihood of success 100%; margin: 40%.
Vanilla royalties	8.9	0.02	Launched; peak sales: $30m; likelihood of success 100%; royalty: 4%.
Nootkatone	120.9	0.28	Launched; peak sales: $150m; likelihood of success 75%*; margin: 40%.
Valencene	28.7	0.07	Launched; peak sales: $10m; likelihood of success 100%; margin: 40%.
Santalol	15.0	0.03	Launch date: 2018; peak sales: $10m; likelihood of success 60%; margin: 40%.
Legacy products	35.6	0.08	EV-077 for diabetic nephropathy, EV-035 antibiotic indications
L'Oréal/Takasago revenues	51.7	0.12	Launch date: 2020-22; number of products: 5; peak sales: $150m per product; likelihood of success: 30%; royalty: 6%.
Other consumer royalties	32.0	0.07	Royalties from alliances with Ajinomoto, BASF and Roquette; launch date: 2016-18; number of products: 3; peak sales: $150m per product; likelihood of success: 50%; royalty: 2%.
Other revenues	0.9	0.00	Only includes revenues from existing collaborations and grants.
R&D and Admin	-202.2	-0.47	
Tax	-90.7	-0.21	
Capex	-41.5	-0.10	Includes investment of $60m for commercialisation of stevia with Cargill and new bioprocessing facility.
Net cash	27.1	0.06	Net cash at FY17
Total	**297.8**	**0.69**	**Using FY18e 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 note that, according to our forecasts, the bulk of Evolva's value is derived from the three products that are currently on the market: stevia, resveratrol and nootkatone. As discussed above, we have modified our forecasts to assume a slower uptake of the key products, but we have left peak sales assumptions unchanged. We have cut our forecast for R&D spend to reflect management's comments regarding greater focus on products on the market.

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	8,407	12,144	34,207
Cost of Sales	0	(2,951)	(2,342)	(4,890)	(17,593)
Gross Profit	13,364	6,578	6,065	7,254	16,614
EBITDA	(30,305)	(34,011)	(29,275)	(27,678)	(17,863)
Operating Profit (before GW and except.)	(31,947)	(36,124)	(26,308)	(23,680)	(30,328)
Intangible Amortisation	(3,779)	(5,090)	(5,090)	(5,090)	(5,090)
Exceptionals	0	0	0	0	0
Operating Profit	(35,726)	(41,215)	(35,418)	(33,812)	(23,995)
Net Interest	(129)	497	(60)	(32)	(3,069)
Other financial income	0	(338)	0	435	3,482
Profit Before Tax (norm)	(32,076)	(35,965)	(30,388)	(28,318)	(18,491)
Profit Before Tax (FRS 3)	(35,855)	(41,055)	(35,478)	(33,408)	(23,582)
Tax	4,067	5,160	0	0	0
Profit After Tax (norm)	(28,113)	(30,926)	(30,388)	(28,318)	(18,491)
Profit After Tax (FRS 3)	(31,788)	(35,896)	(35,478)	(33,408)	(23,582)
Average Number of Shares Outstanding (m)	353.0	397.9	424.2	432.8	450.1
EPS - normalised (c)	(8.0)	(7.8)	(7.2)	(6.5)	(4.1)
EPS - FRS 3 (c)	(9.0)	(9.1)	(8.4)	(7.7)	(5.2)
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	163,348
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	40,903
Current Assets	88,780	56,880	41,298	2,816	11,498
Stocks	2,217	5,687	1,283	1,608	4,338
Debtors	2,785	2,139	1,382	1,996	5,623
Cash	83,228	47,517	37,095	(2,326)	0
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)	(28,511)	(37,532)	(50,212)
Long term borrowings	0	0	(10,000)	(20,000)	(30,000)
Finance lease obligations	(4,134)	(3,564)	(2,586)	(1,607)	(629)
Other long term liabilities	(17,303)	(15,925)	(15,925)	(15,925)	(19,583)
Net Assets	203,416	173,057	150,429	129,870	119,138
CASH FLOW					
Operating Cash Flow	(31,353)	(33,597)	(23,353)	(27,386)	(17,940)
Net Interest	(376)	(301)	(60)	(32)	(3,069)
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	10,000	10,000	10,000
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)	(20,376)	(49,421)	(18,053)
Opening net debt/(cash)	(57,191)	(83,188)	(47,407)	(27,030)	22,390
HP finance leases initiated	0	0	0	0	0
Other	331	(50)	0	0	0
Closing net debt/(cash)	(83,188)	(47,407)	(27,030)	22,390	40,443

Source: Edison Investment Research, company data

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