Allenby Capital

Company Note

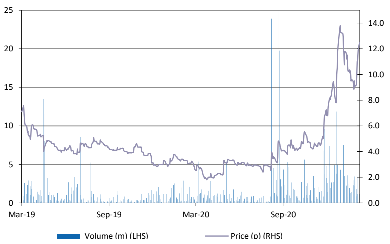
Update

9 February 2021

Corporate

Current price	**12.25p**
Sector	**TMT**
Code	**CPX.L**
AIM	**AIM**

Share Performance



	1m	3m	12m
CPX.L	+6.3%	+169%	+278%

Source: Thomson Reuters, Allenby Capital

Share Data		
Market Cap (£m)		**56.0**
Shares in issue (m)		**456.8**
52 weeks (p)	High	Low
	13.75	**1.8**
Financial year end		**30 June**

Source: Company Data, Allenby Capital

Key Shareholders	
Canaccord Genuity Group	10.83%
Quilter Cheviot	10.62%
Ruffer	4.99%
D Newlands	2.97%
A Kongats	2.19%

Source: Company Data, Allenby Capital

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Equity Research

CAP-XX Ltd (CPX.L)

Revenue growth and positive order book update

The interim trading update from CAP-XX Ltd, the leading designer and manufacturer of prismatic and cylindrical supercapacitors, demonstrates good levels of overall revenue growth with strong growth in Product sales offset by lower Licence Fees and Royalties revenue, as anticipated. The Murata production lines went live at CAP-XX's new facility during H1. Commercial production has started and is being ramped up. This represents a step change in CAP-XX's manufacturing capacity and enables it to address the record level of sales enquiries - the current order book is >100% this point last year. H1 EBITDA loss is expected to be c. A$1m (H1 FY20: A$0.8m), including Murata project expenses. CAP-XX has also become an approved supplier to a global smart phone manufacturer and has started a similar process with a global tier-1 automotive component supplier. Interims are scheduled for 25th February and we reintroduce FY21 forecasts.

- **Financial performance:** H1 Group revenue expected to increase c. 10% to A$2.1m with product sales +26% to A$1.8m. This growth came in spite of the significant disruption caused by COVID on both supply and demand. Licence Fees and Royalties down c. 40% to A$0.3m as Murata royalty revenue reduced. This revenue mix will have resulted in lower gross margins but we would anticipate that the GM will recover as production on the highly automated Murata lines increases. H1 EBITDA loss of c. A$1.0m (H1 FY20: A$0.8m).

- **Operational performance:** CAP-XX successfully commissioned the DMF/DMT lines during H1 in spite of the challenges posed by COVID-19 and the facility is performing to plan. Production is being gradually ramped up and this ramp will result in lower yields (shorter production runs, calibration etc) and lower gross margins in the short term but over time a 60% GM remains a realistic target. CAP-XX's existing contract manufacturing facility in Malaysia was also impacted by COVID given travel restrictions. CAP-XX is now an approved supplier to a global smart phone manufacturer and has started the accreditation process with a global tier 1 automotive component supplier.

- **Forecasts:** The order book is currently more than double the same point last year and management reports high levels of interest across a variety of target markets (including smart meters, security products, medical devices, consumer products and IoT sensors). That said, there is still uncertainty on how interest will translate into revenue given the bigger macro-economic picture and we only reintroduce forecasts for FY21 at this stage. Revenue growth of 14% reflects growth in product sales and a reduction in licences and this mix change impacts gross margins. EBITDA loss, excluding share based payments, reduces 45% to A$2.4m as there were some savings given the absence of international travel. Cash benefits from inflows of the R&D tax rebate (A$3.1m) and exercise of options (A$1.3m) offset by elevated capital expenditure that should reduce going forward.

Year End: 30 June					
(A$'000)	**2017A**	**2018A**	**2019A**	**2020A**	**2021E**
REVENUE	4,142	4,906	3,205	3,588	4,099
EBITDA	-1,197	-1,477	-1,793	-4,447	-2,436
ADJ. EBITDA*	-1,197	-1,567	-1,609	-1,584	-896
ADJ. PBT*	-1,664	-2,533	-2,813	-2,046	-2,321
ADJ. EPS* (c)	-0.59	-0.85	-0.89	-0.54	-0.58
NET CASH	3,887	1,911	2,429	2,895	882
EV/REVENUE (x)	23.2	20.0	30.5	27.1	24.2

Allenby Capital acts as Nomad & Broker to CAP-XX Ltd (CPX.L).
* excludes net Murata project cost, patent infringement and share based payment expenses.

Please refer to the last page of this communication for all required disclosures and risk warnings.

Revenue growth and positive order book update

Growth in revenue and gross margin appreciation provide a route to profitability

The interim trading update demonstrates good overall revenue growth with strength in Product Sales more than offsetting the anticipated reduction in Licence fees and Royalties. H1 included some sales of existing Murata stock but minimal revenue from the new production lines. As previously argued, the production expansion project offers a step change in the company's manufacturing capacity but also the opportunity for higher gross margins as the Murata lines are much more automated than CAP-XX's existing manufacturing. The combined growth in revenue and gross margin appreciation provide a route to profitability for this leading designer and manufacturer of prismatic and cylindrical supercapacitors.

Order book at the end of January more than doubled

Management reports that the order book at the end of January was more than double the same point last year and it has also become an approved supplier to a global smart phone manufacturer and commenced the formal process to become an accredited supplier to a global tier 1 automotive component supplier. The functional advantages of supercapacitors are widely applicable as evidenced by the range of CAP-XX's target markets (including smart meters, security products, medical devices, consumer products and IoT sensors).

CAP-XX continues its twin strategy of product manufacturing and IP licensing and will turn to litigation where necessary. The company has already secured licence agreements with Murata, AVX, Cornell-Dubilier and TDK. It also won litigation against Ioxus and continues to pursue Maxwell Technologies, now part of Tesla. Most recently the Maxwell case in the US was referred to a magistrate judge for alternate dispute resolution (ADR) but a timetable has also been set out on how the case will otherwise proceed.

Forecasts

Ultimate realistic target GM of c. 60%

In H2, we anticipate further growth in Product Sales and for Licence Fees and Royalties to continue to decline. As a result, FY21 gross margins should be c. 42% (FY20: 52.0%) on FY revenue of A$4.1m, +14%. As production ramps, we would expect gross margin to return to historic levels with an ultimate realistic target of c. 60% given the higher levels of automation, longer production runs and higher yield available on the Murata lines.

Operating costs, excluding Murata project costs, benefited from reduced travel and the allocation to project costs. Given some recruitment in sales and marketing and additional production staff as manufacturing ramps up, we would expect operating costs will increase going forward. FY21 project costs are likely to be A$1.9m (FY20: A$3.7m) and legal fees should also be down significantly (A$150k versus A$700k).

Cash

In January, CAP-XX announced that it had been advised by the Australian Tax Office that it had approved CAP-XX's R&D tax rebate, amounting to A$3.1m (November 2019: A$1.6m) and that these funds would be remitted shortly. CAP-XX has been the recipient of R&D tax rebates from the Australian government for a number of years but the size of the 2020 R&D rebate is substantially higher than the historic norm (A$1.6m in each of 2017, 2018 and 2019) and reflects the incremental rebate associated with the Murata manufacturing project. We would anticipate the 2021 rebate will also be higher than normal at c. A$2.6m, reflecting the additional project spend and this will be received at the end of CY21.

Cash also benefited from November's exercise of share options (A$1.3m) but we anticipate higher than usual levels of capital expenditure in FY21, similar to FY20 at A$1.1m. As a result, period end cash should be c. A$0.9m.

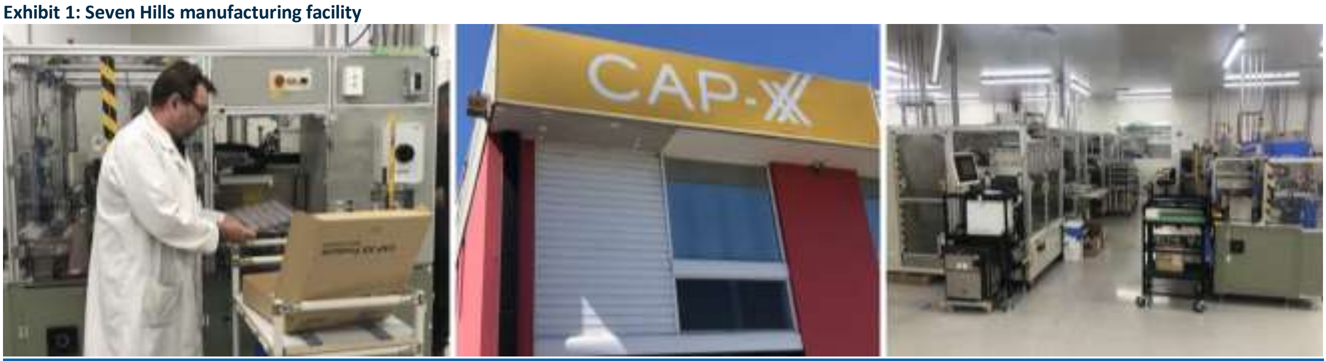
Production has now moved into the commercial phase and the facility is performing in line with plan

At November's AGM, the company reported that, following the successful installation of the former Murata production lines at its new facility at Seven Hills, Sydney, it was manufacturing product for the first customer shipments in December. This was in line with previous guidance. Production has now moved into the commercial phase and the facility is performing in line with plan, according to management.

COVID-19 created a number of additional challenges for what was already an ambitious project. These included cancelled and delayed ships from Japan to Sydney; the inability of Japanese engineers to assist with on-site commissioning in Sydney due to travel restrictions; and delays/challenges in procuring some equipment and raw materials. Limiting the impact to a three-month delay and still coming in within budget represented a considerable achievement.

At full capacity, the four lines will be able to produce c. 4.8m DMF or DMT units and more than 2.4m DMH units p.a. all at a much lower cost per unit than CAP-XX's current manufacturing in Malaysia given the higher automation levels. Using an indicative selling price of A$3.40 per unit, this capacity equates to more than A$24m of potential revenue on the basis of three shift operation. With a target gross margin of 60%, this suggests a potential gross profit of A$14.5m per annum.

Exhibit 1: Seven Hills manufacturing facility



Source: Company

Strategic rationale

Step change in revenue and hasten the move to profit and cash generation

We reiterate the attractions of the Murata deal that should result in a step change in CAP-XX's revenue and hasten its move to profit and cash generation.

- **Customer base.** The acquisition potentially expands CAP-XX's sales and customer base in its target markets for small form factor supercapacitors as CAP-XX expects to retain the majority of Murata's existing customers as well as a number of customers moving into production. CAP-XX continued to supply some Murata-manufactured product during the recommissioning phase.

- **Established products.** Murata had focused on five main products. As a result, it had longer run times and higher gross margins. CAP-XX can now offer three tiers of products: its existing prismatic supercapacitors in multiple form factors, Murata's volume prismatic products and CAP-XX's own cylindrical products.

- **Proven manufacturing capacity at a very low cost.** There was minimal outlay for the assets even though Murata had invested more than $100m in developing its third-generation manufacturing lines. The acquisition represented the lowest cost option to increase its manufacturing capacity to respond to the record sales enquiries.

- **Competition.** Murata was both a licensee and competitor and the acquisition has removed a competitor from CAP-XX's target markets.

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