EDISON

Taronis Technologies

Continuing with build-and-buy strategy

Acquisition

Alternative energy

Taronis Technologies (formerly MagneGas) has continued with its 'buy-and-build' strategy, recently completing the acquisition of one of the largest remaining independent industrial gas and welding supply distributors in East Texas for $2.5m in cash. Together with the acquisitions completed during 2018, this takes the group closer to achieving its goal of creating a profitable platform for selling metal-cutting gases and associated products. The cash generated from gas sales will be used to help commercialise its proprietary technology for renewable fuel gasification and water decontamination.

Year end	Revenue (US$m)	EBITDA (US$m)	PBT* (US$m)	EPS* (US$)	DPS (US$)	EV/Sales (x)
12/16	3.6	(9.6)	(10.3)	(620.5)**	0.0	7.5
12/17	3.7	(10.3)	(11.0)	(306.2)**	0.0	7.3
12/18e	10.0	(11.5)	(13.7)	(4.29)**	0.0	2.7
12/19e	18.8	(5.6)	(7.3)	(0.79)**	0.0	1.4

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

Acquisition strengthens presence in key geography

In January, Taronis completed the acquisition of a substantial independent industrial gas and welding supply distributor in East Texas, thus adding c $3.7m annualised sales and strengthening its retail network in the key Greater Texas region. This follows the purchase of six other businesses during FY18 in the greater California and Texas regions. Collectively these acquisitions enabled the group to generate $1.0m in sales during December 2018 compared with $0.3m for the same month in 2017. Both November and December sales are typically lower than average because of the public holidays in both months.

Private placing finances transaction

In December 2018, the company announced that 98% of the $25m Series C Convertible Preferred financing instrument issued in June 2017 had been converted. This had been the primary source of finance during the intervening period. In January, the company raised $4.3m (gross) through a private placing at $0.14/share, part of which was used to fund this latest acquisition. Management notes that the group needs to generate revenues of $20-23m annually for it to be profitable, with further acquisition the preferred route to close the gap. Additional finance will be required to fund this expansion, or if underlying cash burn continues at the level modelled for FY19 into FY20.

Valuation: Trading at a discount to peers

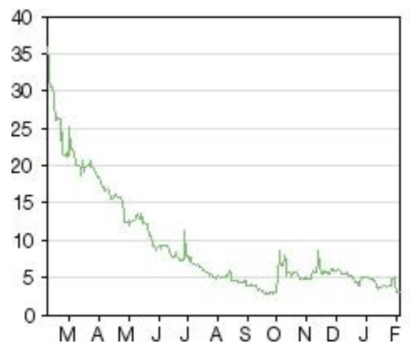
Taronis's shares are trading at a substantial discount to the EV/sales mean of our sample of suppliers of industrial gases for 2019 (1.4x vs 3.0x). We see scope for share price appreciation on positive newsflow regarding cash burn, water decontamination commercialisation and European expansion. This would give greater clarity on future funding requirements and potential dilution as well as the likelihood of further estimates downgrades.

5 February 2019

Price	**US$2.99**
Market cap	**US$28m**

Net cash (US$m) at end September 2018	0.9
Shares in issue (after 20:1 reverse share split)	9.3m
Free float	99.9%
Code	MNGA
Primary exchange	NASDAQ
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	(40.2)	(38.2)	(92.7)
Rel (local)	(44.4)	(38.2)	(92.6)
52-week high/low		US$35.8	US$2.8

Business description

Taronis is a technology company that has developed a plasma-based system for renewable fuel gasification and water decontamination. This process generates a hydrogen-based fuel called MagneGas as a by-product that is sold as an alternative metal-cutting fuel to acetylene.

Next event

Q418 results	April 2019

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Edison profile page

Taronis Technologies is a research client of Edison Investment Research Limited

Revisions to estimates

We have revised our estimates to reflect:

- The acquisition made in January 2019, which adds $3.7m annualised sales.
- Slower organic growth than we previously modelled, resulting in an average monthly run rate excluding the acquisition made in January 2019 of $1.17k/month rather than $1.28k/month as previously expected.
- $4.3m (gross) funds raised from a Placing in January 2019, together with the issues of 31.0m new shares and warrants to purchase up to 31.0m new shares.
- Dilutive effect of conversion of remaining Series C Convertibles during Q418.
- 20:1 reverse share split at end January 2019.

Exhibit 1: Changes to estimates

Year end December	FY17	FY18			FY19		
($m)	Actual	New	Old	% change	New	Old	% change
Revenues	3.7	10.0	10.3	-4.0%	18.8	16.8	10.5%
EBITDA	(10.3)	(11.5)	(11.4)	1.2%	(5.6)	(5.6)	-0.7%
PBT	(11.0)	(13.7)	(13.6)	1.0%	(7.3)	(7.7)	-5.8%
EPS ($)	(306.2)	(4.3)	(0.2)	95.1%	(0.8)	(0.1)	92.9%

Source: Edison Investment Research

Valuation

Although there is potential for Taronis to start generating revenues from the sale of sterilisation equipment, the provision of sterilisation services during FY19 or sales of MagneGas in Europe, we treat these sources as upside to our estimates. Consequently, our estimates are based solely on revenues derived from US sales of industrial gases and associated equipment. We have therefore selected a sample of listed companies supplying industrial gases for our valuation. We note that Taronis is trading at a substantial premium to the mean with regard to historical EV/sales multiples (7.3x vs 2.0x), which is the period before the rapid growth from acquisitions, at a small discount to the mean EV/sales multiple for 2018 (2.7x vs 3.2x), which does not show the full year benefit for the acquisitions, and at a substantial discount to the mean multiple for 2019 (1.4x vs 3.0x), which is when the full benefit of the acquisitions becomes apparent. While some discount for Taronis's small market capitalisation and level of losses is justified, its exceptionally strong projected sales growth would generally be expected to partly counteract this. However, while there is potential for significant share price appreciation as the full benefit of the recent acquisitions becomes clear, commentary in the most recent SEC filing stating substantial doubt about the company's ability to continue as a going concern given the need to raise additional finance is hindering share price development because of investor concerns about potential dilution.

The share price has fallen by almost 40% since the announcement of the reverse share split on 30th January which appears to have stoked speculation about impending stock dilution. However, the fundamentals have not changed. The substantial acquisition made in January takes the group closer to reaching break-even purely from sales of industrial gases and related accessories. The project with the US Department of Agriculture to validate the water decontamination application appears to be on track, as are the initiatives to establish MagneGas generation facilities in mainland Europe, secure EU funding to develop the next generation of gasification technology and to undertake a water decontamination project at a very large dairy farm in the Netherlands. In our view, investors should be more interested in how close the combination of successive acquisitions and rationalisation takes the group to break even, which will be clearer when the Q418 and Q119 results are announced, provisionally in April and May respectively, and on whether commercialisation of the water decontamination technology and expansion in Europe, both of which present substantial upside to our estimates, are proceeding to plan. Information on these issues will give investors a better view of additional funding requirements, and potential dilution of their shareholdings, and of the risk of further estimate downgrades. Given the size of the Year 2 EV/Sales multiple discount to peers, positive newsflow on cash burn, technology commercialisation and European expansion has the potential to reassure investors and drive a recovery in the share price.

Exhibit 2: Peer multiples

Name	Market cap ($m)	EV/Sales last (x)	EV/Sales FY1 (x)	EV/Sales FY2 (x)	CAGR (%)*
Air Liquide	52,338	3.0	2.9	2.8	4%
Air Products and Chemicals	36,435	4.2	4.0	3.7	6%
Koatsu Gas Kogyo Co	390	0.4	-!	-!	-
Linde	41,324	2.6	2.5	2.4	2%
Maxima Air Separation Center	74	2.2	-	-	-
SOL	1,090	1.6	-	-	-
Toho Acetylene Co	87	0.2	-	-	-
Mean		**2.0**	**3.2**	**3.0**	
Taronis Technologies	**28**	**7.3**	**2.7**	**1.4**	**125%**

Source: Refinitv estimates, Edison Investment Research. Note: Prices at 4 February 2019. *Year 0 to Year 2.

We note that the multiple paid for the most recent acquisition was 1.5x historic sales, which is a discount to the listed peers and Taronis itself.

Exhibit 3: Financial summary

Accounts: GAAP, Yr end: December, USD: Thousands	2016	2017	2018e	2019e
Income statement				
Total revenues	3,552	3,719	9,951	18,774
Cost of sales	(2,018)	(2,217)	(6,380)	(9,668)
Gross profit	1,534	1,503	3,571	9,107
SG&A (expenses)	(10,479)	(11,664)	(15,053)	(14,332)
R&D costs	(679)	(172)	(12)	(360)
Exceptionals	(1,856)	50	0	0
Depreciation and amortisation	(651)	(673)	(1,317)	(1,680)
Reported EBIT	(12,130)	(10,956)	(12,811)	(7,265)
Finance income/(expense)	(52)	(15)	(895)	(54)
Other income/(expense)	50	(2)	0	0
Exceptionals	(5,338)	(52)	0	0
Reported PBT	(17,470)	(11,024)	(13,706)	(7,319)
Income tax expense (includes exceptionals)	0	(4,974)	0	0
Reported net income	(17,470)	(15,999)	(13,706)	(7,319)
Basic average number of shares, m	0.0	0.0	3	9
Basic EPS	(52.74)	(22.22)	(4.3)	(0.8)
Adjusted EBITDA	(9,623)	(10,333)	(11,494)	(5,585)
Adjusted EBIT	(10,274)	(11,006)	(12,811)	(7,265)
Adjusted PBT	(10,276)	(11,022)	(13,706)	(7,319)
Adjusted EPS*	(620.45)	(306.21)	(4.29)	(0.79)
Adjusted diluted EPS*	(620.45)	(306.21)	(4.29)	(0.79)
Balance sheet				
Property, plant and equipment	6,403	6,865	9,961	10,337
Goodwill	2,109	2,109	3,359	3,359
Intangible assets	437	412	2,366	2,321
Other non-current assets	27	352	352	352
Total non-current assets	8,975	9,739	16,038	16,368
Cash and equivalents	1,616	587	10,759	4,475
Inventories	1,616	739	1,908	5,072
Trade and other receivables	443	390	1,908	2,057
Other current assets	226	198	198	198
Total current assets	3,901	1,913	14,774	11,802
Non-current loans and borrowings	620	584	556	529
Other non-current liabilities	0	0	0	0
Total non-current liabilities	620	584	556	529
Trade and other payables	416	1,717	2,454	2,829
Current loans and borrowings	9	579	27	27
Other current liabilities	8,002	954	772	772
Total current liabilities	8,428	3,250	3,253	3,628
Equity attributable to company	3,829	7,819	27,003	24,014
Cash flow statement				
Profit before tax	(17,470)	(11,024)	(13,706)	(7,319)
Net finance expenses	0	0	895	54
Depreciation and amortisation	651	673	1,317	1,680
Share based payments	347	425	330	330
Other adjustments	8,515	3,024	1,955	0
Movements in working capital	(682)	2,114	49	(437)
Interest paid / received	0	0	(895)	(54)
Income taxes paid	0	0	0	0
Cash from operations (CFO)	(8,640)	(4,788)	(10,055)	(5,747)
Capex	(1,425)	(129)	(1,510)	(2,010)
Acquisitions & disposals net	0	(325)	(8,107)	(2,500)
Other investing activities	(55)	(0)	0	0
Cash used in investing activities (CFIA)	(1,480)	(454)	(9,617)	(4,510)
Net proceeds from issue of shares	6,422	5,008	30,423	4,000
Movements in debt	0	0	(552)	0
Other financing activities	(5)	(795)	(27)	(27)
Cash from financing activities (CFF)	6,416	4,213	29,844	3,973
Increase/(decrease) in cash and equivalents	(3,703)	(1,030)	10,172	(6,284)
Cash and equivalents at end of period	1,616	587	10,759	4,475
Net (debt) cash	987	(576)	10,175	3,919
Movement in net (debt) cash over period	(3,773)	(1,563)	10,751	(6,257)

Source: Company data, Edison Investment Research. Note:*Adjusted for reverse share splits.

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