



## THE BOURSE FACTOR RESEARCH

# AERIS ENVIRONMENTAL LIMITED (AEI)

Building sales momentum coupled with a falling cash burn reflect successful implementation of the business model and growing commercial acceptance of the value proposition

### DIRECTORS

Maurie Stang, Chairman  
Huw Jones, Executive Director  
Steven Kritzler, Non- Executive Director  
Bernard Stang, Non- Executive Director

### SENIOR MANAGEMENT

Huw Jones, CEO  
Ron Bacskai, VP USA Operations  
Andrew Young, GM Water and Marketing  
Radek Mierzejewski, CFO  
Robert Waring, Company Secretary

### MARKET DATA

Current Price	\$0.25
ASX Code:	AEI
Shares on Issue:	97.3 million
Options on Issue:	7.3 million
52 week Share Price Range:	\$0.17 - \$0.56
Market Capitalisation:	\$24.3 million

### FINANCIAL SUMMARY

\$mill	2005-06	2006-07	2007-08 Half Year
Sales	0.78	1.25	0.922
Pre Tax	-3.61	-4.18	-2.25
Net Profit	-3.53	-4.09	-1.91
Cash Assets	6.01	2.63	4.03

### SENIOR ANALYST

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### KEY POINTS

Aeris Environmental is commercialising a range of novel and patented technologies that deliver major energy efficiency and asset productivity gains in air-conditioning, refrigeration and bulk water systems.

The positioning and value proposition reflect the rapidly increasing global awareness of the environmental impact of rising energy usage and the potential significant efficiency, productivity and health benefits.

Interim 2008 sales up 83% on the same period last year reflecting growing momentum. Monthly cash burn declined by 42% in the March 2008 quarter. The company had cash assets at the end of March 2008 of \$3.6 million.

Sustained profitability on a monthly basis is expected to be achieved during 2009-10.

Two pronged business model now established. Third party product distribution throughout Asia and company owned asset management services in Australia and the US.

Major global air-conditioning group, Trane is driving product sales in Asia. Trane has appointed a product manager for Aeris and is leveraging its established sales, service and distribution infrastructure with the capacity to manage large volumes.

In Australia and the US, Aeris provides asset management services that incorporate the company's products. Service value is about 10 times the value of the underlying product.



## INVESTMENT CONCLUSION

Aeris Environmental provides investment exposure to the rapidly growing cleantech sector. The business building blocks are now firmly in place whilst important contract wins over the past year provide both technical and commercial validation of the value proposition and business model.

The challenge for Aeris management is to accelerate growth and reduce the timeframe to sustainable profitability, which is a fundamental investment milestone. Major contract wins provide ongoing validation with the prospect that a broad client-wide relationship could develop into a “company making” event for Aeris which would be a catalyst for a major share price re-rating.

Whilst the stock has recovered some ground from its April 2008 low of 17 cents, at the current price of 25 cents it remains well below the 52 week high of 56 cents providing plenty of room for forward momentum on the back of positive news.

The business risk profile of Aeris continues to decline, however, investment remains Speculative.

## SUMMARY AND BACKGROUND

Aeris Environmental has made considerable progress over the past year in establishing the foundations for a sustainable business. The 83% gain in interim 2008 sales is evidence that the company’s strategies and recent achievements are creating tangible value and moving the company forward towards this goal.

Aeris is commercialising a range of novel and patented chemical solutions that remove and provide protection against biological contamination in air-conditioning, refrigeration and bulk water systems. Globally, these are multi-billion dollar industries that are prone to contamination and have potentially major productivity or community health issues as a result.

The challenge has been to develop a value proposition that addresses the core needs of its target markets and to build a business model to deliver the proposition that would create substantial value. The issue that had to be confronted was that “biological contamination” is viewed predominantly as a low order maintenance issue and in the absence of economic benefits or regulatory requirements is generally ignored.

Aeris’ solutions are still essentially viewed as maintenance issues; however, the company has successfully constructed its value proposition in economic and ROI terms enabling the breakthrough of resistance and the gaining of valuable contracts with a wide range of companies including large multi-nationals.

Notwithstanding the intellectual property that underpins the company’s novel and patented chemical solutions, the core value of the business lies in the business model that Aeris has developed to deliver the value proposition to its customers. Although the company is still about 2 years away from achieving sustainable profitability, value is building rapidly as the model is deployed, sales growth gathers momentum and the rate of cash burn declines.

### The major achievements over the past year were:

- Acquisition of a 60% stake in Aeris Atlantic to provide a direct service capability in the Mid-Atlantic region of USA
- Pan Asia distribution agreement with Trane, one of the world’s largest manufacturers of air conditioning systems
- Added distribution of 3M filters in USA
- Raised \$3.7 million via a placement



- Major contracts won with
  - Merck (Global Supply Agreement; first two facilities treated in Puerto Rico),
  - A leading global casino group<sup>1</sup> (initially at one casino in Atlantic City). Twelve month contract value US\$200K.
  - The Boston Beer Company

The most significant of these were the acquisition of the majority holding in Aeris Atlantic and the expanded distribution agreement with Trane. These two initiatives lock in place the company's business model and fundamentally establish the foundations for accelerating and driving long term growth.

The contract wins were important as a further validation of both the company's technology and its value propositions. Although they also often represent major breakthroughs in gaining corporate entry, most contracts are still relatively short term and single site focused.

The next step in the commercialisation process will be to leverage these early single site successes into longer term, corporate multi-site contracts. The Company is already seeing evidence of the success of this expansion plan with paid trials secured with a leading global casino group at two other casinos in addition to the initial contract. **The expansion of the initial contract win with the casino group into further trials is a major breakthrough for Aeris. In the view of The Bourse Factor Research, this relationship has the potential to be "company making" if the service is implemented company-wide.** Aeris will also expand the regional coverage in the US of the direct service model and look to expand into Europe.

Revenue for the six months ended 31 December 2007 of \$1.1 million was 54% higher than the previous corresponding period and included an 83% increase in sales to \$922K. The net loss for the period of \$1.9 million was unchanged. Bourse Research has forecast sales for the full fiscal 2008 year to be in the range of \$2.5 million and \$3 million and could exceed \$6 million in 2008-09 as sales in the US gather momentum and as the benefits of the enlarged distribution agreement with Trane flow through. Aeris is expected to breakthrough to profitability during 2009-10 as monthly sales approach \$1 million.

## THE BUSINESS MODEL

Aeris is positioned in the emerging cleantech sector, which is expanding rapidly on the back of increasing environmental awareness and associated health concerns. The "environmental hygiene" market is relatively immature with the competitive barrier being indifference and inertia but this is undergoing change as companies become increasingly aware of the associated cost and financial performance issues both at the asset and corporate levels.

Aeris' market opportunity is substantial reflecting the size of the installed base of commercial and industrial air-conditioning, refrigeration and bulk water systems and the obvious need for regular maintenance and repair. Whilst there is an established market for maintenance services and product supply, Aeris' products fall into a new category within the broader market.

Based on its own research and from industry sources in the US and elsewhere the company has estimated the size of the product-sales opportunity as being between \$3 billion and \$4 billion per annum with service based revenues measured in multiples of this.

Aeris' IP is founded on two key technology platforms: Multi-enzyme biofilm removal and residual anti-microbial coatings.

Biofilm (commonly known as slime) can be found in a wide variety of situations. The world's leading authority on the subject, the Centre of Biofilm Engineering at Montana University in the USA, stated that *"Microbial biofilms on surfaces cost [ USA] billions of dollars yearly in equipment damage, product contamination and energy losses."*

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<sup>1</sup> The global casino group, in line with its PR policy, has requested that Aeris not disclose its identity at this current time.



Biofilm can be readily found in air-conditioning, refrigeration systems, and any large water system. Importantly, not only can biofilm harbour harmful bacteria (including Legionella) it can have a huge impact on the efficiency and life-expectancy of the system resulting in reduced productivity and increased energy consumption.

Air-conditioning and refrigeration systems are particularly complex and require additional protection from re-contamination to ensure that the health and efficiency benefits are sustained. Aeris' unique Anti-Microbial Coating IP has a residual action giving continuous protection for up to 12 months.

The first challenge for Aeris was to define its value proposition in economic and ROI terms, which it has done with the focus on energy reduction and productivity gains. The Company's global supply agreement with Merck (one of the world's largest pharmaceutical corporations) is based on energy savings with considerable gains being achieved from the application of the company's products. Having implemented the AerisGuard Air-Conditioning Performance Solution at the first two Merck sites in Puerto Rico, Aeris is now driving for the AerisGuard solution to be implemented across all of Merck's facilities. On the other hand, the US\$200K twelve month contract with the leading global casino group in Atlantic City is based on improving system efficiency and specifically to improve the flow and quality of the air into the large gaming areas. On the back of this success, Aeris was firstly awarded a paid-trial to treat and protect a group of hotel rooms in the same casino and then awarded trials in two other casinos owned by the group in the same region.

The core issue for the company in building an effective model is that product sales, in which the technology is embedded, represents only a small proportion, maybe 10%, of the value of a transaction. Significantly, much of the value is captured by the delivery of the service and application of the product. Whilst margins on product sales are higher than service revenues, it is doubtful whether the company could achieve economic scale within an acceptable timeframe purely from product sales.

Aeris has developed a two pronged model to drive growth and a global roll-out of its technology. In Asia, Aeris products are being distributed by Trane, a leading manufacturer of air-conditioning equipment. In Australia and the US, Aeris is implementing a direct service model where the company will service and manage client assets, which will include the application of its products.

The company's early performance in the US was disappointing with the local distributor having little impact. Nonetheless, one downstream applicator, Aeris Atlantic, was a champion of the product and was achieving promising results. In May 2007, Aeris Environmental acquired a 60% interest in this business which is now the basis of the company's direct service model in the US.

Aeris Atlantic provides asset management services to its customers utilising the products of Aeris Environmental and realises revenues some 10 times the value of the underlying product. Aeris Atlantic is focussed on acquiring the customer contracts and then subcontracting out the physical application work (under the technical supervision of Aeris Atlantic management) to local businesses. The direct service model will be progressively rolled-out through the US with service delivery sub-contracted to certified applicators (typically with duct cleaning experience).

Aeris also has a direct service operation in Australia through Sydney based Aeris Hygiene Services which is currently focussed on the food cold storage industry.

The company's relationship with Trane in Asia dates back to September 2006 to an initial distribution agreement covering Thailand and Vietnam. In November 2007, this agreement was expanded to cover all of Asia except the residential market in Japan, which is held by Sumitomo 3M. The relationship with Trane is differentiated from more typical distribution relationships by the level of commitment to the product and more specifically the appointment by Trane of a Product Manager solely devoted to the Aeris products.

Trane is one of the world's leading manufacturers of air conditioning equipment and has extensive maintenance and service operations in Asia. Aeris' products are a natural fit with this business. Moreover, Trane provides an established network and infrastructure that Aeris could not otherwise replicate. Notwithstanding that Aeris is only generating product and not the much larger service revenues, Trane has



the infrastructure and reach to generate potentially very large volume sales with significant overall revenue and profit potential.

Since the signing of the pan-Asian agreement with Aeris, Trane has been acquired by Ingersoll-Rand, an \$11 billion industrial manufacturing group with several air-conditioning and refrigeration equipment businesses. Coincidentally in mid 2007 Aeris had commenced early discussions with Thermo King, an international manufacturer of transport temperature-control equipment and an Ingersoll-Rand subsidiary, with regard to establishing a commercial relationship. Whilst these discussions have been temporarily put on hold due to the integration process with Trane, major opportunities may open up for Aeris as a result of Ingersoll-Rand's acquisition of Trane.

## 2008 INTERIM RESULT

Sales grew rapidly in 2006 and 2007, albeit off a low base, as Aeris accelerated the commercialisation of its multi-enzyme technology with a range of high margin products.

Aeris' interim 2008 financial results reflect further considerable progress in commercialising its business as well as the impact of rolling out its service based business model. Whereas sales in 2007 were overwhelmingly from the sale of product, service revenue contributed about one-third of sales in the six months ended 31 December 2007. The share attributable to service revenues will continue to climb.

### AERIS ENVIRONMENTAL - FINANCIAL SUMMARY

\$'000	2005-06	2006-07	Interim 2007	Interim 2008
<b>Sales</b>	<b>780</b>	<b>1253</b>	<b>503</b>	<b>922</b>
Other Revenue	776	507	188	146
<b>EBITDA</b>	<b>-3197</b>	<b>-3836</b>	<b>-1945</b>	<b>-2066</b>
D&A	-75	-80		
Interest	-334	-261	-171	-176
Pre Tax	-3606	-4177	-2016	-2248
Tax	80	85	84	151
Minorities	0	0	0	190
<b>Net Profit</b>	<b>-3528</b>	<b>-4092</b>	<b>-1931</b>	<b>-1907</b>

Revenue for the six months ended 31 December 2007 of \$1.068 million was 54.4% higher than for the same period in the prior year. This included an 83.3% gain in sales to \$922K. Sales represented 86.3% of revenue compared with 72.8% in the prior year.

The large jump in sales was attributable to higher levels of activity generally, the implementation of a number of relatively large, high profile contracts and the contribution of service revenues from 60% owned Aeris Atlantic which was acquired in May 2007.

Gross margins declined due to the impact of lower margin service revenues. Nonetheless, the loss before interest, tax, depreciation and amortisation was only slightly higher at \$2.1 million and the loss after minorities was slightly lower at \$1.9 million.

The role out of the direct service model, through Aeris Atlantic and Aeris Hygiene Services, is having a profound affect on the company's financial structure. In particular, sales are expected to grow at a much faster rate than previously anticipated due to the typically 10 fold increase in service value compared with the value of product sales embedded in each service. Although service margins are lower than product margins, the absolute levels of profit will nonetheless be considerably higher than if Aeris had continued to focus solely on product sales.



Since the end of December 2007 further considerable progress has been achieved with the average monthly cash burn declining from \$340K to \$198K during the March 2008 quarter, a 42% improvement. As at the end of March 2008, Aeris had cash reserves of \$3.6 million.

Both the 2008 interim and the 2008 March quarter financial results reflect good progress by the company in building its business but they do not reflect recently won contracts which in the view of The Bourse Factor Research, have the potential to provide Aeris with a quantum leap in scale and rapidly advance the move towards sustainable profitability.

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