Fairlight Capital

Alloy Steel International, Inc. (AYSI – OTC Pink):

Market Capitalization at 7/1/2021: $37 million

Intel Corporation, Pharmaceuticals, and Local Competition

> "Barriers to entry are easier to maintain in sharply circumscribed markets. Only within such confines can one or several firms hope to dominate their rivals and earn superior returns on their invested capital. When competition is global in scope, the need to circumscribe the competitive arena is even greater. That is why Jack Welch, instead of just setting revenue and growth targets, insisted that the only markets in which GE would do business were ones where it could be first or second.
>
> The conduct of strategy, then, requires the competitive arena to be "local," either in the literal, geographic sense or in the sense of being limited to one product or a handful of related ones. The two most powerful competitive advantages, customer captivity and economies of scale—which pack an even bigger punch when combined—are more achievable and sustainable in markets that are restricted in these ways.
>
> Indeed, it's perilous to chase growth across borders. Because a global market's dimensions are wider and less defined than a nation's or a region's, firms face a higher risk of frittering away the advantages they have secured on smaller playing fields. If a company wants to grow and still maintain superior returns, the appropriate strategy is to assemble and dominate a series of discrete but preferably contiguous markets and then expand only at their edges. As we will show, Wal-Mart's diminishing margins over the past 15 or so years are strong evidence of the danger of proceeding otherwise.
>
> **The Varieties of Competitive Advantage**
>
> A competitive advantage is something a firm can do that rivals cannot match. It either generates higher demand or leads to lower costs. "Demand" competitive advantages give firms unequaled access to customers. Also known as customer captivity, this type of advantage generally arises from customers' habits, searching costs, or switching costs. "Cost" (or "supply") advantages, by contrast, almost always come down to a superior technology that competitors cannot duplicate—because it is protected by a patent, for example—or a much larger scale of operation, accompanied by declining marginal costs, that competitors cannot match…
>
> Intel benefits from all three fundamental factors. Its customers, the PC manufacturers, are reluctant to switch to another supplier because of their long-established relationships with Intel as well as *their* customers' preference, thanks in part to the "Intel Inside" campaign. Intel's many patents and years of production experience allow the company to reach a higher yield rate—fewer defects—in chip production more quickly than its competitors. And because it can spread the fixed costs of R&D for each new generation of chips over many more units than its rivals, it enjoys major economies of scale...

Globalization has eroded competitive advantages among the established drug companies just as it did in the automobile industry. Fortunately, the benefits of specialization by research area have allowed small drug firms to seek, though not always find, competitive advantages and operational efficiency within particular product market niches. By acquiring licenses from these focused companies, the major pharma firms are simply adapting to the new strategic mandates that the advent of global markets has brought about.

In contrast to the development of new drugs, their marketing remains an essentially local operation. Selling new drugs through U.S. doctors, hospitals, and pharmacies has always involved U.S.-based clinical trials, sales teams, and distribution systems. Marketing is also targeted to medical specialties. For a U.S. firm to carry out all these functions in Germany, for instance, it would have to have an elaborate infrastructure there; similar infrastructures would be needed in all the other significant national markets. Each of these organizations would have a large fixed-cost component as well. The patients reached by such marketing efforts happen to be consistent in their purchases, which translates into substantial customer captivity. As a result, each national drug-marketing organization enjoys competitive advantages in both its geographic and its specialty markets."

All Strategy is Local
Bruce Greenwald and June Kahn
Harvard Business Review
September 2005
https://hbr.org/2005/09/all-strategy-is-local

AYSI Company Overview

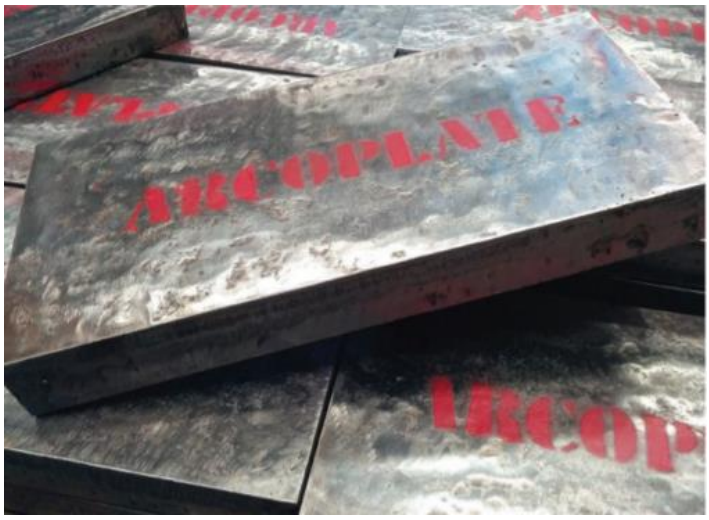
Alloy Steel International, Inc. (AYSI or the Company) is the manufacturer of Arcoplate anti-wear plates and is also a service and product provider of other anti-wear and hang-up solutions to the mining and bulk materials industries. The Company is based in Perth, Western Australia. Arcoplate is a technically superior market leading fused alloy overlay wear plate that is used to extend the life of heavy equipment wear parts from bulldozers and dumptrucks to chutes, feed bins, crushers, screen plates and other places on fixed plant equipment where material is transported.

What are steel, carbon steel, stainless and alloy steel? Steel is a mixture of iron and carbon and is around a thousand times stronger than pure iron. Carbon steel has a higher amount of carbon which makes it stronger (diamonds which are pure carbon are the hardest naturally occuring thing on earth). Carbon steel is the hardest but can be brittle. Stainless steel has the addtion of chromium which makes it corrosion and oxidation resistant but is softer. Alloy steel is a mixture of steel and common alloying elements such as manganese, nickel, chromium, molybdenum, banadium, silicon and boron. Alloy steels have extra strength, hardness, toughness, weldability and wear and corrosion resistance. Arcoplate has a 39% smaller coefficient of friction than utility stainless steel. Further, Arcoplate outperforms Q&T (Quenched & Tempered) steel plates by a factor greater than 8 times.

https://www.youtube.com/watch?v=QbEYZgkWtyE&t=57s

https://alloysteel.net/wp-content/uploads/2020/04/Alloy-Steel-International-Arcoplate-Brochure.pdf

Arcoplate provides three large benefits over traditional wear materials: 1) Extends the useful life of the equipment, 2) Reduces downtime for maintenance by maximizing abrasion resistance thereby reducing total cost of ownership, and 3) Reduces hang-ups by reducing friction between material and equipment which increases production and thereby decreases the cost per tonne of output.



https://alloysteel.net/

Uses

TLO

Truck Body

Digger Bucket

Shovels

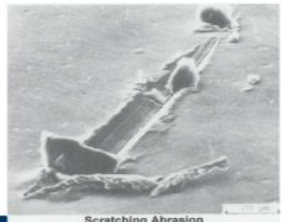
Dozer Blade

Arcoplate Wear & Anti Carry Back Kit

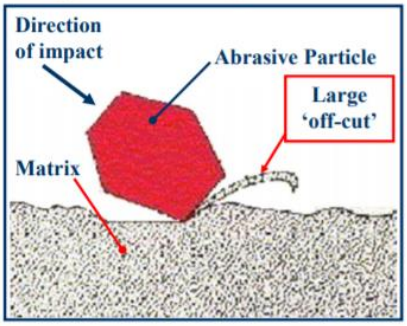
- *ARCOPLATE* at Headboard eliminates carry back.
- Loading Zone no Arcoplate Liners
- *ARCOPLATE* on Tail Section reduces abrasion & allows materials to quickly discharge.

ARCOPLATE

Abrasion Resistance

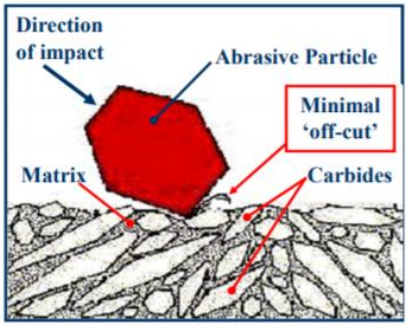


High Carbon Q & T Plate



- Particle erodes matrix unhindered

ARCOPLATE

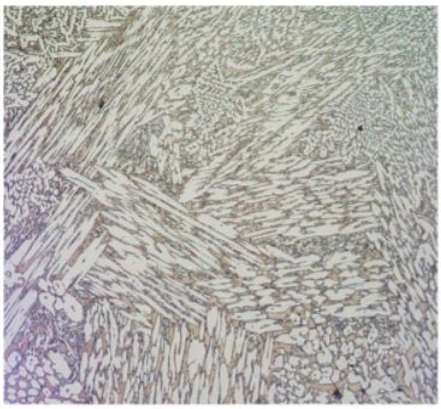


- Carbides limit extent of erosion to matrix

ARCOPLATE

Microstructure

Quenched & Tempered Plate



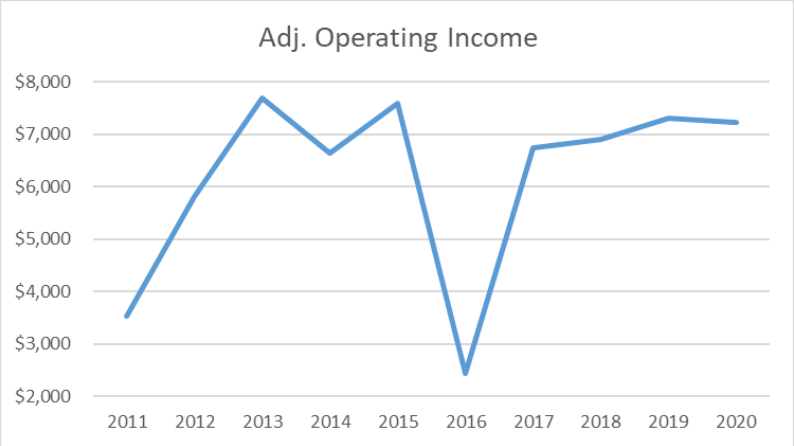
ARCOPLATE

Intellectual Property and Competitive Advantage

Arcoplate was invented and patented in the early 1990s by Geen Kostecki, with the first protype being produced in 1991. AYSI was founded in 2000 by Mr. Kostecki. In May 2000 AYSI acquired the exclusive licenses to develop and market the proprietary Arcoplate process and to commercially exploit the patent rights and technology rights related to Arcoplate for a 25 year term. The license provided for a royalty payment of 2% (raised to 6% in 2016) of net sales of Arcoplate products. In 2020, AYSI purchased the intellectual property rights for Arcoplate products from the Kostecki family for AUD$17.8 million. The royalty expense was AUD$2.2 millin in 2019. Thus, AYSI paid approximately an 8x pretax multiple for the intellectual property.

The purchase price paid for the intellectual property gets to the core of the AYSI investment thesis. On the one hand, did AYSI overpay to the controlling family for a technology that is no longer patented and has been around for years? Or did they pay a fair price for key intellectual propety tied to deep know-how about wear steel and a hard to replicate production process with industry leading engineering expertise?

To illustrate the intellectual property importance, since 2011 AYSI's operating income adjusted for royalties expense, amortization and one-time costs has averaged USD$6.4 million. This is against net operating assets and operating equity that currently stand at approximately USD$22.4 million and USD $14.7 million. It appears that AYSI does have some sort of competitive advantage and enjoys high returns on capital employed.



AYSI Operating Balance Sheet	
	3/31/2021
Accounts Receivable	$6,128,511
Inventories	$8,586,747
Prepaids & Other	$257,764
Property & Equipment	$2,867,809
Righ of Use Asset	$4,558,617
Operating Assets	**$22,399,448**
Accounts Payable	($1,170,461)
Current tax payable	($918,412)
Accued Payroll	($890,402)
Other Liablities	($53,941)
Lease Liabilitiy	($4,674,214)
Operating Equity	**$14,692,018**

For investors, one of the most pertitent questions related to AYSI shares are what is the Company's competitive advantage and will it last? Alloy International Steel has an advantage created by an intellectual property stack that is hard to replicate. An intellectual property stack consists of patents, know-how and data exclusivity. For AYSI, patents are no longer as important as they were when the Company was young and creating a new market for alloy steel wear liners in Western Australia. Now, however, know-how and data exclusivity form a formidable barrier for AYSI. AYSI has undoubetly improved and optimized its manufacturing process over the thirty years since Gene Kostecki first began manufacturing Arcoplate and filing for patents. Competitors will have to find the best methods of hardening, heating, cooling, bonding, providing uniformity and stress relief, composing alloy powders, forming metallurgical and chemical formulas along with creating computer controls, niche software, technical designs and a library of specialized drawings.

While know-how alone may be a formidable advantage, data exclusivity can be a very difficult thing for new entrants to acquire. The above mentioned know-how formulas and methods are further complicated by their application to different materials. The composition of minerals changes from mine to mine. Mine operators have tens to hundreds of millions of dollars invested in equipment at a mine and will only trust providers with an intimate knowledge of alloy steel and site specific mineral properties who have a long history of providing superior products and services in the region. The sales cycle for a project is long as the customer's engineering team will work closely with AYSI when designing and installing equipment. Once a decision is made, however, the mine operator will not change supplier. See the below links to get an idea of just how many mines are in Western Australia. Also, it is important to remember Western Australia is 3.6x the size of Texas. The geographical area is quite large.

https://www.cmewa.com.au/wp-content/uploads/2021/04/MajorResourceProjectsA4_2021.pdf
http://dmp.wa.gov.au/Investors/Resource-Maps-18345.aspx

Alloy Steel International has a large facility in Perth that is dedicated to the manufacture of Arcoplate and a host of other wear resistant products. The other part of the factory houses a fully equipped scientific laboratory for material analysis, an electronics lab, a computer-aided design facility, CNC lathes and milling machines and an abundance of qualified technicians and engineers to bring each of these elements together. The common market perception is that AYSI is a manufacturer of commodity equipment parts. Steel is steel and anyone can figure out how to produce AYSI's alloy steel. While there is a sliver of truth in this statement, the reality is AYSI is more of an research and development company that provideds engineering solutions for material handling systems. AYSI's know-how and data from years of operations are used to minimize a customer's production costs by reducing hang-ups, spillages, energy consuption, friction and unscheduled maintenance or repair. Further, its business model is enhanced by selling maintenance and operation supplies after the large engineering project is complete as opposed to solely selling into capital projects.

Its unlikely that a competitor can cheapily acquire this knowledge along with industry-wide customer trust. Hence, it is quite likely the market for alloy steel proucts in Australia will evolve slowly and pricing will not become the main consideration for customers. AYSI should maintain current sales, margins and returns for years into the future.

Alloy Steel International Pty Ltd
826 followers
3w • Edited •

ASI Wear condition specialists will come to you during Rainbows, Dust Storms or Sunshine. To discuss YOUR upcoming project and get the best possible advice, GET IN TOUCH WITH ONE OF OUR PROFESSIONAL CONSULTANTS. +61 8 9248 3188.

#alloysteelinternational #wam #asiteam #arcoplate #madeinaustralia #australianwearplate #safetyfirst

Alloy Steel International Pty Ltd
826 followers
5mo •

Continuous improvement of wear resistant materials at Alloy Steel International.

#Alloysteel #ironore #segnut #safer

Segnut
716 followers
5mo •
+ Follow

BHP has adopted Segnut for use on the refurbishment of the Car Dumper #4 at its Port Operations in the Pilbara. Alloy Steel International Pty Ltd is undertaking major works on the project and is using Segnut to secure the wear liners on the equipment, greatly improving the maintainability and safety of the facility.

After more than two years of testing and proving trials in the field with BHP, Segnut is now a WAIO spec product and is listed on BHP's inventory system for use across its Iron Ore operations. #safer #faster #smarter

Western Australia Mining and Long-term Iron Ore Outlook

AYSI had low sales and net income until about 2011. Note that 2010 is missing as the Company went dark in 2010 but began filling again in 2013. All financial numbers are in USD '000s.

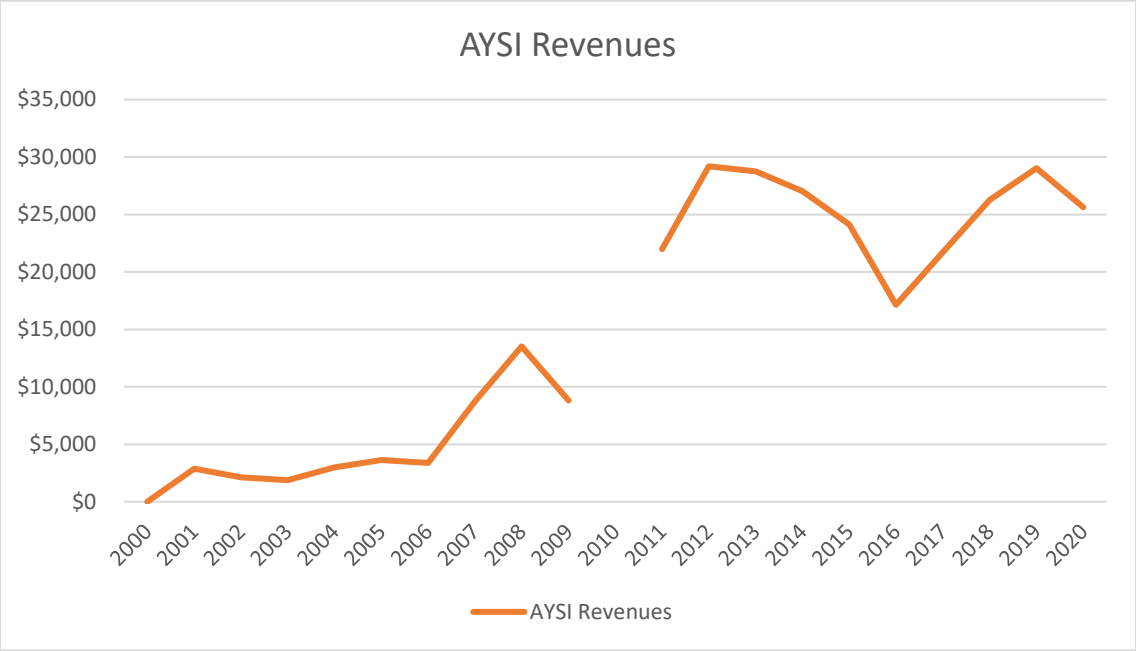


Table 3	Australian metals and other minerals private exploration expenditure, Australia 2007-08 to 2018-19 ($ million)								
	Copper	Diamonds	Gold	Iron ore	Mineral sands	Nickel, cobalt	Silver, lead and zinc	Other	Total metals and other minerals
2007-08	294	22	593	450	37	303	187	111	1,995
2008-09	179	10	438	589	31	260	81	154	1,741
2009-10	202	4	575	524	16	204	52	166	1,742
2010-11	323	1	652	665	6	271	76	224	2,218
2011-12	443	3	768	1,151	20	265	88	227	2,965
2012-13	319	6	662	1,011	38	165	80	161	2,442
2013-14	177	8	434	711	21	99	46	170	1,666
2014-15	144	5	396	448	27	83	52	131	1,286
2015-16	130	4	548	291	20	51	50	115	1,209
2016-17	136	2	689	291	20	81	55	150	1,423
2017-18	193	8	810	292	27	200	103	177	1,811
2018-19	290	9	935	298	35	199	92	189	2,048
5 year average	179	6	676	324	26	123	70	153	1,556
Per cent share	11%	0%	43%	21%	2%	8%	5%	10%	100%

Tables 4 to 6 summarise the production outlooks for the Base, High and Low scenarios, respectively, for Western Australia on a calendar year basis.

Table 4	Western Australian commodity production forecasts for the Base scenario									
Calendar	Alumina (Mt)	Copper (kt)	Gold (t)	Iron ore (Mt)	Nickel (kt)	Zinc (kt)	Lithium (kt)	Lead (kt)	Cobalt (kt)	Mineral sands (kt)
2016	13.8	178.7	193.3	846.5	203.1	78.4	440.5	5.1	5.1	1502.6
2017	13.8	178.7	202.3	877.3	178.9	85.4	1706.6	9.1	5.0	1105.9
2018	13.5	183.9	211.0	892.4	148.5	90.8	2300.0	9.4	5.1	1011.8
2019	13.8	192.9	212.0	882.8	175.1	106.3	2871.1	9.2	5.0	1016.1
2020	14.0	198.2	218.3	895.7	189.8	114.7	3557.7	10.7	6.6	1426.7
2021	14.1	217.7	213.9	904.0	208.2	125.7	3968.1	11.2	7.8	1773.4
2022	14.5	231.2	204.3	940.2	234.0	133.8	4262.9	11.4	8.6	1772.4
2023	14.5	219.0	205.5	948.3	267.6	134.9	4396.4	11.4	9.5	2357.0
2024	14.5	239.3	193.8	952.8	289.0	133.4	4618.2	11.1	11.3	2232.1
2025	14.5	202.0	199.1	965.5	299.9	130.6	4657.1	11.0	11.6	2403.2
2026	14.5	191.8	213.7	982.0	284.9	129.5	4703.0	11.3	12.1	2735.3
2027	14.5	196.7	214.3	1000.8	273.9	134.3	5075.0	11.5	12.7	2930.8
2028	14.5	198.3	218.2	1006.3	293.0	134.7	5104.2	11.6	14.4	2896.2
2029	14.5	208.5	213.7	1027.4	309.0	135.2	5126.3	11.6	15.0	2923.3
2030	14.5	220.4	212.5	1049.5	325.0	135.6	5149.5	11.7	15.6	2809.8

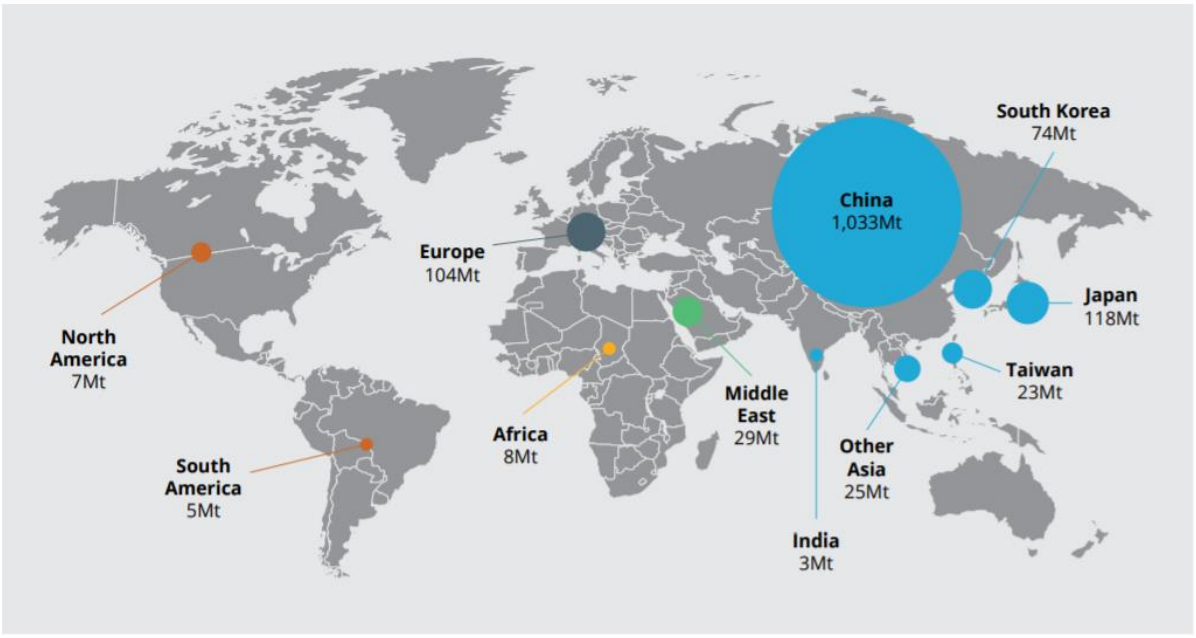
Source: NIEIR.

https://www.aemo.com.au/-/media/files/gas/national_planning_and_forecasting/wa_gsoo/2019/nieir---commodity-forecasts-report.pdf?la=en

Iron Ore Supply

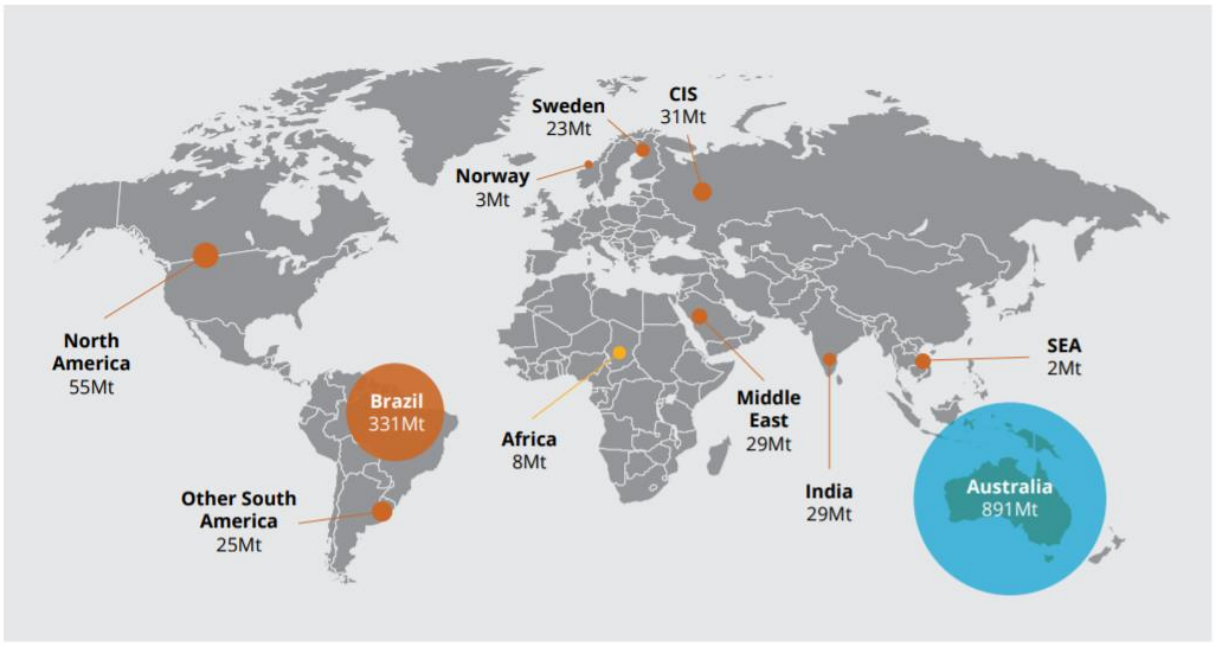
We want to focus on the long-term supply and demand for iron ore as this has more implications for AYSI's equity value than short-term fluctuations.

FIGURE 1: ESTIMATED SEABORNE IMPORTS 2019 (MT, WET)



Source: CRU Market Outlook.

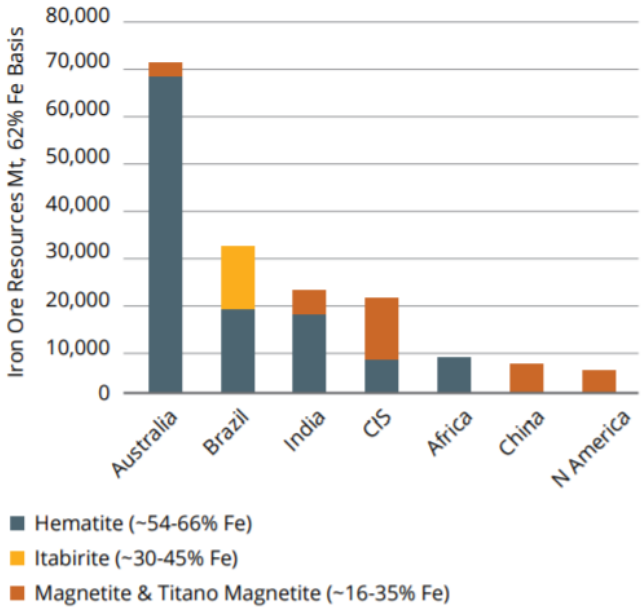
FIGURE 2: ESTIMATED SEABORNE EXPORTS 2019 (MT, WET)



Source: CRU Market Outlook.

Fairlight Capital

FIGURE 3: GLOBAL IRON ORE RESOURCES OF KEY PRODUCING COUNTRIES



Source: Australia, Brazil, India & N America resources based on producer company resource statements and presentations; CIS, Africa and China based on a combination of company reports, CISA publications, and USGS reports from https://www.usgs.gov/centers/nmic/iron-ore-statistics-and-information.

FIGURE 6: AUSTRALIA VS BRAZILIAN IRON ORE EXPORTS 2005 TO 2019 (WET METRIC TONNES)

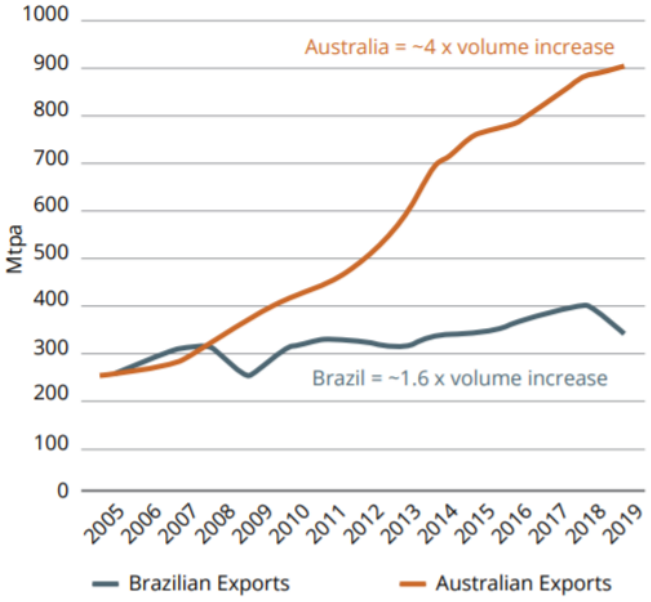
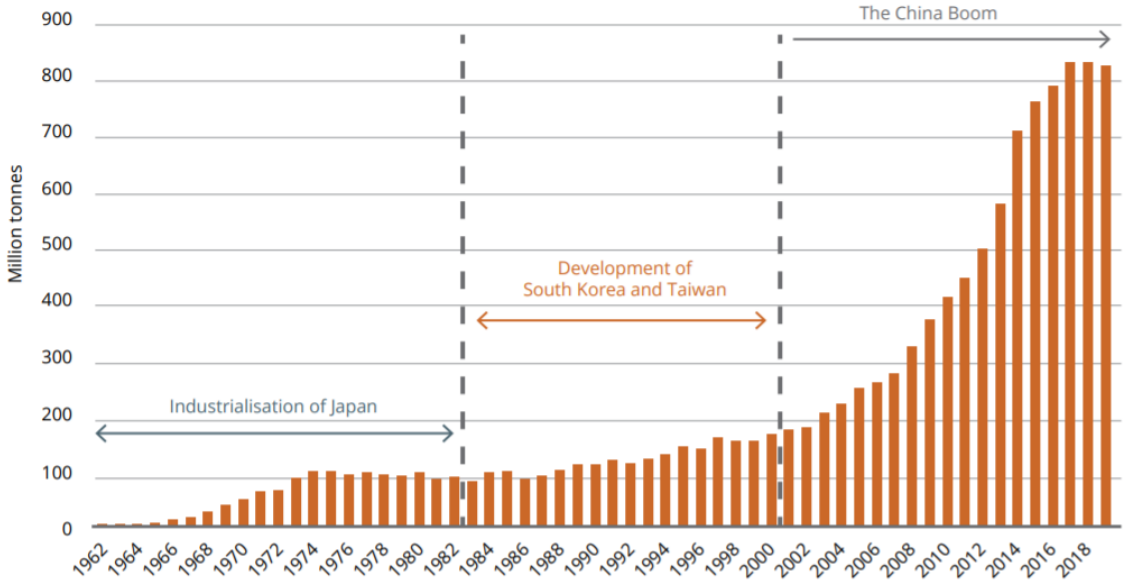


FIGURE 5: AUSTRALIAN IRON ORE PRODUCTION (DRY METRIC TONNES) 1962 TO 2019



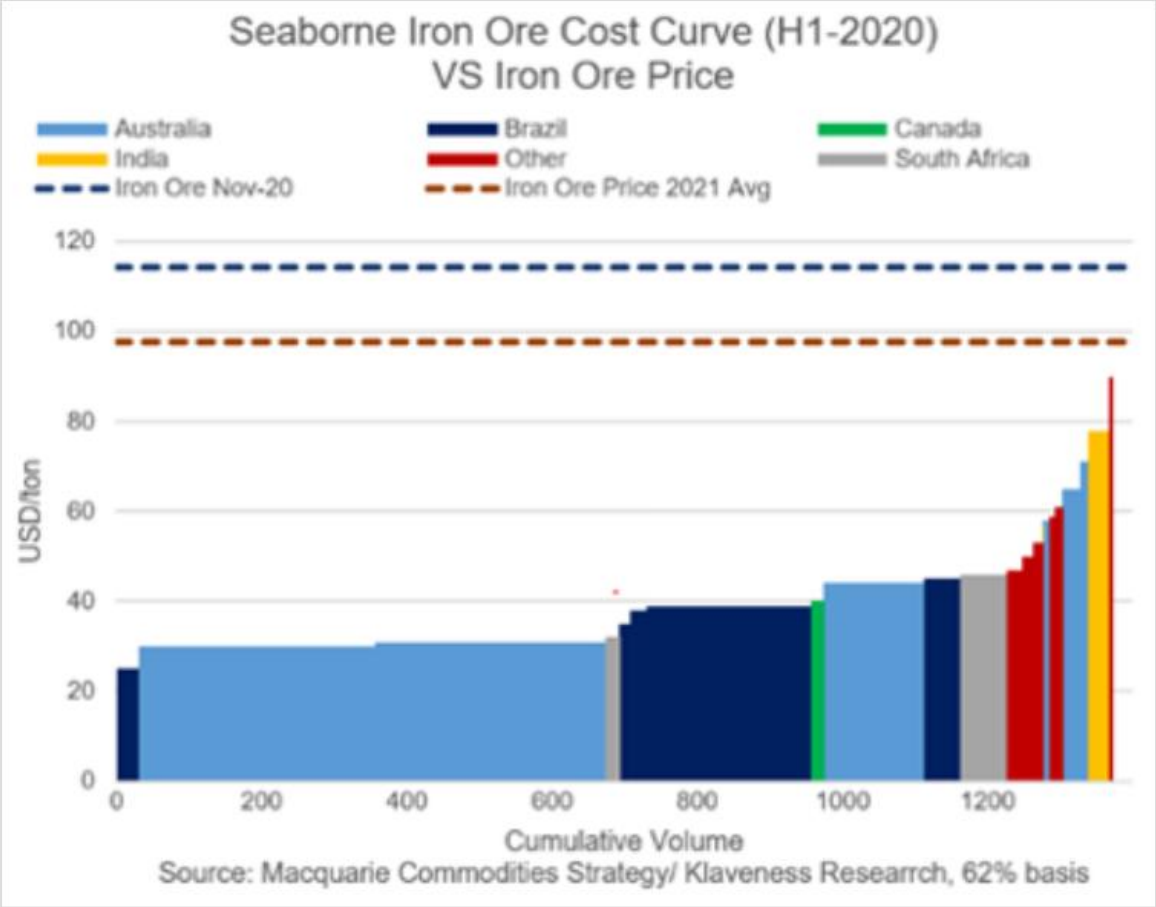
Source: DMIRS and CoCE.

FIGURE 7: MAP OF THE IRON ORE MINES & RAILWAYS IN THE PILBARA REGION OF WESTERN AUSTRALIA

Source: Main map was created using Open Street Map Data, rendering with Maperitive and editing with Inkscape.

Australia still has an estimated 70 billion tonnes of 62 per cent Fe basis ore avaiable to mine which is enough to sustain production for many decades. The remaining resource lives of all major producers are substantial with the weighted average life for the major Pilbara producers at 65 years.

https://minerals.org.au/sites/default/files/Best%20in%20Class%20-%20Australian%20Iron%20Ore%202021.pdf



https://www.hellenicshippingnews.com/2021-dry-bulk-outlook-will-iron-ore-export-be-able-to-meet-demand/

Fitch forecasts that Australian iron ore production will grow by an annual average of 1.7% from 2021-2025. While this is significantly lower than the previous five-year average of 3.4%, it is on a higher base meaning that annual output will increase by approximately 84 million tonnes by 2025.

https://www.mining.com/iron-ore-output-returns-to-growth-after-shrinking-for-five-years/

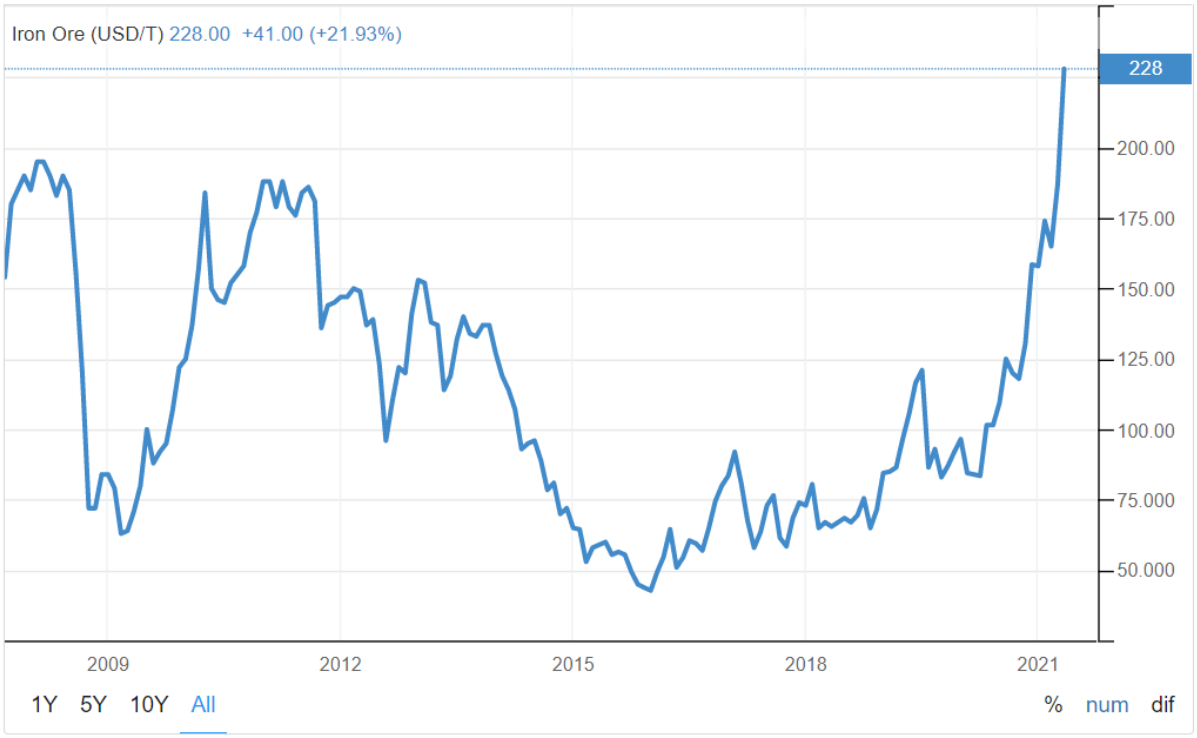
Demand

According BHP, emerging Asia continues to be an opportunity for continued growth. Later state urbanisation and industrialisation in China, early-stage urbanisation in India and ASEAN, and the multi-decadal impact of China's Belt and Road initiative are expected to provide additional demand for iron ore. The core elements of population growth, urbanisation, decarbonisation and rising living standards will continue to drive the need for iron ore for many decades.

https://www.bhp.com/media-and-insights/prospects/2021/02/bhps-economic-and-commodity-outlook/

https://www.riotinto.com/invest

https://www.oecd.org/industry/ind/Item_4b_Accenture_Timothy_van_Audenaerde.pdf



https://tradingeconomics.com/commodity/iron-ore

Historical Income Statement, Cash Flow, Current Valuation and Balance Sheet

At 7/22/2021, AYSI had a market capitalization of $36.0 million, and a net cash balance of $11.5 million

Year-end Sept, $ in 000s	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	TTM 3/31/21
Revenues	$21,977	$29,197	$28,760	$27,041	$24,135	$17,125	$21,735	$26,285	$29,036	$25,637	$29,625
Royalties	($440)	($584)	($575)	($541)	($1,335)	($1,018)	($1,262)	($1,368)	($1,645)	($408)	($408)
COGS	($12,990)	($17,713)	($14,283)	($13,828)	($11,373)	($10,153)	($11,840)	($14,581)	($17,024)	($14,380)	($16,876)
Gross Profit	**$8,548**	**$10,901**	**$13,902**	**$12,672**	**$11,427**	**$5,953**	**$8,633**	**$10,336**	**$10,367**	**$10,849**	**$12,341**
SG&A	($5,462)	($5,677)	($6,780)	($6,570)	($5,172)	($3,868)	($2,487)	($4,101)	($4,005)	($4,031)	($3,807)
Rent						($658)	($659)	($701)	($705)		
Amortization										($1,032)	($1,617)
Consultancy						($179)					
Impairment				($303)	($814)	($373)	($433)				
Operating Income	**$3,086**	**$5,224**	**$7,123**	**$5,798**	**$5,441**	**$874**	**$5,055**	**$5,534**	**$5,657**	**$5,786**	**$6,917**
Adj. Operating Income	**$3,526**	**$5,808**	**$7,698**	**$6,642**	**$7,589**	**$2,445**	**$6,749**	**$6,902**	**$7,302**	**$7,226**	**$8,942**
Interest	$36	($19)	$9	$63	$129	$105	$139	$174	$250	$109	($13)
Other	$115	($16)	$81	$146	$194	$194	$74	$114	$107	$769	$787
FX	$22	($189)	$568	$536	$2,022	($532)	($177)	$442	$57	$95	($239)
EBT	**$3,260**	**$5,000**	**$7,780**	**$6,544**	**$7,786**	**$641**	**$5,091**	**$6,263**	**$6,070**	**$6,759**	**$7,452**
Taxes	($834)	($1,503)	($2,330)	($1,513)	($2,641)	($1,009)	($1,594)	($1,865)	($1,627)	($1,548)	($1,679)
Net Income	**$2,426**	**$3,497**	**$5,450**	**$5,031**	**$5,145**	**($367)**	**$3,497**	**$4,398**	**$4,443**	**$5,211**	**$5,773**
Adjusted Net Income	**$2,715**	**$4,472**	**$5,927**	**$5,115**	**$5,844**	**$1,883**	**$5,197**	**$5,314**	**$5,622**	**$5,564**	**$6,886**
Share Repurchase									($1,481)		
Purchase IP										($7,061)	($7,061)
Payment Related Party Note										($1,137)	($1,673)
Purchase Matrix							($5,981)				
Sale of Indonesian Plant									$3,813		
Purchase PPE	($2,582)	($3,954)	($1,411)	($1,611)	($439)	($135)	($1,574)	($1,605)	($772)	($1,022)	($543)
Depreciation	$888	$1,607	$1,147	$1,716	$588	$593	$1,279	$686	$721	$2,513	$3,240
Estimated Cash Flow	**$732**	**$1,151**	**$5,186**	**$5,135**	**$5,294**	**$91**	**($2,779)**	**$3,479**	**$6,725**	**($1,496)**	**($264)**

Adjusted operating income equals reported operating income plus royalties, amortization, impairments and consultancy. Adjusted net income equals operating income adjusted for taxes at 23%. Estimated cash flow equals net income plus cash flow items, which exclude working capital movements.

In 2011-2014, large payments were made for the construction of a manufacturing plant in Indonesia. These plans were abandoned in 2015. In 2017, AYSI purchased Matrix Metals International from the Kostecki family. Matrix Metals supplied various metals and production inputs to AYSI.

TTM Adjusted Net Income of $6.9 million gives a P/E ratio of 5.2x and an EV/E ratio of 3.5x.

Return on operating assets (adjusted net income divided by opeating assets) and operating equity (adjusted net income divided by opeating equity) are 31% and 47%.

See page 8 for operating assets and operating equty figures.

	March 2021 (unaudited) US$	September 2020 (audited) US$
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	15,316,085	10,385,738
Accounts receivable, less allowance for doubtful accounts of $33,676 at March 31, 2021 and $44,661 at September 30, 2020	6,128,511	6,263,409
Inventories	8,586,747	8,308,358
Prepaid expenses and other current assets	257,764	299,543
TOTAL CURRENT ASSETS	30,289,107	25,257,048
PROPERTY AND EQUIPMENT, net	2,867,809	2,883,843
RIGHT OF USE ASSET, net	4,558,617	4,570,508
INTELLECTUAL PROPERTY ASSETS, NET	11,525,349	11,620,444
OTHER ASSETS		
Other financial assets	152,039	142,160
Deferred tax assets	956,822	713,831
Total other assets	1,108,861	855,991
TOTAL ASSETS	50,349,743	45,187,834
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	1,170,461	1,353,625
Current tax payable	918,412	678,103
Accrued payroll and related costs	890,402	665,541
Lease liability-current portion	761,866	712,358
Note payable to related party-current portion	1,118,869	1,022,675
TOTAL CURRENT LIABILITIES	4,860,010	4,432,302
LONG-TERM LIABILITIES		
Lease liability	3,912,348	3,934,975
Note payable to related party	2,691,353	3,046,708
Deferred tax liabilities	67,019	167,602
Other liabilities	53,941	30,533
TOTAL LONG-TERM LIABILITIES	6,724,661	7,179,818
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY		
Preferred Stock: $0.01 par value; authorized 3,000,000 shares; issued and outstanding – none	-	-
Common Stock: $0.01 par value; authorized 50,000,000 shares; 15,902,597 at 31/03/2021 and 15,902,597 at 30/09/2020 issued and outstanding	159,026	159,026
Capital in excess of par value	1,651,083	1,651,083
Retained earnings	40,933,007	38,028,631
Accumulated other comprehensive income (loss)	(3,978,044)	(6,263,026)
TOTAL STOCKHOLDERS' EQUITY	38,765,072	33,575,714
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	50,349,743	45,187,834

Downside Risks

1) Australian Chinese Trade War:

   https://www.mining-technology.com/features/how-china-is-moving-beyond-australia-for-its-iron-ore-hunger/

2) Reduction in Thermal Coal Mining:

   https://www.argusmedia.com/en/news/2191357-australian-iron-ore-exploration-boom-continues

3) New Wear Liner Technology:

   It is possible a competitor creates a new alloy steel or other material that is superior to Arcoplate. However, it would take years for the competitor to acquire data and customer relationships giving AYSI time to develop a similar product.

4) Low International Growth Opportunities:

   The same factors that give AYSI an edge in the Western Australia market limit its ability to easily grow in international markets. To enter a new market it would have to accumulate extensive know-how and data that is hard to obtain. This is not so much a risk as a limitation on employing capital.

5) Misallocation of Capital Resources:

   The Company is now largely done consolidating the other assets that were held by the Kostecki family. The family still owns than the office and manufacturing space. However, AYSI can use debt to purchase this fixed asset versus cash or seller financing for previous intangible purchases. Going forward, AYSI will likely continue to generate strong cash flows. How management and the Board of Directors allocate this capital will have a large impact AYSI's future share price.

6) Customer Concentration:

AYSI has moderate customer concentration. However, the real concentration that matters is on a project by project or mine by mine basis which reduces the risk posed by each customer.

11. Major customers, suppliers, and geographic information

The Company had revenues from five major customers for the years ended September 30, 2020 and five customers for the year ended September 30, 2019 of approximately $12,161,286 and $15,587,213 respectively. Accounts receivable due from these customers were approximately $1,968,619 and $3,965,954 at September 30, 2020 and 2019.

	2020 Revenue
Customer A	15%
Customer B	12%
Customer C	8%
Customer D	8%
Customer E	5%

	2019 Revenue
Customer A	29%
Customer B	8%
Customer C	6%
Customer D	5%
Customer E	5%

Conclusion

Alloy Steel International is an undervalued nanocap stock. The Company is misunderstood by the market as a spare parts manufacturer. The reality is much different. AYSI is a research and development engineering firm providing turnkey solutions to industrial materials extraction and handling companies. AYSI's know-how, accumuated data and customer relationships are very expensive to reproduce and provide a barrier to new entrants while at the same time keeping competition among current market participants rational.

Much of the negativity surrounding the purchase of the intellectual property and family relationships is unjustified. One of the risks for AYSI is the majority ownership the Kostecki family and their future treatment of minority shareholders. But given the current valuation investors are smart to underwrite these risks at the current valuation of 3.5x enterprise value-to-earnings with limited downside. Given the long-term trends in the Western Australia minerals market driven by increasing population growth, urbanisation, decarbonisation and rising living standards along with the barriers to entry in the Australian wear plate market and Alloy Steel International's strong capital structure and history of innovation, AYSI is an attractive investment opportunity with stable cash flows.

News update 7/27/21:

https://www.streetinsider.com/Corporate+News/Alloy+Steel+International%2C+Inc.+%28AYSI%29+and+Kostecki+Brokerage+Announces+Merge+Agreement/18727857.html

"Alloy Steel International, Inc. (OTC: AYSI) the manufacturer of Arcoplate and provider of anti-wear and hang-up solutions to the mining and bulk materials industries, based in Perth, Western Australia, and Kostecki Brokerage Pty Ltd (a wholly owned entity owned by the Kostecki family) today announced that they have entered into a definitive merger agreement under which Kostecki Brokerage Pty Ltd ('KBPL") will acquire the non-controlling shareholders' interest in the Company in an all cash transaction. Under the agreement, the Company's shareholders, excluding the Kostecki family and its affiliated entities, will receive $2.55 per share in cash upon completion of the transaction for a total implied market capitalization of the Company of approximately $40.6 million.

The Special Committee, comprised of independent members of the Board of Directors (the "Board") of the Company was formed in May 2021 to review the proposal from the Kostecki family and, with the assistance of independent legal and financial advisors, completed a thorough review of the proposal, unanimously concluding that the transaction with the Kostecki family was in the best interests of the Company's shareholders. Based on the unanimous recommendation of the Special Committee, the agreement was also approved by the full Board.

According to Mr. Steven Kostecki, Director of KBPL, "the Kostecki family, with a 65% majority ownership interest in the Company, believes that the Company can better compete in its markets as a privately held company. The family believes that the cash transaction will

provide non-controlling shareholders with certainty of value and liquidity at a fair value which exceeds the Company's historical trading price."

According to Mr. Alan Scott, the Company's Chairman of the Board, and a member of the Special Committee, "we believe that the proposed transaction provides the Company with the opportunity to improve its competitive position as a privately held company and provide liquidity to its minority shareholders, which has been historically lacking." He added that, "the Special Committee and the Board believe it is a good time to privatize the Company with expected competitive benefits for the business as well as providing a good result for our minority shareholders."

Jaffe Raitt Heuer & Weiss, P.C. served as legal advisor to the Company. Conner & Winters, LLP served as legal advisor to the Special Committee. Davis Graham & Stubbs LLP served as legal advisor to Kostecki Brokerage Pty Ltd.”