

January 10, 2020

ENVELA CORPORATION (NYSE/AMERICAN: ELA)

Envela Corporation is a Dallas-based holding company with diverse subsidiaries in the recommerce (wholesale and retail) and electronics-recycling industries.

COMPANY HIGHLIGHTS

- * Pushing the Envelope on Recommerce.
- * In our view, Envela is uniquely positioned for continued growth. The company has undergone a successful turnaround that saw it reestablish profitability in its core retail business as a marketplace for authenticated consignment luxury items, including fine jewelry and watches. In 2019, the company diversified into electronics recycling through the asset acquisitions of Echo Environmental and ITAD USA, and the purchase of Teladvance. This led to the formation of a new business unit that has made solid traction among large corporate clients and significantly enhanced Envela's gross margin profile.
- * We expect Envela to diversify revenue streams further by acquiring other cash-generating companies across the recommerce landscape, utilizing roughly \$40 million of net operating loss carryforwards from prior leadership.
- * As of September 30, 2019, the company had \$2.2 million in cash/restricted cash and marketable securities and \$9.4 million in long-term debt, most of which is tied to a promissory note to CEO John Loftus, which enabled the Echo and ITAD acquisitions. Driven by improving fundamentals, we expect Envela to retain sufficient working capital to invest in and expand its corporate footprint.
- * We think that Envela shares are extremely undervalued, on both a price/sales and price/earnings basis, and we expect the valuation gap compared with relevant benchmarks to converge in the coming years. Based on our forward P/E analysis, we arrive at a fair value estimate of \$4 per share.

INVESTMENT THESIS

Envela Corporation is an emerging leader in the recommerce industry. The company was established in 1965 as American Pacific Mine and later renamed Dallas Gold & Silver

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KEY STATISTICS

Key Stock Statistics

Recent price (1/6/20)	\$1.44
52 week high/low	\$1.68-\$0.37
Shares outstanding (M)	26.9
Market cap (M)	\$39.0
Dividend	Nil
Yield	Nil

Sector Overview

Sector	Consumer Discretionary
Sector % of S&P 500	9.8%

Financials (\$M)

Cash & Mkt Securities	2.6
Debt	9.4
Working Capital (\$M)	12.2
Current Ratio	4.0
Total Debt/Equity (%)	90.0%
Payout ratio	NM
Revenue (M) TTM	73.4
Net Income (M) TTM	2.5
Net Margin	3.4%

Risk

Beta	-0.26
Inst. ownership	2%

Valuation

P/E forward EPS	7.6
Price/Sales (TTM)	0.5
Price/Book (TTM)	3.6

Top Holders

Renaissance Technologies
SG Capital Management
UBS Group

Management

CEO	Mr. John Loftus
CFO	Mr. Bret Pedersen
Company website	www.envela.com

PRICE CHART



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Exchange, before rebranding as Envela in December 2019. It has a more than 40-year commitment to being eco-friendly, and its current business model promotes reducing, reusing and recycling goods by extending the useful life of consumer products. Envela provides a marketplace for an enhanced buying experience of jewelry and bullion, specializing in luxury watches and jewels. It is supported by an in-house staff of experts, including horologists, gemologists and authenticators who inspect items for authenticity and value. The company hosts an on-site, state-of-the-art Swiss watch repair service with dedicated watch craftsmen who have trained at the esteemed American Watchmakers-Clockmakers Institute (AWCI), testing and servicing fine mechanical timepieces to ensure they operate at optimum levels.

Envela's Bullion Express unit is one of the largest precious metals dealers in the southwest United States, offering a wide selection of gold, silver, platinum and palladium coins, bars, bullion rounds, collectibles and other numismatics products from mints around the world. Its inventory includes over 250 bullion products, including American Eagles, Canadian Maple Leafs, South African Krugerrands, and Credit Suisse gold bars and kilo silver bars.

The company operates four retail stores in the Dallas/Fort Worth Metroplex in Texas, and one retail store in Charleston, South Carolina. In the nine-month period ending September 30, 2019, the Texas operations accounted for over 95% of revenues.

Envela's e-recycling unit also represents a compelling domestic-growth story, as all electronics processing takes place in the United States. We believe this may appeal to larger clients seeking to support a local economy.

In 2018, jewelry accounted for 33% of the company's revenue (34% in 2017), bullion/rare coins accounted for 54% of revenue (53% in 2017), scrap precious metal accounted for 9% of revenue (10% in 2017), and "other" accounted for 3% of revenue (1% in 2017). In 2018, revenue from continuing operations declined by 12.8%, largely attributable to lower jewelry sales and a drop in gold prices. Notably, the company generated positive cash flow from operations in both 2018 and 2017, despite a challenging market environment.

Management is led by President, Chairman & CEO John Loftus, who was appointed in December 2016 amid a multi-year period of unprofitability. Several months into his tenure, S&P Global Market Intelligence named the company the second-most-likely company to go bankrupt, behind Sears Holdings. Under Loftus's leadership, however, the company delivered annual profits in 2017 and 2018, renewing its retail focus. Envela implemented several key business strategies to change the company's culture and business execution. These included

promoting transparency to the transaction process by having in-house experts appraise the value of goods, and increasing sales velocity to enhance cash flow and capitalize on favorable market-pricing trends. Recently, the company rolled out a new point-of-sale system that helps facilitate collecting market data and expanding its market presence.

With the legacy retail business (the DGSE Brands operating unit) stabilizing and generating net income despite market challenges, the company revised its strategy to acquire businesses and brands in the environmentally friendly recommerce subindustry. This adds diversified revenue streams and produces attractive investment yields. From a corporate-portfolio viewpoint, Envela seeks acquisitions that provide promising synergies of cost reductions and efficiencies, but also contribute to revenue and earnings accretion.

Toward this end, Envela identified IT asset disposition (ITAD) as a key market opportunity. Exponential growth in the technology industry, particularly in consumer electronics, has grown the need for innovation in disposing and managing end-of-life electronics and e-waste recycling. In addition, large companies increasingly face reputation and liability considerations as well as the need to safeguard confidential corporate information previously stored or used on such electronics.

During 2019, Envela made several acquisitions that, combined, created a second business unit, referred to as ECHG (Echo Consolidated Holdings Group) or the "Echo Entities." This unit includes Echo Environmental Holdings and ITAD USA Holdings, whose assets were purchased in May 2019, and Teladvance Partners, acquired in August 2019.

The Echo Entities capture value across the recommerce spectrum. This includes parts harvesting for components with secondary value; recycling to provide clients with an opportunity for recovery revenue and bottom-line enhancement from asset disposition; resale and white-label service, which helps customers find buyers for technology products; and redeployment, providing services for customers who need their assets sanitized, function tested, re-imaged and re-configured for internal distribution.

Echo Environmental processes circuit boards and electronic waste, delivering fast and cost-efficient service to many different industries that need to recycle electronic components, while meeting or exceeding applicable environmental regulations. The product mix generates three primary revenue streams: (1) recycling fees, whereby electronic components and other materials are processed from a vendor, (2) outright sales, which are the sale of processed material to customers after

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PEER COMPARISON

Company	Ticker	Recent Price (\$)	52-Week High (\$)	52-Week Low (\$)	Mkt. Cap (\$MIL)	1-yr Price Change (%)	1-yr Rev Growth (%)	1 YR EPS Growth (%)	P/E Ratio	Beta	Yield (%)
ENVELA CORP.	ELA	1.44	1.68	0.37	39	215	-13	-71	73.0	-0.26	NA
THE REAL REAL INC.	REAL	18.2	30.05	12.58	1500	NA	NA	NA	NA	NA	NA
WINMARK CORPORATION	WINA	204.3	204.3	152.7	783	27	4	28	27.0	0.24	0.5
ADVANCED DISPOSAL SERVICES INC.	ADSW	32.9	33.01	23.76	2900	36	3	-74	NA	0.63	NA

sorting, recycling and payment to initial vendors, and (3) settlement of processed precious metals sent to refiners.

Teladvance focuses on managing end-of-life processes for IT assets, including those of public companies and some of the world's best-known brands seeking to reduce overall IT costs and dispose of unneeded equipment in secure and ecologically responsible ways. ITAD USA offers end-to-end solutions for clients' reverse-logistics supply chain, focusing on devices such as mobile telephones, tablets, accessories and wearables.

Revenue related to the Echo Entities for three months ending September 30, 2019, was \$6.2 million, consisting of recycled material sales (83%) and reused material sales (17%). Importantly, gross margin from the Echo unit during the period was 51%, driving expansion of the consolidated gross margin to 22.7%, which compares favorably to 18.1% during the same period in 2018 (prior to the Echo acquisitions). Of note, Envela's financial results for the third quarter of 2019 (boosted by the first full quarter inclusion of the Echo unit) represented the company's highest quarterly net profit during the last 10 years.

At an organization level, Envela's operating businesses are managed primarily on a decentralized basis. With few exceptions, there is minimal involvement by Envela's corporate headquarters in the day-to-day business activities of its operating businesses. We view this favorably for the sustained success of acquired companies and future acquisition opportunities. As such, we expect less management attrition and more continuity in corporate culture compared with acquisition strategies involving consolidation into a centralized structure.

RECENT DEVELOPMENTS

In 2019, Envela's stock increased by 193% versus a 29% gain for the S&P 500. Its shares are thinly traded, with an average daily volume of approximately 45,000 shares over the past three months.

In November 2019, Envela reported EPS of \$0.04 for the third quarter of 2019, compared with a loss of \$0.06 per share for the same period in 2018. The quarter's net profit of \$1.04 million represented the company's highest quarterly net profit in the last decade. Total revenue rose \$9.2 million, or 60%, to \$22.8 million, reflecting both organic growth (\$3 million, 22%) and contribution of the Echo Entities (\$6 million). Organic growth from the DGSE Brands unit was boosted by a 93% increase in precious-metal scrap sales, as Envela increased its sales velocity to capitalize on a rise in gold prices.

In December 2019, Envela was rebranded to its new corporate name, reflecting its vision to pursue acquisition opportunities from a variety of recommerce industries and create diversified revenue streams and shareholder value.

In August 2019, Envela secured a parts account with Swiss luxury watch manufacturer, The Swatch Group, which expanded the scope of its services to include genuine Swatch Group timepieces (e.g., Omega, Longines, Rado, Tissot, Mido and Hamilton) and watches with Swiss ETA movements. In the same month, Envela acquired Teladvance, LLC, an ITAD company.

In May 2019, Envela acquired the assets of Echo Environmental, LLC and its subsidiary ITAD USA, LLC for \$6.9 million.

EARNINGS & GROWTH ANALYSIS

We forecast revenue of \$83 million in 2019 and \$100 million in 2020, representing increases of 54% and 20%, respectively. Despite a lower gross margin from its retail unit and the addition of the Echo Entities mid-year, gross margins should increase to 19.5% in 2019 and to 23% in 2020, up from approximately 18% in the prior two years. In the third quarter of 2019, gross profit margin from retail operations was 12.1% compared to 18.1% during the same prior-year period. In contrast, gross profit related to the Echo Entities was 51%, which led to a consolidated Q3 2019 gross margin of 22.7%.

In our view, Envela is well positioned to control expenses, driven by its decentralized business model, which we expect to keep corporate overhead low and enable portfolio companies to operate unencumbered. With the exception of accounting and marketing, Envela's operating businesses are managed on a decentralized basis.

Our EPS estimates for 2019 and 2020 are \$0.11 and \$0.19, respectively.

FINANCIAL STRENGTH & DIVIDEND

Our financial strength rating for Envela is Medium. As of September 30, 2019, Envela had \$2.2 million in cash/restricted cash/marketable securities and \$9.7 million in debt, most of which is tied to promissory notes to CEO John Loftus that enabled the acquisition of Echo Environmental and ITAD assets in May 2019.

As of September 30, 2019, Envela had \$16.2 million in current assets and \$4.0 million in current liabilities, representing \$12.2 million in working capital and a current ratio of 4.0X. As such, we view Envela as well positioned to retain the flexibility needed to execute its business model.

During the nine months ended September 30, 2019, cash flows used in operating activities totaled \$2.7 million, driven largely by the settlement of a \$3 million trade account payable from a previous bullion-trading partner. Excluding this outflow, operational cash flow for the nine-month period would have been positive, as it was in both 2017 and 2018. As of September 30, 2019, long-term notes payable on Envela's balance sheet totaled \$9.4 million.

Envela does not pay a dividend, and we do not expect one to be initiated in the near term.

MANAGEMENT & RISKS

John R. Loftus has served as CEO, president and chairman of the board of directors since December 2016. Under his leadership, the company posted profits in both 2017 and 2018. Previously, Mr. Loftus was the CEO of a precious-metals company, acted as an efficiency consultant focusing on optimizing existing operations and cutting waste to increase value, and managed a personal real estate portfolio. Mr. Loftus holds an M.B.A. from the SMU Cox School of Business. He controls over 70% of the voting power in Envela.

Envela's board has five members, including three independent directors. We view Envela's board, consisting of a majority of independent directors, favorably and note that Envela has independent directors chairing the key audit, compensation and nominating/corporate-governance committees.

Risks include Envela's exposure to the macro-economy's appetite for buying and selling luxury items, which tend to be volatile. Additionally, many aspects of the retail business are impacted by changes in the price of precious metals, particularly gold, which rise and fall based upon global supply-and-demand dynamics. The market for buying and selling pre-owned or "scrap" gold has been negative during the past several years. The company closely monitors the climate for scrap-gold purchases, which contributed to increasing sales velocity across 2019 due to a rise in gold prices. Risks to its environmental recommerce unit include an economic slowdown that could spur large corporate clients to defer major recycling projects and equipment upgrades.

COMPANY DESCRIPTION

Envela, together with its subsidiaries, buys and sells jewelry and bullion products to individual consumers, dealers and institutions in the United States. As of December 31, 2018, the company marketed its products and services through five retail locations, as well as several e-commerce sites. In 2019, the company acquired Echo Environmental, ITAD USA and Teladvance to expand its portfolio into areas of electronic recommerce. The company was known previously as DGSE Companies, Inc. and became Envela Corporation in December 2019. The company was founded in 1965 and is based in Dallas, Texas.

VALUATION

We think that Envela shares are undervalued on both a price/sales and price/earnings basis. The former is under one-times our 2019 sales estimate of \$83 million, and less than 0.5-times our 2020 forecast of \$100 million. The latter represents a multiple of 12.7-times our 2019 EPS estimate of \$0.11 and approximately seven-times on our 2020 estimate of \$0.19. We attribute the disconnect in valuation to Envela's legacy reputation among investors as well as inconsistent revenue growth from its retail unit, despite achieving profitability since 2017. As mentioned above, the company's viability was questioned in early 2017 based on its prior performance, before CEO John Loftus took the helm in December 2016. As such, we are confident that the recent rebranding to Envela and diversification of its revenue streams will introduce the company to new institutional investors. We expect the valuation gap to narrow significantly in the coming years. For reference, the Russell 2000 Small Cap Index recently traded at a forward P/E of 25-times for 2020 and the S&P Small Cap 600 Index traded at 18-times for 2020. Applying the average multiple of 21.5-times to our 2020 EPS estimate of \$0.19, we arrive at a \$4 fair value estimate for the ELA shares.

Steve Silver, Analyst

INCOME STATEMENT

Growth Analysis (\$MIL)	2015	2016	2017	2018	2019E	2020E
Revenue	60.9	48.3	62.0	54.0	83.2	100.0
Gross Profit	9.7	8.3	11.3	9.7	16.1	23.2
SG&A	11.1	10.3	9.0	8.7	12.3	17.0
R&D	NA	NA	NA	NA	NA	NA
Operating Income	-2.0	-2.4	2.0	0.7	3.5	6.0
Interest Expense	0.3	0.4	0.2	0.1	0.4	0.4
Pretax Income	-2.3	-4.0	1.8	0.7	3.2	5.3
Tax Rate (%)	NA	NA	0.0	8.0	4.0	4.0
Net income	-2.3	-4.0	1.8	0.7	3.0	5.1
Diluted Shares	12.3	13.2	27.4	27.0	26.9	27.2
EPS	-0.18	-0.30	0.07	0.02	0.11	0.19
Dividend	NA	NA	NA	NA	NA	NA

Growth Rates (%)

Revenue	NA	NA	28	-13	54	20
Operating Income	NA	NA	NA	-65	400	71
Net Income	NA	NA	NA	-61	329	70
EPS	NA	NA	NA	-71	450	73

Valuation Analysis

Price (\$): High	1.75	1.37	1.74	1.27	1.68	NA
Price (\$): Low	0.25	0.27	0.75	0.57	0.37	NA
PE: High	NA	NA	24.9	63.5	15.3	NA
PE: Low	NA	NA	10.7	28.5	3.4	NA
PS: High	NA	NA	0.8	0.6	0.5	NA
PS: Low	NA	NA	0.3	0.3	0.1	NA
Yield: High	NA	NA	NA	NA	NA	NA
Yield: Low	NA	NA	NA	NA	NA	NA

Financial & Risk Analysis (\$MIL)

Cash	1.8	1.4	1.3	1.5	NA	NA
Working Capital	1.7	4.1	5.3	6.8	NA	NA
Current Ratio	1.2	1.60	2.00	2.50	NA	NA
LTDebt/Equity (%)	60	NA	NA	NA	NA	NA
Total Debt/Equity (%)	100	NA	NA	NA	NA	NA

Ratio Analysis

Gross Profit Margin	NA	17%	18%	18%	19%	23%
Operating Margin	NA	-5%	3%	1%	4%	6%
Net Margin	NA	NA	3%	1%	4%	5%
Return on Assets (%)	NA	NA	NA	NA	NA	NA
Return on Equity (%)	NA	NA	NA	NA	NA	NA
Op Inc/Int Exp	NA	-6	10	7	9	15
Div Payout	NA	NA	NA	NA	NA	NA

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