

### Key Facts

Company Code	FLC
Closing Price	\$0.38
Date of Report	1/11/18
Company Website	<a href="http://fluencecorp.com">fluencecorp.com</a>
Analyst	Johan Hedstrom

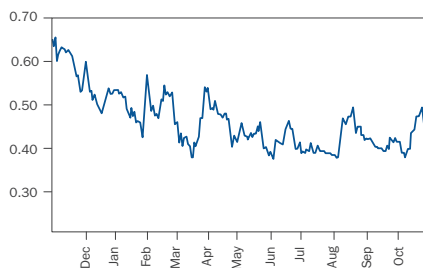
### Company Statistics

12-Month Range (A\$)	\$0.34-\$0.66
Market Cap (A\$Mil)	\$200m
Issued Shares (Mil)	525m
Issued Options (Mil)	49m
Cash (A\$Mil)	\$60m

### Major Shareholders

RSL Investments	30.0%
Pond Ventures Nominees	8.3%

### Share Price Performance



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### Fluence announces a good September Quarterly

The company announced its September Quarter results, with revenues of US\$29m, up 28% on Q2 2018 and 140% higher than 3Q 2017. Fluence maintains the lower end of revenue guidance of US\$105-115m for the 2018 year, indicating a strong final Quarter of about US\$43m, as US\$61.8m has been received YTD.

The company also achieved positive EBITDA of US\$0.5m for the period, which wasn't supposed to occur until 2019.

A number of new sales contracts were agreed during the Quarter, while a very good, and large sale of +US\$45m in China was announced a couple of weeks ago.

### Capital raising is not entirely surprising

Fluence has also announced a capital raising of A\$33m, by issuing 89.5m shares at A\$0.37, a 16% discount to the 15 day VWAP. An SPP of A\$5m to a maximum of A\$15,000 per shareholder will follow. The raise is not a major surprise, as the company continues to experience negative cash flow during this early part of its growth phase. Net cash used in the Q3 was US\$12.9m and guidance for the Q4 is US\$16.5m. With a cash position of US\$23.1m, Fluence is acting now, rather than when cash would be a lot tighter.

The company "anticipate the cash used in operating activities in Q1 2019 to be vastly reduced" and is also looking at debt facilities. The company says it will become cash flow positive in 2019.

### Sales growth is impressive – and it needs to be

Fluence continues to win new sales agreements across a wide range of water treatment technologies, geographies and industries. The +US\$45m sale of Aspiral plants to ITEST of China is arguably the most exciting deal, as it represents the first large scale order in China, and offers a glimpse of the potential. ITEST is only one, relatively new customer in a country where Fluence has established 23 strategic partnerships. In addition, the US\$7.6m Nirobox sale to Egypt represents the largest order for desalination plants to date, so that is also very positive. However, this growth needs to keep going to generate the sales targets outlined by the company, and reflected in our forecasts.

### We upgrade revenue estimates, but valuation is diluted

We have upgraded our revenue estimate for 2018 from US\$86m to US\$96m on the back of the good Q3 result, and the company's confidence in reaching US\$105m. Our risked Target Price is reduced by A\$0.13 to A\$0.83/share, due to the equity raising.

We maintain a positive view of the stock, and it's good to hear that four US institutional investors have come on board through the placement.

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# Fluence Corporation Financial Summary

## PROFIT AND LOSS US\$

Year ending December	Unit	2016A	2017A	2018E	2019E	2020E
Revenue	\$m	60.9	33.2	95.6	134.7	240.8
Operating Expenses	\$m	(49.3)	(27.2)	(75.0)	(102.9)	(176.9)
Admin and Other Expenses	\$m	(28.7)	(31.4)	(32.2)	(33.0)	(33.8)
<b>EBITDA</b>	<b>\$m</b>	<b>(17.1)</b>	<b>(23.9)</b>	<b>(11.5)</b>	<b>(1.2)</b>	<b>30.1</b>
Depreciation	\$m	(1.6)	(0.7)	(3.3)	(4.2)	(6.0)
EBIT	\$m	(18.8)	(24.6)	(14.8)	(5.4)	24.2
Net interest (expense)	\$m	6.5	0.1	1.6	0.8	0.8
<b>PBT</b>	<b>\$m</b>	<b>(12.3)</b>	<b>(24.4)</b>	<b>(13.2)</b>	<b>(4.6)</b>	<b>25.0</b>
Tax expense	\$m	(2.8)	0.1	3.3	1.2	(6.2)
<b>NPAT (pre-abnormal)</b>	<b>\$m</b>	<b>(14.9)</b>	<b>(24.3)</b>	<b>(9.9)</b>	<b>(3.5)</b>	<b>18.7</b>
Abnormal items	\$m	-	-	-	-	-
<b>NPAT (reported)</b>	<b>\$m</b>	<b>(14.9)</b>	<b>(24.3)</b>	<b>(9.9)</b>	<b>(3.5)</b>	<b>18.7</b>

## CASH FLOW US\$

Year ending December	Unit	2016A	2017A	2018E	2019E	2020E
<b>OPERATING CASHFLOW</b>						
NPAT	\$m	(14.9)	(24.3)	(9.9)	(3.5)	18.7
Add: non-cash items	\$m	1.6	0.7	3.3	4.2	6.0
Change in working capital	\$m	(7.3)	(6.4)	(51.4)	5.7	(10.6)
<b>Operating cash flow</b>	<b>\$m</b>	<b>(20.6)</b>	<b>(30.1)</b>	<b>(58.1)</b>	<b>6.4</b>	<b>14.1</b>
<b>INVESTING CASHFLOW</b>						
Net PP&E	\$m	(0.4)	(3.7)	(4.9)	(7.4)	(6.4)
Evaluation	\$m	(0.2)	-	-	-	-
Other/merger	\$m	(3.8)	55.0	-	-	-
<b>Investing cash flow</b>	<b>\$m</b>	<b>(4.4)</b>	<b>51.3</b>	<b>(4.9)</b>	<b>(7.4)</b>	<b>(6.4)</b>
<b>FINANCING CASHFLOW</b>						
Share capital	\$m	3.3	31.3	23.5	-	-
Interest bearing debt	\$m	4.3	(0.6)	-	-	-
<b>Financing cash flow</b>	<b>\$m</b>	<b>7.7</b>	<b>30.7</b>	<b>23.5</b>	<b>-</b>	<b>-</b>
Change in cash	\$m	(17.3)	51.9	(39.4)	(1.0)	7.7

## BALANCE SHEET US\$

Year ending December	Unit	2016A	2017A	2018E	2019E	2020E
<b>ASSETS</b>						
Cash	\$m	8.0	79.9	40.5	39.5	47.2
Accounts receivable	\$m	3.1	26.7	33.5	33.7	60.2
Property Plant & Equipment	\$m	0.6	7.1	8.7	11.9	12.3
Inventory	\$m	-	18.5	18.5	18.5	18.5
Other	\$m	3.8	72.4	72.4	72.4	72.4
<b>Total assets</b>	<b>\$m</b>	<b>15.5</b>	<b>204.7</b>	<b>173.6</b>	<b>176.0</b>	<b>210.6</b>
<b>LIABILITIES</b>						
Accounts payable	\$m	0.4	59.0	14.3	20.2	36.1
Deferred tax liabilities	\$m	-	1.7	1.7	1.7	1.7
Borrowings	\$m	3.4	2.1	2.1	2.1	2.1
Provisions	\$m	4.2	38.2	38.2	38.2	38.2
<b>Total liabilities</b>	<b>\$m</b>	<b>8.0</b>	<b>101.1</b>	<b>56.4</b>	<b>62.3</b>	<b>78.2</b>
<b>SHAREHOLDER'S EQUITY</b>						
Share capital	\$m	15.8	156.9	180.4	180.4	180.4
Retained earnings	\$m	(10.5)	(51.9)	(61.8)	(65.3)	(46.6)
Reserves & outside equity	\$m	2.2	(1.4)	(1.4)	(1.4)	(1.4)
<b>Total equity</b>	<b>\$m</b>	<b>7.5</b>	<b>103.6</b>	<b>117.2</b>	<b>113.7</b>	<b>132.4</b>
Weighted average NoSh	m	228.6	336.1	470.3	525.4	525.4

## FINANCIAL RATIOS

Year ending December	Unit	2016A	2017A	2018E	2019E	2020E
<b>VALUATION</b>						
NPAT (adjusted)	\$m	(14.9)	(24.3)	(9.9)	(3.5)	18.7
EPS (adjusted)	c/sh	(6.5)	(7.2)	(2.1)	(0.7)	3.6
EPS growth	%		11%	-71%	-69%	-639%
PER	x	-6.8x	-6.1x	-20.8x	-66.6x	12.4x
DPS	c/sh	-	-	-	-	-
Yield	%					
EV/EBITDA	x	-13.2x	-6.4x	-16.7x	-158.2x	6.2x
<b>PROFITABILITY RATIOS</b>						
Gross margin	%			28%	31%	36%
EBITDA margin	%			-12%	-1%	13%
Return on assets	%	-13%	-22%	-5%	-2%	10%
Return on equity	%	-27%	-44%	-9%	-3%	15%
<b>LIQUIDITY &amp; LEVERAGE</b>						
(Net debt) / cash	\$m	5	78	38	37	45
ND / E	%	45%	2%	2%	2%	2%
ND / (ND + E)	%	31%	2%	2%	2%	2%

## ASSUMPTIONS

Year ending December	Unit	2016A	2017A	2018E	2019E	2020E
<b>Volumes</b>						
MABR modules	#	100	100	300	2,000	8,000
Nirobox units	#	10	3	40	75	150
Custom Revenue growth	%	8%	-44%	130%	3%	3%
RaaS agreements	#	-	-	4	5	10

## MARGINS

		2016A	2017A	2018E	2019E	2020E
MABR	%	35%	35%	35%	35%	35%
Nirobox	%	20%	20%	20%	20%	20%
Custom Projects	%	19%	20%	20%	20%	20%
RaaS	%	-	-	50%	50%	50%

## CURRENCY

USD/AUD	0.75	0.78	0.73	0.73	0.74
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## A\$ SOTP VALUATION AT WACC

11.9%	Risked		Risking	Unrisked	
	NPV (A\$m)	A\$/sh		NPV (\$m)	A\$/sh
MABR	266	0.51	75%	355	0.68
Nirobox	102	0.20	75%	137	0.26
Custom Projects	104	0.20	100%	104	0.20
RaaS	42	0.08	75%	56	0.11
<b>Net asset value</b>	<b>514</b>	<b>0.98</b>		<b>651</b>	<b>1.24</b>
Corporate overheads	(134)	(0.25)		(134)	(0.25)
(Net debt) / cash	54			54	0.10
<b>Equity value</b>	<b>434</b>			<b>571</b>	
# Shares	525			525	
<b>Value per share (\$/sh)</b>	<b>0.83</b>			<b>1.09</b>	

## Strategic goals are being realized

Fluence is pleased with the progress of its business plan, with key objectives for this year being realized:

- China expansion is showing evidence of ramping, particularly through the US\$45m agreement with ITEST.
- Smart packaged water treatment plants are proliferating around the world, with sales in Asia, Africa, North and South America.
- Increased recurring revenues achieved through contracts such as San Quintin in Mexico, the Caribbean and in Egypt.

## Sales agreements 2018 YTD

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The September Quarter revenue of US\$29m was a 28% increase on Q2 2018, and 140% higher than Q3 2017.

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Month	Location	Industry	Technology	m3/day	Value
Feb	Buenos Aires, Argentina	Municipal	Nirobox	2 x 1,500	
	J-Park, Philippines	Resort	Nirobox	1,000	
March	Italy	Agriculture	Water reuse		
	Sao Paulo, Brazil	Pharmaceutical	Wastewater	180	
	USA	Food and Beverage	Aeration		
	Jinzi, China	Municipal	Aspiral	1,000	
April	San Quintin, Mexico	Municipal	Desalination	22,000	US\$48m
	Rosenblad, California	Industrial	Water reuse		
May	Beijing, China	Municipal	Aspiral	20	
June	Hunan, China	Municipal	Aspiral		
	Yiyang, China	Municipal	Aspiral	4 x 200	
	Ghent, Belgium	Steel	Wastewater to energy		€3.9m
July	Guizhou, China	Municipal	Aspiral	1,000	
	Hubei, China	Municipal	Aspiral	200	
	Bimini+Barbuda, Bahamas	Resort	Nirobox	4 x 1,000	
August	Texas	LNG	Aspiral	125	
	Argentina	Power	Combined		US\$3.5m
	Philippines	Municipal	Aspiral	400	
October	Central China	Municipal	Aspiral	66,000	US\$45m
	Oregon, USA	Resort	MABR		
	Egypt	Municipal	Nirobox	12,000	US\$7.6m

## Revenues are ramping up

The September Quarter revenue of US\$29m was a 28% increase on Q2 2018, and 140% higher than Q3 2017. The YTD revenue of US\$61.8m, with Fluence very confident that another US\$33.2m will be recognized in Q4 2018, equal to US\$95m for the year.

On top of that, some revenues from the current sales pipeline and sales activities leads Fluence to reiterate revenue guidance of US\$105m for the year. This compares to the previous guidance range of US\$105-115m for 2018. US\$105m would represent an 81% improvement on 2017. We have upgraded our revenue estimate from US\$86m to US\$96m for 2018, which would also represent an impressive 66% increase on last year.

## Gross profit guidance unchanged

Fluence has not revised its gross profit guidance of US\$22-25m, despite the higher revenue estimate being dropped. This reflects the changing mix of contracts, with special mention of the San Quintin project assisting the confidence. Our gross profit estimate is US\$21m.

## Good progress on most fronts

The company highlighted a number of projects progressing well:

- The San Quintin, Mexico project started construction in Q3, leading to revenue recognition. This project has a 20 month construction period, to be followed by a 30 year O&M agreement estimated to average US\$10m per annum.
- The US\$45m ITEST China agreement is the first material contract in the country, and very encouraging. The first 80 Aspiral plants will be delivered over the next 18 months, with a likely repeat of that order in the following 18 month period. Now that ITEST has taken the lead, we expect many of Fluence's other 23 partners in China will follow suit.
- The PDVSA project in Venezuela will continue to generate revenues, despite the economic situation in that country, and without currency risk.
- Likewise, the economic situation in Argentina will not disrupt the US\$3.5m EPC contract to support a power plant expansion. However, the cash balance of the company is about US\$3m lower due to a short term investment position, which has now been closed out.
- The first Aspiral projects in the Philippines will be commissioned over the next three months, with further opportunities being negotiated in the country.
- US sales of MABR units and Aspiral plant demonstrate progress in this important market, to an LNG project developer and an operator of RV parks.
- The Nirobox sale of US\$7.6m in Egypt is the largest such sale to date, and will be delivered in Q4 2018 as the units are coming out of inventory. Follow-up sales opportunities appear good, and the project includes an O&M contract as well, with ongoing revenues.
- The large (+US\$100m) contract with an unnamed African Government is making progress. Fluence did say that it is for a West African country, providing clean drinking water for 1m people. The project is essentially awaiting export credit financing, and the company remains optimistic that this 2 year project will be realized.
- Some delays are being experienced in Ethiopia, due to difficulties with local contractors, and a hurricane in the US Virgin Islands caused some damage to associated infrastructure, but will be repaired.

## Summary

We think that the Q3 report shows excellent progress on the many fronts that Fluence is working on. Sales agreements are growing at an impressive pace, and revenue increases reflect the high level of growth. The large China contract with ITEST is particularly important, as the potential in this market is evidently large.

The capital raise is not unexpected, as we have discussed in previous research reports.

The fact that Fluence has attracted four significant US institutional investors through the equity placement is good. With stronger interest from US investors than in Australia, the company will be looking at a listing in the US at the appropriate time.

With the company posting its first positive EBITDA result (although modest), we believe Fluence is poised to turn cash positive in 2019, with excellent upside potential.

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