

Fluence Corporation

Delivering on expectations

Q3 saw Fluence delivering on expectations. It signed its first multiproduct Aspiral deal in China (\$45m), reported in-line revenue (up 140% y-o-y) and held FY18 gross profit guidance. An equity offer raising c \$23m (net) should address any funding concerns. Capital raising aside, our forecasts are unchanged; the company still has to deliver a strong Q4, but following the China deal, confidence in the long-term story should be growing.

Year end	Revenue (US\$m)	EBITDA* (US\$m)	EPS* (US\$)	EV/revenue (x)	EV/EBITDA (x)	P/E (x)
12/17	33.2	(23.6)	(0.07)	4.0	N/A	N/A
12/18e	107.3	(13.4)	(0.03)	1.2	N/A	N/A
12/19e	154.0	(2.0)	(0.01)	0.9	N/A	N/A
12/20e	194.4	11.9	0.02	0.7	11.1	16.2

Note: *EBITDA and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

Growth trajectory on track

The most significant development for long-term prospects during Q3 was the Aspiral deal signed with ITEST in China. Aside from generating at least \$45m of revenue over the next three years, it highlights Aspiral's credibility and the potential of the Chinese market (see our note, [China contract catalyst?](#)). Reported Q3 revenue of \$29m was up 140% y-o-y and in line with our forecast (\$28.7m). FY18 guidance of \$105m, the bottom end of its previous \$105–115m range, implies \$43.2m of revenue in Q4. With \$33m of contracted revenue due to be recognised, seasonality and healthy 'turns' activity (see analysis overleaf), we remain comfortable with our \$45m (\$107m) forecast. Gross profit guidance of \$22–25m was maintained.

Capital raising addresses any funding concerns

On 30 October, management announced completion of an A\$33.1m (US\$23m) equity offering and expects to complete a share placement plan in late November. This looks a sensible pre-emptive move to address any lingering funding concerns from investors (see our initiation note, [Time for better treatment?](#)), particularly as H218 cash collection appears to be lagging our expectations. The proceeds, coupled with the receivables due in Q119e, should ensure cash resources do not dip below \$22m; it now has comfortably enough cash to reach cash flow break-even, in our view.

Valuation: 70% upside on a DCF basis

At A\$0.42 and assuming US\$29m of net cash, Fluence's current share price implies a US\$132m enterprise valuation (EV) and 11x FY20e EV/EBITDA. Its capital raising and the recent market-wide de-rating have largely closed the discount to the sector multiple. However, a DCF approach that reflects the growth and margins of which we believe Fluence ultimately capable, suggests an A\$0.71 valuation and 70% upside (adjusted from A\$0.85 to reflect the additional shares). We believe it will take both time and execution against near-term goals to realise this upside, but the China deal illustrates the potential of its unique technology. With any lingering funding concerns now addressed, the rewards look substantially greater than the risks.

Q318 results, capital raising

General industrials

2 November 2018

Price **A\$0.42**

Market cap **A\$226m**

US\$/A\$0.709

Estimated net cash (US\$m) at end-FY18 29

Shares in issue 538m

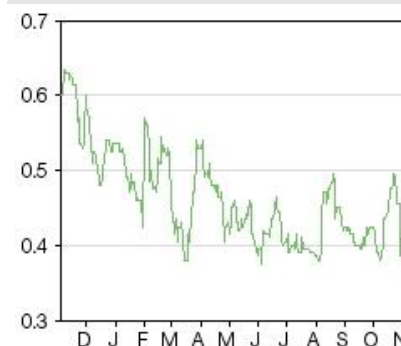
Free float 60%

Code FLC

Primary exchange ASX

Secondary exchange N/A

Share price performance



% 1m 3m 12m

Abs 3.6 11.7 (32.3)

Rel (local) 10.0 19.9 (31.4)

52-week high/low A\$0.7 A\$0.4

Business description

Fluence is a global supplier of water and wastewater treatment solutions. Its decentralised products provide municipal customers with 'plug and play' solutions that are both quicker to deploy and substantially cheaper than traditional alternatives.

Next events

FY18 business update January 2019

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Q3 review: China, growth in decentralised solutions and cash

The most significant development during Q3 was undoubtedly the deal signed with ITEST in China. Aside from generating at least \$45m of revenue over the next three years, this deal highlights the credibility of Fluence's decentralised wastewater treatment product (Aspiral) in a large and highly cost-sensitive market with stringent wastewater effluent standards (Class 1A). We reviewed the full implications of this deal and the potential of the China market in our recent note, [China contract catalyst?](#) and in our [initiation report](#). Ultimately, we see success here as probably the most significant driver of long-term value for investors. This deal illustrates that potential, further deals of this type and size could lead to large uplifts in long-term forecasts.

Elsewhere, progress was broadly in line with expectations, albeit demonstrating continuing growth in demand for Fluence's decentralised solutions. The company announced a \$7.6m Nirobox order in Egypt, the largest single order of this technology, the first Aspiral sales in the Philippines and the US and additional MABR orders to a system integrator (Orenco) in the US. In customised projects, it recognised the first revenue from San Quintin (as expected), PDVSA revenue was reported as on track and negotiations on the potentially large Africa deal (\$100m+, not factored into forecasts) continue. Reported Q3 revenue of \$29m was up 140% y-o-y and bang in line with our forecast (\$28.7m) and the order book stood at \$80m, at 20 October. The company unexpectedly reported its first positive quarter of EBITDA (\$0.5m) due to the recognition of high margin revenue.

At \$23m the Q3 cash position was marginally behind our model (\$27m) due to cash collections. The company received \$11m in cash from customers vs the \$29m of revenue recognised and the \$16m it had forecast. The majority of the difference between cash collected and revenue recognised (c \$10m of the \$18m) reflects the PDVSA contract (cash all received in advance) and the San Quintin contract. This was partially offset by lower than expected cash outgoings.

Q4 and FY18 guidance

Ultimately, the overall growth trajectory and longer-term prospects are the key drivers for investors. Nevertheless, meeting FY18 guidance is important – we believe that delivering on FY18 numbers and exiting the year with a \$160m+ revenue run rate and profitable business could be a positive catalyst for the share price. The FY18 guidance of \$105m, the bottom end of its previous \$105–115m range, implies Q4 revenue of \$43.2m (up 57% q-o-q doubling y-o-y). With \$33m of contracted revenue due to be recognised (predominantly PDVSA and San Quintin) this implies just \$10m of 'turns' revenue. In Q318, the company generated \$13m of 'turns' revenue and in Q417 reported revenue rose c 70% q-o-q. We remain comfortable with our FY18e of \$107m, implying \$45m in Q4.

Cash flow guidance (\$17m outflow of cash from operations) implies low cash collection again in Q4. We had been expecting modest positive cash flow as Nirobox inventory was monetised and the first major payment from San Quintin was received. This appears to be just a timing issue. The gap between cash collection and revenue recognition should close in Q119 as the PDVSA contract rolls off and the company receives its first San Quintin payment.

Capital raising

We forecast that the company will have raised total net proceeds of \$23m by the time the share purchase plan (SPP) is completed on 21 November. Gross proceeds of A\$33.1m (US\$23m) have already been raised via the placement and these shares will begin trading on 5 November; the additional proceeds from the SPP will largely net off against fees. This should reassure investors that the company has sufficient capital to execute its current plan, particularly given the lag in cash

collection highlighted above. In [Time for better treatment?](#) we highlighted that, even with flawless execution, cash resources were likely to trough at c \$14m during FY19, below a level that the company saw as providing comfortable working capital headroom. Factoring these proceeds into our revised cash flow forecast, we see a cash minimum of \$22m in Q219e, with the company sustainably cash flow positive beyond that point.

The capital raising is also significant for demonstrating the support of large existing shareholders, such as RSL, and attracting new US-based institutional shareholders on to the register. The company indicates it will begin planning for a dual listing in the US in 2019.

Forecasts: P&L unchanged, cuts to near-term cash flow offset by capital raising

We make no material changes to our P&L forecasts other than reflecting the 103m increase in the share count, which dilutes FY20e EPS by 17%. We reduce our FY18e cash flow forecasts to reflect lower cash collection in H218e, but longer-term cash generation assumptions are unchanged and the impact is offset by factoring in \$23m from the capital raising.

Valuation: 70% upside on a DCF basis

At A\$0.42 and assuming US\$29m of net cash (FY18e), Fluence's current share price implies a US\$132m EV and 11x FY20e EV/EBITDA. Its capital raising and the recent market-wide de-rating have largely closed the rating discount to the sector. However, our P&L forecasts are unchanged and, therefore, a DCF approach that reflects the growth and margins of which we believe Fluence ultimately capable is also largely unchanged. Factoring in the dilution of the additional shares suggests this DCF-driven, per-share valuation falls by 16% from A\$0.85 to A\$0.71, but this still offers a very healthy 70% upside. We believe it will take both time and execution against near-term goals to realise this upside, but the China deal illustrates the potential of its unique technology. With any lingering concerns about funding now addressed, the rewards look substantially greater than the risks.

Exhibit 1: Financial summary

US\$m	2016	2017	2018e	2019e	2020e
31-December	IFRS	IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT					
Revenue	0.8	33.2	107.3	154.0	194.4
Cost of Sales	(2.0)	(27.2)	(82.4)	(113.6)	(138.1)
Gross Profit	(1.2)	6.0	25.0	40.4	56.3
EBITDA	(8.8)	(23.6)	(13.4)	(2.0)	11.9
Operating Profit (before amort. and except).	(9.1)	(24.3)	(15.8)	(4.6)	9.3
Amortisation of acquired intangibles	0.0	0.0	0.0	0.0	0.0
Exceptionals	0.1	(1.2)	(43.1)	0.0	0.0
Share-based payments	0.0	0.0	0.0	0.0	0.0
Reported operating profit	(9.1)	(25.4)	(58.9)	(4.6)	9.3
Net Interest	(0.0)	2.6	3.5	0.5	0.6
Joint ventures & associates (post tax)	0.0	0.0	0.0	0.0	0.0
Exceptionals	0.0	0.0	0.0	0.0	0.0
Profit Before Tax (norm)	(9.1)	(21.7)	(12.3)	(4.2)	9.9
Profit Before Tax (reported)	(9.1)	(22.9)	(55.4)	(4.2)	9.9
Reported tax	0.0	(0.7)	0.3	0.0	0.0
Profit After Tax (norm)	(9.1)	(22.4)	(12.0)	(4.2)	9.9
Profit After Tax (reported)	(9.1)	(23.6)	(55.1)	(4.2)	9.9
Minority interests	0	0	0	0	0
Discontinued operations	0	0	0	0	0
Net income (normalised)	(9.1)	(22.4)	(12.0)	(4.2)	9.9
Net income (reported)	(9.1)	(23.6)	(55.1)	(4.2)	9.9
Average Number of Shares Outstanding (m)	214	320	477	538	538
EPS - basic normalised (\$)	(0.04)	(0.07)	(0.03)	(0.01)	0.02
EPS - diluted normalised (\$)	(0.04)	(0.07)	(0.03)	(0.01)	0.02
EPS - basic reported (\$)	(0.04)	(0.07)	(0.12)	(0.01)	0.02
Dividend per share (\$)	0	0	0	0	0
Revenue growth (%)	4.7	(10.4)	39.5	36.1	22.7
Gross Margin (%)	N/A	18.0	23.3	26.2	28.9
EBITDA Margin (%)	N/A	N/A	N/A	N/A	6.1
Normalised Operating Margin	N/A	N/A	N/A	N/A	4.8
BALANCE SHEET					
Fixed Assets	3.2	72.7	24.8	26.2	27.6
Intangible Assets	2.1	60.2	5.8	5.8	5.8
Tangible Assets	1.0	7.1	13.9	15.3	16.7
Investments & other	0.1	5.5	5.0	5.0	5.0
Current Assets	24.4	131.9	148.6	140.9	160.3
Stocks	0.5	18.5	36.7	34.6	31.4
Debtors	0.7	26.7	71.0	69.2	75.4
Cash & cash equivalents	22.9	75.2	29.4	25.8	42.0
Other	0.3	11.5	11.4	11.4	11.4
Current Liabilities	(2.5)	(95.9)	(123.9)	(121.8)	(132.7)
Creditors	(1.4)	(27.8)	(49.0)	(49.4)	(62.9)
Tax and social security	0.0	(0.1)	(0.1)	(0.1)	(0.1)
Short term borrowings	0.0	(1.1)	(1.1)	(1.1)	(1.1)
Other	(1.1)	(66.9)	(73.8)	(71.2)	(68.7)
Long Term Liabilities	(1.0)	(5.1)	(11.0)	(11.0)	(11.0)
Long term borrowings	0.0	0.0	0.0	0.0	0.0
Other long term liabilities	(1.0)	(5.1)	(11.0)	(11.0)	(11.0)
Net Assets	24.1	103.6	38.4	34.3	44.1
Minority interests	0.0	0.2	0.1	0.1	0.1
Shareholders' equity	24.1	103.8	38.5	34.4	44.2
CASH FLOW					
Op Cash Flow before WC and tax	(8.8)	(23.6)	(13.4)	(2.0)	11.9
Working capital	1.7	(4.8)	(45.5)	2.7	8.6
Exceptional & other	0.0	0.2	0.7	0.0	0.0
Tax	0.0	(0.9)	(0.3)	(0.4)	(0.4)
Net operating cash flow	(7.2)	(29.0)	(58.5)	0.2	20.1
Capex	(0.4)	(3.7)	(3.5)	(4.0)	(4.0)
Acquisitions/disposals	(1.0)	50.6	(1.8)	0.0	0.0
Net interest	0.0	0.5	2.7	0.1	0.2
Equity financing	22.9	31.3	23.3	0.0	0.0
Dividends	0.0	0.0	0.0	0.0	0.0
Other	(0.2)	1.1	(3.7)	0.0	0.0
Net Cash Flow	14.2	50.8	(41.5)	(3.7)	16.3
Opening net debt/(cash)	(8.5)	(22.9)	(74.0)	(28.7)	(25.1)
FX	0.2	2.1	(3.7)	0.0	0.0
Other non-cash movements	0.0	(1.8)	0.0	0.0	0.0
Closing net debt/(cash)	(22.9)	(74.0)	(28.7)	(25.1)	(41.3)

Source: Fluence Corporation accounts, Edison Investment Research. Note: these financials assume 103m additional shares from the capital raising currently taking place and net proceeds of \$23m.

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