Fourth Quarter 2018 Business Update
Conference Call
Webcast Script

January 30, 2019 5:30 PM EDT/
January 31, 2019 9:30 AM AEDT

Richard Irving, Chairman:

Good morning to those of you in Australia, and good evening to our US listeners. I am Richard Irving, Chairman of Fluence. I am joined on the call by Henry Charrabé, Managing Director and Chief Executive Officer and Francesco Fragasso, Chief Financial Officer.

Before we begin, I want to mention that we will make forward-looking remarks, which are protected under the safe harbor provisions of Australian securities law. Details are provided in the ASX release.

After my introductory remarks, Henry will provide some detail about operations and outlook, Francesco will cover the financials, and then we will answer any questions you might have. I also want to note that all financial references are in US dollars. Now let's begin.

Twelve months ago, we provided guidance that in 2018 we would grow revenues by 80% and deliver gross profit between $22 to $25 million[1]. At our September quarterly update, we reaffirmed that we remained on track to meet this guidance and would achieve revenues in excess of $105 million. Today we are very pleased to confirm the achievement of unaudited revenues in line with guidance at $105.6 million. We also achieved unaudited gross profit for the year of $32.3 million, which benefited from an accounting adjustment in our favour of $7.1 million. The underlying gross profit of $25.2 million is slightly ahead of guidance.

I cannot think of any other publicly listed water infrastructure provider that experienced the same rate of organic growth as we did over the last 12 months. This result is a testament of our leading technology, our deep experience and the quality of our management.

Throughout the year, we kept you updated about our project wins, new sales in new regions and other notable achievements. While revenue was at the lower end of our original guidance, a more favourable sales mix together with tight cost control delivered stronger gross profits.

Henry and his team have proven their ability to meet challenging targets and deliver to their word. With a strong management team in place, I am at ease stepping back from an Executive role to Non-Executive Chairman, effective today. My commitment to the company remains undiminished. Together with our other experienced non-executive directors, we will support management so that the full potential of our promising business can be realised.

Today the Board resolved to issue twenty-seven senior managers an aggregate of 4.6 million employee stock options in light of the excellent results and for retention purposes. Details can be found in the Quarterly Business Update. These options also ensure continued alignment of the long-term incentives of senior management with shareholder interests.

Importantly the granting of these options serves both as recognition for achievement and for talent retention.

Let me now turn over the call to our Chief Executive Officer, Henry Charrabé, to provide more detail on our operating performance and financial highlights. Henry?

Henry Charrabé, Managing Director & Chief Executive Officer:

Thank you, Richard.

It's been a very productive and successful quarter for Fluence. The strong fourth quarter business performance helped us achieve our stated objectives for the year. We are also in a strong position to become sustainably EBITDA profitable by the fourth quarter of 2019.

Starting with this update, we will report future results in three categories that reflect Fluence's business model.

The first category is Smart Products Solutions. This includes NIROBOX™, Aspiral™, and SUBRE water- and wastewater treatment solutions. Smart Products Solutions revenues grew from $10 million in 2017 (on an as-merged basis), to $22 million in 2018, and we are guiding that these will at least double again in 2019.

The second category is Recurring Revenue and Aftermarket. This encompasses three elements. Most importantly are water and wastewater sales from Build-Own-Operate-Transfer plants developed by us. The other elements are operations and maintenance contracts, as well as spare parts sales.

The third category is Custom-Engineered Solutions, which encompass bespoke solutions designed and built by Fluence for customers worldwide.

Our business model increasingly focuses on Smart Products Solutions and recurring revenues. In these areas, we have substantial competitive advantages, achieve higher margins, and foresee significantly large market opportunities. Historically, custom-engineered plants have been a strong contributor to revenue. We expect this to continue to be the case in the future as well.

As Richard mentioned, our unaudited gross profit for the year of $32.3 million benefited from an accounting adjustment in our favour of $7.1 million. Francesco will provide some additional detail about this later. The underlying Gross Profit of $25.2 million benefitted from a more favourable Revenue mix—meaning more sales of our Smart Products Solutions-- and an improved cost structure.

In addition, the amount of our secured annual recurring revenues grew strongly. We now have secured an average of annual recurring revenue contracts from BOOT plants that will generate $14.7 million per year. This secured annual revenue is composed of $1.7 million a year from Bahamas, $3 million a year from Peru, and $10 million a year from San Quintin, Mexico. These sales will start at various times as plants are commissioned, but we expect at least $3 million of recurring revenue to be recognized in 2019.

Because of better visibility and better margins stemming from this revenue stream, we believe this is a substantial and sustainable growth opportunity for Fluence in the years ahead and a fantastic increase from 2017. Furthermore, we have secured a US$50 million project financing facility from Generate Capital, of which we have not drawn any funds to-date. This facility will be used to finance new BOOT projects for Fluence worldwide and it enhances our ability to sell Smart Products Solutions to further grow our recurring revenue base.

Sales of NIROBOX™ units from inventory helped cash generation and enabled rapid deployment. This enhanced our book-to-revenue-cycle resulting in a reduction of backlog compared to prior years. Over the last quarter, we continued to see strong demand for this product. In Egypt, we secured our largest NIROBOX™ sale ever, of $7.6 million. Those plants are expected to be fully operational by Q2 2019. The plants will supply 12,000 cubic meters per day of potable water to a large residential area along the Mediterranean coast. In addition, we will sign a service contract to operate and maintain the units.

We also secured the right to design, build and operate an $8.4 million seawater desalination plant for an industrial client in central Peru. The plant will utilize 5 NIROBOX™ SW Smart Packaged desalination units and is expected to ultimately expand to 10 units. This plant will be another source of recurring revenue, and it should be operational in the third quarter of 2019. We have an initial 10-year Water Purchase Agreement that will generate an average of $3.0 million a year in sales of water as we will own and operate the plant. Additional Water Purchase Agreements have the potential to increase the water sales from initially $3 million to up to $5 million a year at the plant's full capacity.

Earlier this month we secured our first sale in Vietnam. Our client Vucico will use our first ever sold NIROBOX™ MEGA SW desalination unit, which supplies up to 1,500 cubic meters per day of drinking water to the island of Cat Ba out of a single 40-foot-packaged plant

Looking north from Vietnam, China is a key market for our Aspiral™ wastewater treatment solution. The Chinese Government is committed to improving China's rural wastewater treatment quality as part of the current 5-year plan.

In October we signed an exclusivity agreement with Chinese partner Hubei ITEST. This deal anticipates approximately $45 million of Aspiral™ sales over the next three years. The units will be deployed along the highway system under ITEST's scope in central China. In December, we signed the first two contracts under this partnership. Those contracts are for a total of 35 Aspiral™ units to be deployed.

In November, we executed an order for six Aspiral™ units via a new partnership with the environmental EPC firm Zhongzi Huaze. These units were commissioned earlier this month and are a first for Fluence in Jilin Province, China. This region is subject to extreme cold conditions with the temperature often dropping to -30C.

During the quarter, we also made our first MABR sale to a large systems integrator in the State of Oregon, USA. This customer found Fluence's MABR to be a more cost-effective solution than competitors', offering higher water quality and lower operating costs.

Fluence is actively quoting SUBRE—our submerged MABR-- projects for potential clients in China and in other key markets. We expect full commercialisation of this product in the first half of 2019.

Looking at custom-engineered solutions, construction is on plan at the $48 million San Quintin, Mexico project. We recognized $13.5 million of revenue in 2018. The remainder is to be recognised over the 15-month construction period of the project. As a part owner and operator of the plant, we will generate an estimated average of $10 million annual billings during the 30 years after the plant begins operation.

Work is ongoing for the Portugesa project in Venezuela, which is under the umbrella of the PDVSA contract and close to completion. The Portugesa project involves a wastewater treatment solution for ethanol plants. In 2018, this contract generated revenue of $27.2 million. A final $2.6 million is expected to be recognized in 2019.

In the December quarter we won a contract to produce biogas, electricity, and thermal energy for a meat processor in Argentina. The €1.7 million solution was built using anaerobic digestion technology developed by Fluence. This will also serve as a valuable reference site to secure similar projects throughout South America.

Let me now review our outlook and guidance. As mentioned above, we would like to make you aware of a change in how we will characterize our outlook. We will no longer offer specific numerical guidance on Custom-engineered solutions and top-line revenue. The timing of these projects is extremely difficult to predict, the margins tend to be lower, and forecasts with precise timing are not possible. They will continue to be an important revenue stream for us, and we will continue to make announcements, when significant projects are booked.

In contrast, Smart Products Solutions, Recurring Revenue and Aftermarket sales are relatively predictable, less volatile, and tend to deliver higher margins. Smart Products Solutions and recurring revenue projects are the backbone of our ultimate goal in 2019: achieving sustainable, positive EBITDA by Q4 2019. Those categories are the prime focus of the company, so for these we will offer a more detailed outlook. For 2019, we expect Smart Products Solutions revenue of at least $44 million. This is 100% growth from 2018, which itself was over 100% growth from 2017. We also expect continued growth in the recurring revenue backlog. Recall that our secured annual recurring revenue was zero exiting 2017, so we are making outstanding progress in incubating this revenue category. Finally, we are reaffirming our intention to reach sustainable EBITDA profitability by the fourth quarter of 2019.

The fourth quarter 2018, with its excellent results with over US$43 million in revenue, has been Fluence's strongest quarter to-date and combined our sales and execution efforts from our teams, while also benefiting from the delivery of plants from inventory. I want to take this opportunity to thank the Fluence teams around the world for their outstanding efforts in 2018. This success and spirit support our positive outlook to an exciting 2019.

Please let me now turn over the call to Francesco Fragasso to offer you more details on our 2018 financials. Francesco, please go ahead.

Francesco Fragasso, Chief Financial Officer:

Thank you, Henry.

As Henry noted, business momentum continued to build over the fourth quarter of 2018. We met our stated financial and strategic objectives for the year.

In October, we raised $23.6 million before expenses via a share placement of ordinary shares to institutional investors. Alongside this, we raised an additional $2.3 million via a non-underwritten Share Purchase Plan for existing shareholders. Combined with the $50 million project finance facility now in place, we believe we are fully funded, as well as having prepared our balance-sheet to sustain future business growth.

Net Cash Used from Operating Activities in Q4 2018 was $9.7 million, $3.2 million better than Q3. This result reflects improved receivable collection, delivery of products in inventory, and cost controls.

Receipts from Customers in Q4 2018 were $16.3 million. This excludes revenue recognised in Q4 for the Portuguesa project, as that contract value was prepaid in full.

Proceeds from borrowings do not include the drawdown from the North American Development Bank. The bank is financing 75% of the construction costs of the San Quintin Project. The funds from financing the construction incurred in Q4 are expected to be collected in Q1 2019.

Year-end cash and equivalents were $38.7 million, which was higher than our forecast.

Based on current contracts, in Q1 we expect $17.3 million of cash inflows from customers. Total net operating cash outflow for Q1 is expected to be $10.1 million.

The net operating cash outflow reflects accelerating revenue growth, including increased working capital to support further China sales. We anticipate the net cash used in operating activities is expected to progressively reduce as we approach break-even.

The seasonal nature of the industry is such that we expect revenues to build quarter by quarter through the end of the year.

In Q4 we continued to improve the organization by further integrating our global operations. As a result, 2018 Selling, General & Administrative expenses have been reduced by approximately 30%, as compared to 2017, on an as-merged basis.
I would like to bring to your attention an accounting issue regarding our business in Argentina. Last summer, Argentina was declared a hyper-inflation economy for the purposes of international accounting standards. Accounting for hyper-inflation is complex and requires remeasurement of all transactions denominated in foreign

currencies by applying an official inflation index. This index was published by the Argentinian government three weeks ago.

Any potential foreign currency exchange adjustments could result in the statutory re-classification of certain P&L items. Our review of this issue is still ongoing and subject to evaluation by the auditors.

Once we complete our assessment, it is possible that there may be a reclassification of a portion of the revenue generated by Fluence Argentina for fiscal year2018 from “Operating Revenue” to “Exchange Rate Gains” of up to $11.2 million.

It is important to note that such a potential reclassification would also result in a reduction in reported gross profit, offset by an increase in exchange rate gains. Regardless of any potential reclassification, there will not be any impact on cash flow or existing cash balances as already reported in the Appendix 4C.

We do not view any such adjustment as changing the overall underlying business result for 2018.

Let me now turn the call back to Henry for the question and answer session. Henry.

Henry Charrabé, Managing Director & Chief Executive Officer

Thanks, Francesco. Operator, could you please repeat the instructions to submit questions and we are now happy to answer any questions.

On behalf of the Company, we thank you for your interest in Fluence, as well as the support of our shareholders, and we look forward to continuing the path of further growth with you in 2019. Please feel free to get in touch with any of us should there be more questions. This concludes our call. Have a good day or evening from cold New York.