

# Fluence Corporation (ASX:FLC)

## Biggest contract win yet

### Key Facts

Company Code	FLC
Closing Price	\$0.37
Date of Report	4/3/19
Company Website	<a href="http://fluencecorp.com">fluencecorp.com</a>
Analyst	Johan Hedstrom

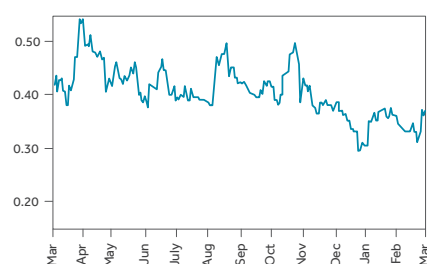
### Company Statistics

12-Month Range (A\$)	\$0.29-\$0.57
Market Cap (A\$Mil)	\$199
Issued Shares (Mil)	535.4
Issued Options (Mil)	49.2
Cash (A\$Mil)	\$55

### Major Shareholders

RSL Investments	29.4%
Pond Ventures Nominees	7.0%
Capital Group	5.4%
Plan B Ventures	3.7%

### Share Price Performance



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## Fluence announces big Government contract in Ivory Coast

Fluence Corporation (FLC) has signed a commercial agreement to build a water treatment plant in Abidjan, with a contract value of €165m (US\$187m). The project is expected to reach Financial Close in Q3 2019, and take 2 years to construct. The contract is conditional upon export credit financing from the Israeli Export Credit Agency (ASHRA), with discussions said to be at an advanced stage. Revenues are anticipated to be boosted by about US\$20m in 2019, US\$80m in 2020, and the remainder in 2021. If the company wins the operations and maintenance contract, there will be ongoing revenues as well. We have only added the EPC contract revenues to our forecasts.

## The 2018 results were largely as expected

FLC announced its financial results for 2018 on the same day as the big contract win, with the latter overshadowing the result. The company reported a loss of US\$63m, largely due to a non-cash US\$56m goodwill write-off. We also note a large US\$16.5m forex loss (also non-cash) due to the collapse in the Argentinian peso, which is suffering from hyper-inflation. The balance sheet has US\$39m of cash, and less than US\$1m in debt. The new debt facility of US\$50m is still undrawn, so the company's funding position is very strong.

## Turning EBITDA positive in 2019

The company expects to become EBITDA positive in Q4 2019, and the new Ivory Coast contract could bring this forward to Q3 2019 if it starts on time. The Custom-Engineered Solutions business will continue to be "lumpy", and difficult to predict but it is pleasing to see the company win such a large contract. Successfully executed, it could lead to similar projects in Africa, and indeed around the world. The need for clean water is universal, and such a challenge in a world of growing populations and economic development.

## Revenue estimates and valuation increased again

Our revenue estimate for 2019 has been increased by 12%, from US\$145m to US\$163m and 2020 by 27% to US\$326m. This includes strong growth expectations in the Smart Products Solutions and Recurring Revenue and Aftermarket businesses. Our risked Target Price is increased by A\$0.06 to A\$0.92/share, due to the new contract win.

We think that the market remains too skeptical of FLC's growth potential. The broadening uptake of its Aspiral/MABR and Nirobox water treatment solutions is very encouraging, and the Ivory Coast contract shows its Custom-Engineered Solutions can bring in substantial new business. Once the business becomes EBITDA positive (which could be only six months away), we expect a re-rating of the stock. BUY recommendation maintained.

# Fluence Corporation

## Financial Summary

### PROFIT AND LOSS US\$

Year ending December	Unit	2016A	2017A	2018A	2019E	2020E
Revenue	\$m	60.9	33.2	101.1	163.2	325.8
Operating Expenses	\$m	(49.3)	(27.2)	(66.5)	(126.4)	(243.9)
Admin and Other Expenses	\$m	(28.7)	(31.4)	(45.6)	(41.7)	(42.7)
<b>EBITDA</b>	<b>\$m</b>	<b>(17.1)</b>	<b>(23.9)</b>	<b>(8.1)</b>	<b>(4.9)</b>	<b>39.2</b>
Depreciation	\$m	(1.6)	(0.7)	(1.0)	(4.1)	(5.6)
EBIT	\$m	(18.8)	(24.6)	(62.7)	(8.9)	33.6
Net interest (expense)	\$m	6.5	0.1	(0.5)	0.8	(2.2)
<b>PBT</b>	<b>\$m</b>	<b>(12.3)</b>	<b>(24.4)</b>	<b>(63.2)</b>	<b>(8.1)</b>	<b>31.4</b>
Tax expense	\$m	(2.8)	0.1	(0.4)	2.0	(7.9)
<b>NPAT (pre-abnormal)</b>	<b>\$m</b>	<b>(14.9)</b>	<b>(24.3)</b>	<b>(63.6)</b>	<b>(6.1)</b>	<b>23.6</b>
Abnormal items	\$m	-	-	(16.5)	-	-
<b>NPAT (reported)</b>	<b>\$m</b>	<b>(14.9)</b>	<b>(24.3)</b>	<b>(80.1)</b>	<b>(6.1)</b>	<b>23.6</b>

### CASH FLOW US\$

Year ending December	Unit	2016A	2017A	2018A	2019E	2020E
<b>OPERATING CASHFLOW</b>						
NPAT	\$m	(14.9)	(24.3)	(80.1)	(6.1)	23.6
Add: non-cash items	\$m	1.6	0.7	1.0	4.1	5.6
Change in working capital	\$m	(7.3)	(6.4)	(27.7)	(57.3)	(16.2)
<b>Operating cash flow</b>	<b>\$m</b>	<b>(20.6)</b>	<b>(30.1)</b>	<b>(106.8)</b>	<b>(59.3)</b>	<b>13.0</b>
<b>INVESTING CASHFLOW</b>						
Net PP&E	\$m	(0.4)	(3.7)	(2.8)	(7.1)	(6.6)
Evaluation	\$m	(0.2)	-	-	-	-
Other/merger	\$m	(3.8)	55.0	(2.6)	-	-
<b>Investing cash flow</b>	<b>\$m</b>	<b>(4.4)</b>	<b>51.3</b>	<b>(5.4)</b>	<b>(7.1)</b>	<b>(6.6)</b>
<b>FINANCING CASHFLOW</b>						
Share capital	\$m	3.3	31.3	26.2	-	-
Interest bearing debt	\$m	4.3	(0.6)	(3.1)	41.5	9.9
<b>Financing cash flow</b>	<b>\$m</b>	<b>7.7</b>	<b>30.7</b>	<b>23.1</b>	<b>41.5</b>	<b>9.9</b>
<b>Change in cash</b>	<b>\$m</b>	<b>(17.3)</b>	<b>51.9</b>	<b>(89.2)</b>	<b>(24.8)</b>	<b>16.3</b>

### BALANCE SHEET US\$

Year ending December	Unit	2016A	2017A	2018A	2019E	2020E
<b>ASSETS</b>						
Cash	\$m	8.0	79.9	41.2	16.3	32.6
Accounts receivable	\$m	3.1	26.7	33.5	57.1	97.7
Property Plant & Equipment	\$m	0.6	7.1	14.8	17.8	18.8
Inventory	\$m	-	18.5	18.9	18.9	18.9
Other	\$m	3.8	72.4	33.1	33.1	33.1
<b>Total assets</b>	<b>\$m</b>	<b>15.5</b>	<b>204.7</b>	<b>141.5</b>	<b>143.3</b>	<b>201.1</b>
<b>LIABILITIES</b>						
Accounts payable	\$m	0.4	59.0	58.1	24.5	48.9
Deferred tax liabilities	\$m	-	1.7	1.1	1.1	1.1
Borrowings	\$m	3.4	2.1	0.4	41.9	51.8
Provisions	\$m	4.2	38.2	30.8	30.8	30.8
<b>Total liabilities</b>	<b>\$m</b>	<b>8.0</b>	<b>101.1</b>	<b>90.4</b>	<b>98.3</b>	<b>132.6</b>
<b>SHAREHOLDER'S EQUITY</b>						
Share capital	\$m	15.8	156.9	185.1	185.1	185.1
Retained earnings	\$m	(10.5)	(51.9)	(117.4)	(123.5)	(99.9)
Reserves & outside equity	\$m	2.2	(1.4)	(16.7)	(16.7)	(16.7)
<b>Total equity</b>	<b>\$m</b>	<b>7.5</b>	<b>103.6</b>	<b>51.1</b>	<b>45.0</b>	<b>68.5</b>
Weighted average NoSh	m	228.6	336.1	473.3	531.4	531.4

### FINANCIAL RATIOS

Year ending December	Unit	2016A	2017A	2018A	2019E	2020E
<b>VALUATION</b>						
NPAT (adjusted)	\$m	(14.9)	(24.3)	(63.6)	(6.1)	23.6
EPS (adjusted)	c/sh	(6.5)	(7.2)	(13.4)	(1.1)	4.4
EPS growth	%		11%	86%	-91%	-487%
PER	x	-5.5x	-5.0x	-2.7x	-31.4x	8.1x
DPS	c/sh	-	-	-	-	-
Yield	%					
EV/EBITDA	x	-10.9x	-4.8x	-18.7x	-44.7x	5.4x
<b>PROFITABILITY RATIOS</b>						
Gross margin	%			52%	29%	34%
EBITDA margin	%			-8%	-3%	12%
Return on assets	%	-13%	-22%	-46%	-4%	14%
Return on equity	%	-27%	-44%	-104%	-13%	42%
<b>LIQUIDITY &amp; LEVERAGE</b>						
(Net debt) / cash	\$m	5	78	41	(26)	(19)
ND / E	%	45%	2%	1%	93%	76%
ND / (ND + E)	%	31%	2%	1%	48%	43%

### ASSUMPTIONS

Year ending December	Unit	2016A	2017A	2018A	2019E	2020E
<b>VOLUMES</b>						
MABR modules	#	100	100	300	2,000	8,000
Nirobox units	#	10	3	32	75	150
Custom Revenue growth	%	8%	-44%	165%	3%	3%
RaaS agreements	#	-	-	3	3	15

### MARGINS

		2016A	2017A	2018A	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

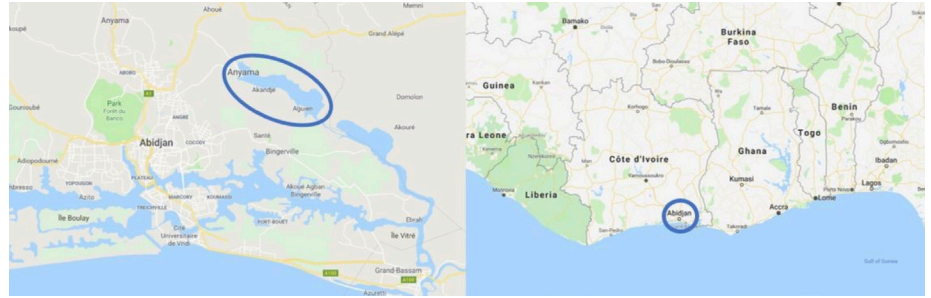
USD/AUD	0.75	0.78	0.72	0.73	0.74
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### A\$ SOTP VALUATION AT WACC

11.9%	Risked		Risking	Unrisked	
	NPV (A\$m)	A\$/sh		NPV (\$m)	A\$/sh
MABR	266	0.50	75%	355	0.67
Nirobox	102	0.19	75%	136	0.26
Custom Projects	157	0.30	100%	157	0.30
RaaS	42	0.08	75%	56	0.11
<b>Net asset value</b>	<b>568</b>	<b>1.07</b>		<b>704</b>	<b>1.33</b>
Corporate overheads	(134)	(0.25)		(134)	(0.25)
(Net debt) / cash	57			57	0.11
<b>Equity value</b>	<b>491</b>			<b>628</b>	
# Shares	531			531	
<b>Value per share (\$/sh)</b>	<b>0.92</b>			<b>1.18</b>	

## The Ivory Coast contract

Water from Lagune Aghien, indicated below left, to supply potable water for Abidjan, below right



“

The Ivory Coast water treatment project is a very good contract win for Fluence. Apart from adding significant value to the business, it could also lead to a lot of follow-on business from Governments and utilities needing to invest in new water treatment capacity.

”

For the last 18 months, the company has indicated the potential for an African EPC project worth more than US\$100m. Having signed a commercial agreement with the Ivory Coast Government last week, the project looks to have become reality. The only condition is the finalization of export credit financing, which is at an advanced stage of discussion.

- The project is a turnkey development to supply 150,000m<sup>3</sup>/day of clean water to parts of Abidjan, the largest city in the Ivory Coast with a population of 4.7m.
- The water source is Lagune Aghien, a fresh water lake which suffers from algal bloom and other contamination.
- The project includes the design for water intake, treatment, storage, piping and associated infrastructure. The plant will have the flexibility to treat water of varying quality, to WHO standards.
- The design combines FLC's suite of water treatment technologies, for optimal operating and cost efficiencies.
- A manager for the project was hired six months ago, and the use of sub-contractors will reduce the need for adding fixed costs to the group.
- The €167m funding for the project will be through a loan from Israel Discount Bank, supported by the State of Israel's Export Credit Agency (ASHRA). This loan agreement has been discussed for a long time, and should be finalized in the coming months.
- FLC has also been invited to bid for the operating and maintenance contract of the plant. The company is clearly in an advantageous position to win this contract, which would add to the Recurring Revenue business. As already mentioned, we do not include this upside in our revised forecasts.

The Ivory Coast water treatment project is a very good contract win for FLC. Apart from adding significant value to the business, it could also lead to a lot of follow-on business from Governments and utilities needing to invest in new water treatment capacity. It shows that FLC can offer both larger scale water treatment solutions, as well as their decentralized, smart packaged technologies such as Aspiral, Nirobox and SUBRE.

## The 2018 Financial result

The company also released its calendar 2018 results on February 27, which was largely as expected, following the December Quarterly report released in late January.

The company reported a loss of US\$63m before foreign exchange losses of US\$16.5m. The losses are largely non-cash, with a US\$56m write-down of goodwill the biggest item. This is a positive in our view, as future profits will not be reduced by ongoing depreciation, as this goodwill "asset" is no longer on the balance sheet.

The forex losses were incurred in the Argentinian business, where hyper-inflation is causing large re-statements for accounting purposes. Again, these are non-cash and not of any real concern, as the company is getting paid in US\$.

The Argentinian currency depreciation did cause reported revenue numbers in Q4 of 2018 to be about US\$4m lower than stated in the quarterly, so annual revenues have been re-stated from US\$105m to US\$101m.

The 2018 result has only resulted in minor changes to our estimates. With the balance sheet still cashed up with US\$39m and an undrawn debt facility of US\$50m, the company is in a strong position to grow in CY19 and beyond.

### Revised estimates

We have added the Ivory Coast EPC contract to our forecasts, which has increased our risked Target Price from A\$0.86 to A\$0.92/share. The unrisks valuation increases from A\$1.11 to A\$1.18/share.

Revision to estimates	Old	New	Change	Old	New	Change
	2019	2019		2020	2020	
Revenues	145	163	13%	257	326	27%
EBITDA	0	(5)		34	39	14%

Canaccord Genuity Estimates

- We haven't added the full amount of additional revenue (US\$20m in 2019 and US\$80m in 2020) from the Ivory Coast contract, to be conservative.
- We are also being cautious on the EBITDA impact in 2019, but the benefits will flow through in 2020, and again we could be conservative.
- Sustainable EBITDA profitability is targeted no later than 4Q 2019.

### Summary

We think that FLC has won a very important EPC contract in the Ivory Coast. The company calls it a landmark project as it is the largest contract won by the company, and it could be the precursor for many similar projects.

We continue to like how FLC is progressing its growth strategy. Large and small sales agreements are growing at an impressive pace, and revenue increases reflect the high level of growth.

The company is well funded to tackle multiple growth opportunities, and should turn cash positive in 2019, with excellent upside potential as indicated by our risked Target Price of A\$0.92/share.

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### Sydney

Level 26, 9 Castlereagh Street, Sydney 2000  
Ph: +61 2 9263 2700

### Melbourne

Level 4, 60 Collins Street, Melbourne 3000  
Ph: +61 3 8688 9100