Third Quarter 2019 Business Update
Conference Call
Webcast Script

October 28, 2019 6:30 PM EDT/
October 29, 2019 9:30 AM AEDT

Adam Hinckley, VP Investor Relations & Project Finance:

Good morning to those of you in Australia, and good evening to our US listeners. I am Adam Hinckley, Vice President of Investor Relations & Project Finance for Fluence. I am joined on the call by Henry Charrabé, Managing Director and Chief Executive Officer, and Francesco Fragasso, Chief Financial Officer.

To begin the call, Henry will provide some detail about operations and outlook. He will then hand it over to Francesco to cover the financials, and finally we will answer any questions you might have.

I also want to note that all financial references are in US dollars, unless indicated otherwise, and that we will make forward-looking statements, which are protected under the safe harbor provisions of Australian securities law. Details are provided in the ASX release.

Now, let me now turn over the call to our Managing Director & Chief Executive Officer, Henry Charrabé, to provide more detail on our operating performance. Henry?

Henry Charrabé, Managing Director & Chief Executive Officer:

Thank you, Adam.

By now, you have hopefully had the opportunity to review the September 2019 quarterly business update, along with the Appendix 4C, that were released to the ASX earlier today. Rather than summarize the releases, I would like to provide some high-level views and additional context on some of the key points.

This was an exciting quarter for Fluence, as two large Chinese partnership opportunities, which we had been cultivating for some months came to fruition, namely with Aerospace Kaitian Environmental Technology in Hunan Province and with

Liaoning Huahong New Energy in Liaoning Province. These two framework supply agreements represent potential future orders for our unique MABR technology of 40,000 m^3/day and 52,500 m^3/day of capacity, respectively through the end of the 2021. Together with the previously announced ITEST agreement, we have potential future order visibility of more than 150,000 m^3/day over a time period of slightly more than 2 years. When you compare that to the capacity deployed to date being a small percentage of the potential future amount, our excitement over the growth of the MABR business is justified. And these three agreements were signed just within the past 12 months.

The significance of our three Chinese partnerships for MABR products provides benefits beyond the direct associated orders and revenue. They have helped raise Fluence's profile in China, opening doors for discussions with potential customers and partners that we never would have had access to even 6-9 months ago. The number of inbound leads has grown dramatically, helping accelerate the sales efforts in the region. Growing our MABR footprint to over 88 plants deployed globally from just 2 in less than two years is a significant and exciting achievement for Fluence and proves the market need of our MABR products.

Staying on China for the moment, we had our first two SUBRE orders this quarter in the region, as well. The first, a 3,000 m^3/day order from Liaoning Huahong New Energy for a greenfield facility in Panjin, was a technically challenging project due to the very low outside ambient operating temperatures during the winter at the project site. Conventional wastewater treatment plant efficiency is inversely related to ambient operating temperature, meaning the colder the outside temperature, the worse the performance of the plant. Our SUBRE system was able to demonstrate superior performance in a region where winter temperatures can reach as low as negative 20° Celsius.

The second SUBRE order in China came from Sichuan Development Guorun Environmental Investment Company for a facility in Mianzhu City. This 1,200 m^3/day project will meet the extremely stringent Class IV standards without any modification or additional cost to the Fluence equipment. The Class IV standards require effluent with total nitrogen to be one-tenth the level of the Class 1A standards. The ability to meet these higher standards could result in additional business opportunities in the future. In summary, the more stringent the domestic wastewater effluent standards, the more competitive and attractive the MABR technology becomes.

Turning to NIROBOX, we witnessed a return of higher demand in Q3 compared to first half-year bookings. Beyond the 5-unit emergency order in the Middle East, which needed to be shipped in merely two weeks, we also received orders for single units in Puerto Rico and Taiwan during the quarter, which were not previously announced. We have seen increased customer interest for our desalination products and are working on the establishment of multi-year partnership opportunities like what we have done in China for MABR.

Based on an attractive pipeline of opportunities and the chance to capitalize on additional business prospects, we conducted a successful capital raise that brought in A$36 million before fees. Additionally, a share purchase plan, which by law is restricted to Australian residents, is underway seeking to raise up to an additional A$6 million. We are very pleased by the support of existing investors and the participation by more than a dozen new Australian institutional investors in the recent capital raise. The proceeds will be used to fund MABR assembly capacity expansion in China associated with the two partnerships signed during the September quarter, working capital investments for those facilities, as well as future anticipated orders, a second module manufacturing line for our Changzhou facility that might be commissioned sometime in later 2020, potential NIROBOX partnerships, project guarantees for Custom Engineered Solutions, minor cost realignment and general corporate purposes.

Before turning the call over to Francesco to discuss the financials, I would like to provide a quick update on the Ivory Coast project, as well as San Quintin and the Generate Capital corporate term loan.

The Ivory Coast project is progressing towards financial close and all indications are that we will reach Financial Close in Q4. As a result, we continue to forecast revenue of $20 million from this project in Q4 that will come at higher margins than the overall lifetime project gross margin. This gives us the confidence to expect EBITDA profitability in Q4. The work to recognize this $20 million of revenue has largely been completed, so the exact timing of financial close within Q4 will have no impact on revenue recognition for the quarter.

Turning now to San Quintin and Generate Capital. The customer in San Quintin has requested a modification to the timing of the project schedule, which we are working to accommodate. We enjoy a strong relationship with the customer and given that this is a 30-year off-take agreement, we will do our best to accommodate reasonable requests and maintain that strong working relationship. A new administration will be taking over on November 1st. Unfortunately, we will have to wait for the new appointee for the Director of the State Water Commission of Baja California to formalize the amendments and expect to schedule the first available meeting to move this process along. As a result, we expect the amendments to be finalized by year-end.

The formalization of these amendments is a condition precedent to closing the Generate Capital corporate term loan facility, so we expect that to occur shortly after the San Quintin amendments are finalized. This will bring us to early 2020 to begin civil construction at the site and resume revenue recognition.

Please let me now turn over the call to Francesco to offer you more details on our Q3 2019 financials. Francesco, please go ahead.

Francesco Fragasso, Chief Financial Officer:

Thank you, Henry.

Third quarter unaudited revenue was $13.8 million, which included $7.3 million from Smart Products Solutions, $400 thousand from after-market sales, and the remaining $6.1 million from Custom Engineered Solutions. We are pleased with the Smart Products Solutions revenue, which represents growth of 189% over the same quarter of last year. On a nine-month basis, Smart Products Solutions revenue was $12.9 million, representing 122% year-over-year growth.

New orders booked in the quarter were $15 million and backlog ended at $269 million. The backlog declined $10 million sequentially, which was entirely related to foreign exchange fluctuations, as we convert the backlog to USD each quarter.

Cash and Cash Equivalents were $11.0 million at the end of September, which does not include the proceeds from the recent capital raise. Net cash used from operating activities in Q3 2019 was $4.8 million which was $1.2 million lower than the forecasted $6.0 million.

As we look to Q4, I would like to provide some high-level comments regarding the expected increase in revenue. From the Custom Engineered Solutions segment, we expect to recognize $20 million of revenue in Q4 from the Ivory Coast project. Additionally, the $20 million New Mansoura project in Egypt and the $10 million Brazilian steel project previously announced, will both begin to convert to revenue in Q4. These projects will carry over into 2020, so you should not expect the full revenue amounts hitting in Q4.

We have maintained our Smart Products Solutions revenue guidance of $26 million for the year, which implies revenue from this segment of $13.1 million in Q4. We feel confident with this target, as much of the previous 75 Aspiral units ordered by ITEST will be delivered in Q4, as well as Aspiral units from other customers. Additionally, the two SUBRE orders in China that Henry discussed earlier, and the Puerto Rico and Taiwan NIROBOX orders will also convert to revenue in Q4.

Recurring revenue will increase as the Bimini project in the Bahamas begins selling water in Q4. As a reminder, Bimini will produce $1.7 million of revenue annually starting in 2020.

Turning to cash, based on current contracts, we expect $22.0 million of cash receipts from customers during Q4 and cash payments of $28.0 million, resulting in an expected net operating cash outflow for Q4 of $6 million.

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.

With water scarcity increasing, our conviction in the thesis that there will be strong and growing demand for decentralized, pre-engineered and standardized Smart Product Solutions for water and wastewater treatment has only strengthened. We expect Q4 to represent an important turning point for our company as we believe we will achieve sustainable EBITDA profitability. With nearly $270 million of total backlog, we have strong future revenue visibility and see a robust demand environment for our products.

Operator: Could you now please repeat the instructions for how to submit questions?

Thank you for your interest in Fluence, and especially to our supportive shareholders.