Research as a Service

Fluence Corporation Ltd

Q3 FY24 Update

Legacy issues continue to impact

Water Utilities

6 November 2024

Fluence Corporation (ASX:FLC) specialises in the delivery of water and wastewater solutions in industrial, municipal and commercial industries across the globe. The company has released its quarterly 4C cashflow statement and a Q3 financial and operating update containing an overall disappointing set of numbers, driven largely by the ongoing delay in the Ivory Coast (IVC) project. This, plus continued weakness in the SEA (Southeast Asia) and China region, has resulted in management reducing guidance for FY24 (31 December year-end) from revenue of US$70-75m to US$50-60m and EBITDA from "break even" to a loss of US$3.5m-4.5m. The 18-month ~US$50m IVC Addendum project was projected to begin in Q1FY24, but administrative and finance delays have stalled its progress and Fluence now expects to receive the Notice to Proceed in the current quarter. We adjust our forecasts for the new timing, pare growth rates off the lower FY24 revenue base and materially reduce revenue contribution from the SEA and China region. This results in our new FY24 forecasts sitting towards the lower end of the guidance range with revenue at US$51.2m and EBITDA at a loss of US$4.4m. This in conjunction with a reduction in our longer-term forecasts results in our DCF valuation reducing from $0.23 to $0.20 per share.

Business model

Fluence is a diversified business, by product, customer profile and geography, and derives revenue from the design and sale of equipment solutions for water and wastewater treatment in municipal, industrial and commercial settings. This is complemented by the ongoing provision of parts and service, and operation and maintenance contracts.

The core business continues to build momentum

We believe the financial impact from the IVC project delay will without doubt drive short-term negative sentiment for FLC, but it is a clear illustration as to why the new management team has pivoted the strategy away from these legacy large construction projects and towards recurring revenue and higher margin SPS (Smart Product Solutions) projects This core part of the business is building momentum with year-to-date revenue of US$29.1m (+11% over the previous corresponding period) and a significant $1.16bn pipeline of opportunities (+88% over Q3FY23). Management believes conversion will now accelerate and points to a strong Q4 providing good momentum into a "materially improved FY25". The Q3FY24 cash outflow of US$3.5m is set to reverse in Q4, led by a milestone payment and release of security relating to the IVC project totalling ~US$11.5m. With the recent refinance and increase of the debt facility (now provided by the company's two largest shareholders) and cash generation in Q4, we believe FLC remains fully funded and does not require further equity capital and we forecast the company to close the year with a net debt position of US$3.3m (US$14.3m cash and US$17.6m debt). We see the Q3FY24 result as a likely new base from which the company will grow into Q4 and FY25 and beyond.

DCF valuation reduced from $0.23 to $0.20/share

We reduce our FY24 forecasts to the lower end of guidance for conservatism and cut our FY25f and FY26f revenue forecasts by 15% and 18% respectively. As a result, our DCF valuation reduces from $0.23 to $0.20 per share. Recent negative stock price movement in reaction to a disappointing FY24 to date, in our view, presents an opportunity for long-term capital growth in a business that will continue to transition towards higher quality, lower risk earnings in FY25 and beyond.

Historical earnings and RaaS' forecasts (in US$m unless otherwise stated)

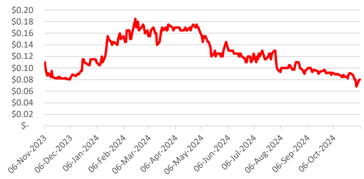
Year end	Revenue	Gross profit	EBITDA adj.*	NPAT adj.*	EPS adj.* (c)	EV/Sales (x)	EV/EBITDA (x)	PER (x)
12/23a	68.8	17.8	0.2	(9.2)	(1.79)	0.4	156.7	n.m.
12/24f	51.2	16.2	(4.4)	(8.5)	(1.12)	1.1	n.m.	n.m.
12/25f	93.0	25.6	5.2	1.1	0.14	0.6	11.5	56.0
12/26f	93.5	29.5	6.5	1.4	0.19	0.6	8.7	42.1

Source: Company data, RaaS estimates for FY24f-FY26f; Adjusted for one-time and non-cash items

Share Details

ASX code	FLC
Share price (5-Nov)	$0.08
Market capitalisation	$86.4M
Shares on issue	1,080M
Net debt at 30-Sep-2024	$10.7M

Share Performance (12 months)



Upside Case

- New contract win-rate ahead of forecasts
- The emergence of a clear BOO model backed by contract wins
- M&A opportunities

Downside Case

- Failure or delays in conversion of pipeline
- Margin expansion story doesn't play out
- Further Ivory Coast delays

Catalysts

- Strong pipeline conversion
- Proof in delivering IVC profitably
- Evidence of maintainable margin expansion

Board of Directors

Doug Brown	Chair
Tom Pokorsky	CEO/Managing Director
Paul Donnelly	Non-Executive Director
Mel Ashton	Non-Executive Director
Nikolaus Oldendorff	Non-Executive Director

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Q3 FY24 Results Discussion

The Q3FY24 result was weaker than we expected at group level, primarily due to the ongoing delay in the IVC project, which has only delivered US$1.0m in revenue year-to-date versus US$15.8m for the first three quarters of FY23. Outside that, the result contained a mix of divisional-specific strengths and weaknesses, but encouragingly the core focus on SPS and recurring revenue contracts delivered growth of 11% over the previous corresponding period (pcp). Exhibit 1 illustrates the divisional contributions for the year-to-date. Note all references to Fluence's earnings from here are in US$ unless otherwise stated.

Exhibit 1: Q3 FY24 Divisional Contribution versus pcp (US$m)

	YTD Q3 FY23		YTD Q3 FY24		Change
	Revenue	EBITDA	Revenue	EBITDA	Revenue
Municipal Water & Wastewater (MWW)	6.8	0.9	6.6	(0.3)	-3%
Industrial Water & Biogas (IWB)	4.7	(0.1)	5.5	0.1	+17%
Industrial Water & Reuse (IWR)	10.5	0.5	12.3	1.9	+17%
SEA & China	3.3	(2.2)	2.9	(0.9)	-12%
BOO	1.7	0.3	2.2	0.3	+29%
IVC	15.8	1.3	1.0	(0.5)	-94%
Corporate	(0.5)	(3.3)	(0.2)	(5.7)	
Total	42.3	(2.6)	30.3	(5.1)	-34%
Total SPS and Recurring (ex IVC)	26.5		29.3		+11%

Source: Company data and RaaS analysis

The key discussion points regarding the recent release are:

- **The IWB and IWR divisions are growing** to our expectation with revenue growth of 17% YTD and both delivering positive EBITDA. We see these as two of the three core growth divisions going forward and expect the municipal business to begin to accelerate traction across FY25. The obvious disappointments were the IVC and SEA & China businesses.

- **Negative EBITDA year-to-date**. Although the magnitude of the loss at $5.1m is higher than we forecast [RaaS forecast a loss of $1.9m] it has been explained by management and should prove to represent a timing issue rather than anything operationally significant. The renewed guidance suggests Q4FY24 will be positive in the range of $0.6m to $1.6m and position the business for solid growth in FY25.

- **Gross margins expanded from 26.3% to 31.8%,** representative of the contribution from higher margin SPS and recurring revenue as stated in the group strategy and is clearly evident when large construction projects such as the IVC addendum do not contribute.

- **Cash flow number reflects delays.** The resulting current cash balance of $4.9m is affected by the IVC delay. The company has a further $7.5m in security deposits, a portion of which is likely to be released in Q4FY24. The recent September quarter should represent the cash low point of the business if the IVC project goes ahead as we expect in Q4, with an associated milestone payment and security deposit release totalling ~US$11.5m.

- **Debt facility increased for working capital.** FLC repaid the existing debt facilities (US$14.25m) in the September quarter, replaced by a new US$15.0m revolving loan facility provided by the company's two largest shareholders in Doug Brown (Chairman and 14% shareholder) and Niko Oldendorff (Director and 10% shareholder). The facility was increased by a further US$5.0m on 30 October 2024 to provide working capital headroom in light of the IVC project delays.

Outlook

The company has guided to a stronger Q4 with forecast revenue in a range of $20m-30m and EBITDA $0.6m-1.6m. Management also spoke with confidence about a materially improved performance in FY25. This should be driven by:

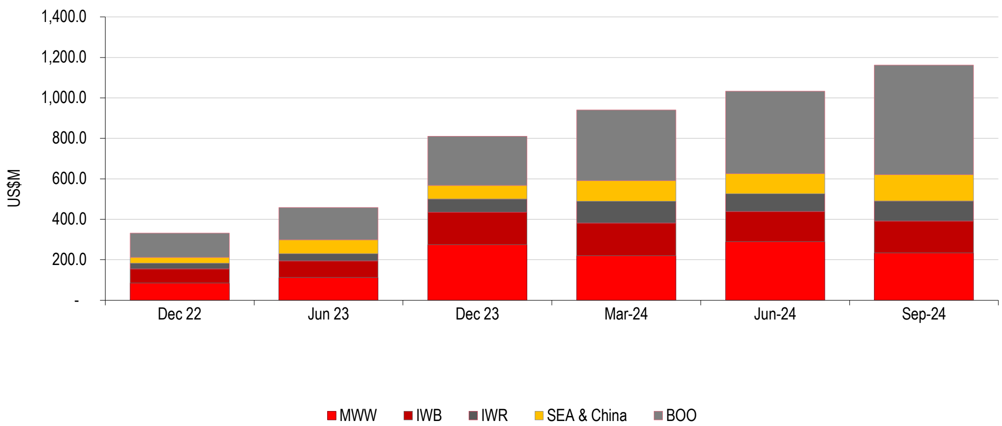
- **The IVC Addendum project commencement:** We believe the revenue guidance range of $10m ($50m to $60m for FY24 in total) is likely driven by uncertainty around the timing of the project. Our forecasts assume $5m in revenue recognised by 31 December 2024 and an even higher cash release due to a milestone payment and security deposit release. It is then assumed that the balance of the project will be delivered over an 18-month period with FY25f revenue of ~$25m-$30m and FY26f revenue of ~$10-$15m (mid-point for RaaS forecasts).

- **Solid and growing backlog of orders:** The order backlog sits at US$101.8m as at the end of Q3 (up from US$91.8m over the course of the year). We expect US$70.2m to be recognised to September 2025 (including the IVC revenue).

- **Recent project orders secured:** FLC has won several orders in Q3 and through October 2024 totalling ~US$15m, a portion of which will contribute in Q4FY24.

- **Further pipeline conversion:** The group sales pipeline remains strong, having increased 88% over the past 12 months, with "broad growth across all segments". The group is projecting US$50m-US$60m in new order bookings in 2HFY24. Management spoke to expected strength in the Industrial Waste & Biogas (IWB) division, complemented by success in BOO project(s) (Build Own Operate). The pipeline by division is illustrated in Exhibit 2.

Exhibit 2: Sales Pipeline



Source: Company reports

Changes to Forecasts

We remain optimistic about the outlook for the business and the capability of the management team to drive the new strategy, however the reduction in guidance and ongoing delays have resulted in us taking a more conservative stance to near-term growth, affecting forecasts for the both the short and medium term (off a lower base). As such we adjust our forecasts as outlined in Exhibit 3.

Exhibit 3: Changes to RaaS Forecasts

	FY24 Old	FY24 New	%	FY25 Old	FY25 New	%	FY26 Old	FY26 New	%
Revenue	69.4	51.2	*(26)*	109.0	93.0	*(15)*	113.6	93.5	*(18)*
EBITDA	**(0.4)**	**(4.4)**		7.7	5.2		11.4	6.5	
NPAT (adj)	(4.8)	(8.5)		3.0	1.1		5.6	1.4	
EPS (adj – A$cps)	**(0.4)**	**(1.1)**		0.4	0.1		0.8	0.2	

Source: RaaS forecasts

- **FY24f:** We reduce our FY24 forecasts to the lower end of the guidance range with revenue of $51.2 and EBITDA at ($4.4m). An upside surprise could come in the form of a higher contribution from the IVC division (we assume $5m revenue in Q4). If FLC does not receive the Notice to Proceed in the current quarter further short-term downside risk remains, in our view.

- **FY25f:** We reduce our revenue forecasts by ~15% due to the slightly slower than previously expected conversion of the pipeline into revenue and a material reduction around our expectation for the SEA and China division. Management has stated that it is currently reviewing operations in that region, so we have reduced our revenue expectation from US$12m to US$5m for FY25f until we get further clarity around the strategy. That said, at group level, management says it is confident Q4FY24 will mark a milestone quarter and position the business well into FY25, with expected order bookings of $50-60m in 2HFY24 across its divisions. We will take a conservative position until the IVC Addendum project commences and the order book is secured, to be complemented by the existing backlog. The lower revenue forecast affects the bottom line to a greater extent as the company will not enjoy the benefit of operating leverage we previously forecast in the short term.

- **FY26f:** Again, reduced revenue growth off a lower base, lower contribution from China and subsequent reduction in operating leverage affect our FY26 forecasts. We believe we now take a conservative stance with potential for an upside surprise. Our new FY26 revenue forecast sits broadly in line with FY25f due to the expected completion of the IVC Addendum project in June 2026. The sales pipeline holds more than enough opportunity to more materially offset the IVC revenue reduction, however we will await conversion before getting more comfortable.

DCF Valuation

In our view, given the early-stage of the turnaround for the Fluence business, the discounted cash-flow methodology is the most appropriate method for valuing the company. We use a weighted average cost of capital of 11.3% (risk free rate 4.0% and equity risk premium 6.0%). We use a beta of 1.2 (observed Beta is 0.86). This gives us a base-case valuation of A$0.20/share fully diluted, reduced from the previous valuation of A$0.23 due to the reduction in our forecasts.

Exhibit 4: DCF valuation

DCF valuation	Parameters
Discount rate / WACC	11.2%
Beta*	1.2
Terminal growth rate	3.0%
Sum of PV (US$m)	34.0
PV of terminal value (US$m)	95.1
PV of enterprise (US$m)	129.1
Net debt 30 Sept US($m)	10.7
Net value – shareholder (US$m)	139.8
No. of shares on issue (in millions and fully diluted)	1,080
NPV in US$	**$0.13**
NPV in A$ (ER 0.65)	**$0.20**

Source: RaaS analysis *LSEG observed beta is 0.86

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Exhibit 5: Financial Summary

Fluence Corporation	All financials in US$ unless stated otherwise				
Profit and Loss (A$m)					
Y/E 30 December	**FY22A**	**FY23A**	**FY24F**	**FY25F**	**FY26F**
Sales Revenue	116.3	68.8	51.2	93.0	93.5
Gross Profit	26.8	17.8	16.2	25.6	29.5
EBITDA underlying	0.5	0.2	(4.4)	5.2	6.5
Depn	(2.0)	(1.8)	(1.6)	(1.8)	(1.8)
Amort	(0.3)	(0.2)	(0.2)	(0.2)	(0.2)
EBIT underlying	(1.7)	(1.4)	(6.3)	3.2	4.5
Interest	(4.0)	(5.7)	(1.5)	(1.6)	(1.6)
Tax	(1.0)	(0.7)	(0.6)	(0.5)	(1.5)
Equity accounted assoc	(0.1)	0.0	0.0	0.0	0.0
NPAT pre significant items	(9.0)	(9.2)	(8.5)	1.1	1.4
Significant & non-cash items	(9.8)	(8.8)	(3.5)	0.0	0.0
NPAT (reported)	**(18.8)**	**(18.1)**	**(11.9)**	**1.1**	**1.4**
Cash flow (A$m)					
Y/E 30 December	**FY22A**	**FY23A**	**FY24F**	**FY25F**	**FY26F**
EBITDA	0.5	0.2	(4.4)	5.2	6.5
Interest	(3.9)	(5.7)	(1.6)	(1.6)	(1.6)
Tax	(0.1)	(0.2)	(0.2)	(0.5)	(1.5)
Working capital & other	(17.0)	(13.3)	(1.4)	(1.8)	1.8
Operating cash flow	(20.5)	(19.0)	(7.6)	1.3	5.3
Mtce capex	0.0	0.0	(1.5)	(0.4)	(0.4)
Free cash flow	(20.5)	(19.0)	(9.1)	0.9	4.9
Capex	(0.4)	(1.8)	(1.6)	(2.0)	(2.0)
Acquisitions/Disposals	0.3	0.1	1.9	0.0	0.0
Other	10.9	6.1	(1.0)	(0.2)	(0.2)
Cash flow pre financing	(9.8)	(14.6)	(9.7)	(1.3)	2.7
Equity	3.7	26.6	0.0	0.0	0.0
Debt	(0.4)	(13.4)	(0.6)	0.0	0.0
Dividends paid	0.0	0.0	0.0	0.0	0.0
Net cash flow for year	(6.5)	(1.4)	(10.3)	(1.3)	2.7
Balance sheet (A$m)					
Y/E 30 December	**FY22A**	**FY23A**	**FY24F**	**FY25F**	**FY26F**
Cash	30.9	24.6	14.3	13.0	15.7
Accounts receivable	49.0	35.3	35.8	42.4	42.7
Inventory	9.3	5.7	3.1	6.5	6.5
Other current assets	10.6	8.7	6.3	6.3	6.3
Total current assets	99.8	74.3	59.6	68.2	71.3
PPE	9.7	8.1	8.1	8.3	8.5
Intangibles and Goodwill	1.3	1.1	1.1	1.2	1.3
Investments	0.3	0.3	0.2	0.2	0.2
Deferred tax asset	0.0	2.0	1.1	1.1	1.1
Other non current assets	12.4	7.2	10.3	10.5	8.9
Total non current assets	23.8	18.8	20.8	21.4	20.0
Total Assets	123.6	93.1	80.4	89.6	91.3
Accounts payable	51.5	32.4	34.3	42.4	42.7
Short term debt	1.3	15.8	15.4	15.4	15.4
Tax payable	0.1	0.7	0.0	0.0	0.0
Other current liabilities	32.3	28.7	27.0	27.0	27.0
Total current liabilities	85.1	77.6	76.7	84.8	85.1
Long term debt	32.9	2.6	2.2	2.2	2.2
Other non current liabs	2.6	0.8	0.7	0.7	0.7
Total long term liabilities	*35.6*	*3.4*	*2.9*	*2.9*	*2.9*
Total Liabilities	120.7	80.9	79.6	87.7	88.0
Net Assets	**2.9**	**12.2**	**0.8**	**1.9**	**3.3**
Share capital	217.7	232.3	232.6	232.6	232.6
Accumulated profits/losses	(198.9)	(214.9)	(226.8)	(225.7)	(224.3)
Reserves	(13.9)	(3.3)	(3.1)	(3.1)	(3.1)
Minorities	(2.0)	(2.0)	(1.9)	(1.9)	(1.9)
Total Shareholder funds	**2.9**	**12.2**	**0.8**	**1.9**	**3.3**

Share price (5 November 2024)	All per share mettrics in A$					0.080
Interim (A$m)						
	1H23A	**2H23A**	**1H24F**	**2H24F**	**1H25F**	**2H25F**
Revenue	30.4	38.4	20.1	31.1	43.1	49.9
EBITDA (adj)	(1.6)	2.2	(3.6)	(0.8)	2.9	2.3
EBIT (adj)	(2.6)	1.2	(4.5)	(1.7)	2.0	1.3
NPAT (normalised)	(5.1)	(3.8)	(6.0)	(2.3)	0.8	0.4
EPS (normalised/diluted)	(0.69)	(0.48)	(0.56)	(0.22)	0.08	0.04
Dividend (cps)	-	-	-	-	-	-
Imputation	-	-	-	-	-	-
Operating cash flow	(12.9)	(0.4)	(13.6)	6.0	0.8	0.5
Divisions	**1H23A**	**2H23A**	**1H24F**	**2H24F**	**1H25F**	**2H25F**
MWW	5.3	5.8	3.7	6.2	7.6	8.0
IWB	3.4	3.6	3.2	7.0	4.8	10.5
IWR	5.7	9.2	8.7	9.2	10.4	11.0
SEA & China	2.2	11.4	2.4	2.0	3.5	3.5
BOO	1.2	0.9	1.5	1.7	1.8	1.8
IVC	13.2	9.1	0.7	5.0	15.0	15.0
Sales revenue	**30.4**	**38.4**	**20.2**	**31.1**	**43.1**	**49.9**
EBITDA (normalised)	(1.6)	2.2	(3.6)	(0.8)	2.9	2.3

Margins, Leverage, Returns		**FY22A**	**FY23A**	**FY24F**	**FY25F**	**FY26F**
Gross Profit Margin		23.1%	25.9%	31.6%	27.5%	31.5%
EBITDA		0.4%	0.3%	(8.6%)	5.6%	7.0%
EBIT		(1.5%)	(2.1%)	(12.3%)	3.4%	4.8%
NPAT pre significant items		(16.2%)	(26.3%)	(23.3%)	1.1%	1.5%
Net Debt (Cash)		3.3	(6.3)	3.3	4.6	1.9
ND/ND+Equity (%)	(%)	933.1%	34.0%	132.6%	168.7%	(133.2%)
EBIT interest cover (x)	(x)	n/a	n/a -	4.1	2.0	2.8
ROA		n/a	n/a	(7.2%)	3.7%	4.9%
ROE		n/a	n/a	(183.3%)	79.7%	55.0%
ROIC		n/a	n/a	(328.3%)	(105.5%)	(280.9%)
Working capital		6.8	8.6	4.7	6.5	6.5
WC/Sales (%)		5.9%	12.5%	9.1%	7.0%	7.0%
Revenue growth		6.3%	(40.9%)	(25.5%)	81.6%	0.5%
EBITDA growth pa		n/a	n/a	-2656%	-218%	26%
Pricing		**FY22A**	**FY23A**	**FY24F**	**FY25F**	**FY26F**
No of shares (y/e)	(m)	651	1,076	1,076	1,076	1,076
Weighted Av Dil Shares	(m)	710	791	1,163	1,163	1,163
EPS Reported (A$)	cps	(4.07)	(3.51)	(1.58)	0.14	0.19
EPS Normalised/Diluted (A$)	cps	(1.94)	(1.79)	(1.12)	0.14	0.19
EPS growth (norm/dil)		n/a	n/a	n/a	-113%	33%
DPS	cps	-	-	-	-	-
DPS Growth		n/a	n/a	n/a	n/a	n/a
Dividend yield		0.0%	0.0%	0.0%	0.0%	0.0%
Dividend imputation		0	0	0	0	0
PE (x)		n/a	n/a	n/a	56.0	42.1
PE market		18.0	18.0	18.0	18.0	18.0
Premium/(discount)		n/a	n/a n/a		210.9%	133.7%
EV/EBITDA		67.6	156.7 -	13.2	11.5	8.7
EV/Revenue		0.3	0.4	1.1	0.6	0.6
FCF/Share (A$)	cps	-4.8	-2.7	-1.3	0.1	0.71
Price/FCF share	x	n/a	n/a	n/a	62.2	11.20
Free Cash flow Yield		-61.3%	-34.5%	-16.4%	1.6%	8.9%

Source: RaaS estimates, Company data for actuals

FINANCIAL SERVICES GUIDE

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Complaints

If you have a complaint about our service, you should contact your representative and tell them about your complaint. The representative will follow BR's internal dispute resolution policy, which includes sending you a copy of the policy when required to. If you aren't satisfied with an outcome, you may contact AFCA, see below.

BR is a member of the Australian Financial Complaints Authority (AFCA). AFCA provide fair and independent financial services complaint resolution that is free to consumers.

Website: www.afca.org.au; Email: info@afca.org.au; Telephone: 1800931678 (free call)

In writing to: Australian Financial Complaints Authority, GPO Box 3, Melbourne, VIC, 3001.

Professional Indemnity Insurance

BR has in place Professional Indemnity Insurance which satisfies the requirements for compensation under s912B of the Corporations Act and that covers our authorized representatives.

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