EDISON

Fluence Corporation

Q3 results

Contrasting trends

General industrials

Fluence's Q319 results reflected contrasting trends. Further delays to Custom Engineering Solutions (CES) contracts lead us to cut our forecasts again, but Smart Product Solutions (SPS) is on track. Significantly, Fluence secured two new large Aspiral deals in China – if these ramp up as we anticipate, SPS revenue could double to more than US$50m in FY20e. If we add this to the existing CES contract base, Fluence is close to the revenue run-rate it needs to reach EBITDA break-even and cash generation.

Year end	Revenue (US$m)	Adjusted EBITDA* (US$m)	EPS* (c)	EV/revenue (x)	EV/EBITDA (x)	P/E (x)
12/17	33.2	(23.6)	(7.0)	6.4	N/A	N/A
12/18	101.1	(8.5)	(2.5)	2.1	N/A	N/A
12/19e	90.0	(21.8)	(4.4)	2.4	N/A	N/A
12/20e	175.9	1.9	(0.1)	1.2	111.9	N/A

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

Further delays to CES contracts…

Q3 revenue of US$13m fell 50% y-o-y and bookings were US$15m. The H219 recovery in CES, anticipated in A quieter Q2, is likely to be more muted. Revenues from the projects in Egypt and Brazil are still expected in Q4 (we assume US$12m and US$5m, respectively) as is Ivory Coast (US$20m), but Fluence has yet to reach financial close on this project and San Quintin revenue recognition is pushed into FY20. Reflecting these delays, we cut our FY19 revenue forecast by 25%.

…but SPS is on track

SPS sales remained healthy (revenue US$7m, up 189% y-o-y). Fluence expects Q4 to be boosted by additional Nirobox and Aspiral sales and is retaining its FY19 SPS revenue guidance of US$26m (implying US$13m in Q4). More significantly, the company signed two new framework Aspiral deals in China: a 40,000m^2/day deal with Kaitian (see Further progress in China) and a 52,000m^2/day deal with Liaoning Huahong New Energy. Our FY20 SPS revenue forecast of US$47m is unchanged for now but these deals suggest revenues could exceed US$50m.

Focus on cash flow

The CES delays have limited impact on Fluence's long-term prospects in our view, but highlight the unpredictability of its revenue base and affect cash flow. Assuming a quarterly cash overhead of US$10m, we estimate Fluence needs sales of c US$48m per quarter (pq) to reach FCF break-even. It has already signed sufficient business to get near this, but the timing of revenues is key. We estimate a year end FY19 cash balance of US$26m and average H219 quarterly cash burn of c US$6m.

Valuation: Substantial upside remains

In our view, Fluence's value is primarily underpinned by the long-term prospects for its SPS products. Recent wins in China highlight that demand for decentralised water and wastewater treatment solutions is rising (see Water: The real liquidity crisis) and Fluence's proprietary solutions are gaining traction. Our DCF-based valuation, which reflects long-term potential, falls to A$0.62/share (from A$0.66/share) on lower forecasts but still implies c 40% upside to the current price.

4 November 2019

Price	**A$0.45**
Market cap	**A$279m**
	US$/A$1.46
Estimated net cash (US$m) at end FY19	24
Shares in issue	620m
Free float	60%
Code	FLC
Primary exchange	ASX
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(15.2)	(5.3)	3.5
Rel (local)	(14.3)	(4.0)	(9.5)
52-week high/low		A$0.6	A$0.3

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 quicker to deploy and substantially cheaper than traditional alternatives.

Next event

Q419 trading update	January 2020

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Changes to forecasts

In previous notes (eg Time for better treatment?) we have highlighted the difficulty in accurately forecasting Fluence's business given that its order book and revenues are dominated by large, lumpy CES contracts. The combination of further delays at San Quintin and the uncertainty of reaching financial close on the Ivory Coast project reinforce this point. Lowering our CES forecasts cuts our group FY19 revenue forecast by 25% (to US$90m) and our FY20 forecast by 15%.

However, our SPS forecasts remain unchanged. The company expects Q419 SPS revenue to be boosted by Nirobox sales to the Middle East and the bulk of Aspiral sales to ITEST in China. More significantly, Fluence has signed two new framework Aspiral deals in China: a 40,000m^2/ day deal with Kaitian in Hunan province and a 52,000m^2/day deal with Liaoning Huahong New Energy in Liaoning Province. Combined, these contracts could generate revenues of over US$40m, with the majority recognised in FY20. Add this to residual ITEST sales, Nirobox (c US$11m) and SUBRE, we believe SPS revenue could double to over US$50m in FY20. However, recognising that timings can shift, we leave our US$47m FY20 forecast unchanged for now.

Exhibit 1: Changes to forecasts

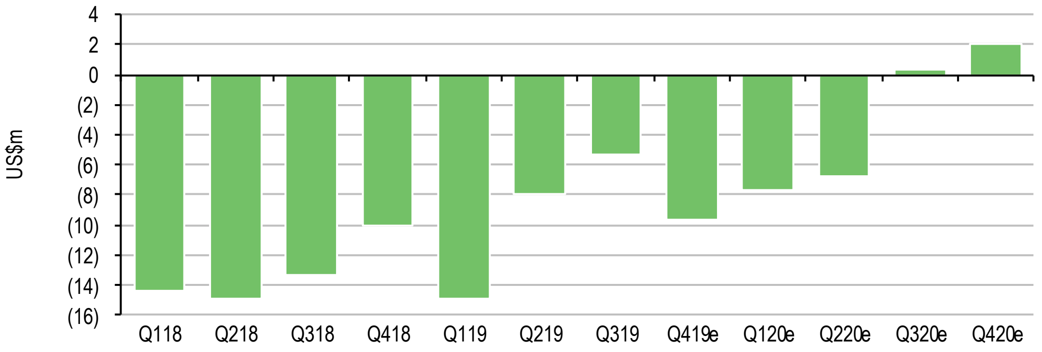
US$m	FY19e			FY20e		
	Old	New	% change	Old	New	% change
Revenue						
- CES	92.0	62.0	(32.6)	154.3	124.9	(19.1)
- SPS	26.0	26.0	0.0	47.0	47.0	0.0
- Recurring	2.0	2.0	0.0	6.0	4.0	(33.3)
Total	**120.0**	**90.0**	**(25.0)**	**207.3**	**175.9**	**(15.1)**
Adjusted EBITDA	(7.5)	(21.8)	N/A	5.7	1.9	N/A
Adjusted EPS (c)	**(1.8)**	**(4.4)**	**N/A**	**0.6**	**(0.1)**	**N/A**

Source: Edison Investment Research

CES project delays have limited impact on Fluence's long-term prospects in our view, but do affect near-term cash flow. Assuming US$10m of cash overheads per quarter, we estimate that Fluence needs sales of c US$44m to reach EBITDA profitability and c US$48m/quarter to reach FCF break-even. Adding the company's estimate of US$80m in revenue to be recognised from the Ivory Coast contract in FY20 to our assumption of US$20m from San Quintin, US$13m in residual revenues from the Egypt and Brazilian desalination contracts suggests Fluence has already signed CES contracts capable of generating US$113m pa in revenues. If we add our SPS forecasts, underpinned by framework agreements with ITEST, Kaitian and Liaoning, and Fluence should already have visibility on revenues of c US$160m pa (US$40m/quarter). However, as the experience of FY19 highlights, the timing of revenue recognition is key.

Taking into account the recent capital raise and Q419 guidance on cash consumption (an operating cash outflow of US$6m) we estimate the FY19 cash balance to be US$26m with an average H219 cash burn of c US$6m per quarter.

Exhibit 2: Reducing cash burn (free cash flow)



Source: Company data, Edison investment research

Exhibit 3: Financial summary

US$m	2016	2017	2018	2019e	2020e
31 December	IFRS	IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT					
Revenue	0.8	33.2	101.1	90.0	175.9
Cost of Sales	(2.0)	(27.2)	(66.5)	(74.0)	(134.2)
Gross Profit	(1.2)	6.0	34.6	16.0	41.7
Adj. EBITDA	(8.8)	(23.6)	(8.5)	(21.8)	1.9
Operating Profit (before amort. and except).	(9.1)	(24.3)	(11.0)	(10.1)	(24.4)
Amortisation of acquired intangibles	0.0	0.0	0.0	0.0	0.0
Exceptionals	0.1	(1.2)	(52.7)	0.0	0.0
Share-based payments	0.0	0.0	0.0	0.0	0.0
Reported operating profit	(9.1)	(25.4)	(63.7)	(24.4)	(0.7)
Net Interest	(0.0)	2.6	0.5	0.4	0.3
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)	(10.5)	(24.0)	(0.4)
Profit Before Tax (reported)	(9.1)	(22.9)	(63.2)	(24.0)	(0.4)
Reported tax	0.0	(0.7)	(0.4)	0.0	0.0
Profit After Tax (norm)	(9.1)	(22.4)	(10.9)	(24.0)	(0.4)
Profit After Tax (reported)	(9.1)	(23.6)	(63.6)	(24.0)	(0.4)
Minority interests	0	0	0	0	0
Discontinued operations	0	0	0	0	0
Net income (normalised)	(9.1)	(22.4)	(10.9)	(24.0)	(0.4)
Net income (reported)	(9.1)	(23.6)	(63.6)	(24.0)	(0.4)
Average Number of Shares Outstanding (m)	214	320	440	538	550
EPS - basic normalised (c)	(4.3)	(7.0)	(2.5)	(4.4)	(0.1)
EPS - diluted normalised (c)	(4.3)	(7.0)	(2.5)	(4.4)	(0.1)
EPS - basic reported (c)	(4.2)	(7.4)	(14.5)	(4.4)	(0.1)
Dividend per share (c)	0	0	0	0	0
Revenue growth (%)			204.7	(11.0)	95.5
Gross Margin (%)	-147.5	18.0	34.2	17.7	23.7
EBITDA Margin (%)	(1,089.3)	(71.1)	(8.4)	(24.3)	1.1
Normalised Operating Margin	(1,126.1)	(73.1)	(10.9)	(27.2)	(0.4)
BALANCE SHEET					
Fixed Assets	3.2	72.7	43.8	45.1	44.5
Intangible Assets	2.1	60.2	5.6	5.6	5.6
Tangible Assets	1.0	7.1	14.8	16.1	15.5
Investments & other	0.1	5.5	23.4	23.4	23.4
Current Assets	24.4	131.9	97.7	114.0	107.7
Stocks	0.5	18.5	18.9	25.5	20.9
Debtors	0.7	26.7	33.5	56.2	62.8
Cash & cash equivalents	22.9	75.2	38.7	25.8	17.4
Other	0.3	11.5	6.5	6.5	6.5
Current Liabilities	(2.5)	(95.9)	(78.7)	(120.4)	(113.9)
Creditors	(1.4)	(27.8)	(47.5)	(54.6)	(52.3)
Tax and social security	0.0	(0.1)	(0.9)	(0.9)	(0.9)
Short term borrowings	0.0	(1.1)	(0.4)	(2.3)	(6.0)
Other	(1.1)	(66.9)	(30.0)	(62.6)	(54.7)
Long Term Liabilities	(1.0)	(5.1)	(11.7)	(11.7)	(11.7)
Long term borrowings	0.0	0.0	0.0	0.0	0.0
Other long term liabilities	(1.0)	(5.1)	(11.7)	(11.7)	(11.7)
Net Assets	24.1	103.6	51.1	27.0	26.6
Minority interests	0.0	0.2	1.2	1.2	1.2
Shareholders' equity	24.1	103.8	52.3	28.3	27.8
CASH FLOW					
Op Cash Flow before WC and tax	(8.8)	(23.6)	(8.5)	(21.8)	1.9
Working capital	1.7	(4.8)	(44.1)	(12.5)	(11.4)
Exceptional & other	0.0	0.2	0.1	0.9	0.0
Tax	0.0	(0.9)	(0.2)	(0.4)	(0.4)
Net operating cash flow	(7.2)	(29.0)	(52.6)	(33.8)	(9.9)
Capex	(0.4)	(3.7)	(2.8)	(3.9)	(2.0)
Acquisitions/disposals	(1.0)	50.6	(1.8)	1.2	0.0
Net interest	0.0	0.5	2.7	(0.3)	(0.1)
Equity financing	22.9	31.3	26.2	23.0	0.0
Dividends	0.0	0.0	0.0	0.0	0.0
Other	(0.2)	1.1	(2.4)	0.1	0.0
Net Cash Flow	14.2	50.8	(30.6)	(13.6)	(12.0)
Opening net debt/(cash)	(8.5)	(22.9)	(74.0)	(38.4)	(23.5)
FX	0.2	2.1	(4.3)	(1.2)	0.0
Other non-cash movements	0.0	(1.8)	(0.7)	0.0	0.0
Closing net debt/(cash)	(22.9)	(74.0)	(38.4)	(23.5)	(11.5)

Source: Company accounts, Edison Investment Research

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