

# Fluence Corporation

Q2 results

## A quieter Q2

Following a record Q1, Fluence had a quieter Q2. A shortfall in new recurring deals and delays at San Quintin lead us to trim our forecasts. Nevertheless, we see a recovery in H2. With a record backlog, healthy prospects in China and the Ivory Coast project set to ramp, growth should rebound. The commitment to reach positive EBITDA in Q4 remains intact.

Year end	Revenue (US\$m)	Adj. EBITDA* (US\$m)	EPS* (c)	EV/revenue (x)	EV/EBITDA (x)	P/E (x)
12/17	33.2	(23.6)	(7.0)	4.0	N/A	N/A
12/18	101.1	(8.5)	(2.5)	1.3	N/A	N/A
12/19e	120.0	(7.5)	(1.8)	1.1	N/A	N/A
12/20e	207.3	5.7	0.6	0.6	23.0	52.7

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

## A quieter Q2

Fluence received \$223m in new orders in Q1. Q2 bookings were a more modest \$19m, primarily comprising a \$10m desalination contract in Brazil (see our flash note, [\\$10m desalination contract win](#)) and Fluence acknowledged a slowdown in new recurring revenue deals. Sales also fell y-o-y to \$11.3m as revenue recognition from San Quintin is on hold while the project is refinanced (a \$4.5m impact; see below). Given their complexity, delays in landing deals and recognising revenue are not uncommon. Revenue generation should resume at San Quintin by Q4.

## SPS: Nirobox shortfall, but China remains healthy

The company is cutting its FY19 smart product solution (SPS) revenue guidance from \$44m to \$26m as a result of a slowdown in Nirobox orders. The company had anticipated that the \$10m Brazilian desalination contract would be Nirobox based and delays in signing new recurring revenue contracts (where Nirobox is also prominent) account for the rest of the cut. The admission that large customers are still opting for bespoke rather than standardised technology suggests the market will take time to evolve. Growth expectations for Aspiral and SUBRE are unchanged. Fluence states that it is close to signing further multi-year Aspiral deals in China and plans to substantially increase production by the end of FY19.

## At an inflection point?

The combination of delays and Nirobox leads us to cut our FY19 and FY20 sales forecasts by 21% and 22%, respectively (see Exhibit 3). However, even with these cuts, Fluence should still grow healthily in both years. Assuming revenues of \$20m from the Ivory Coast, the quarterly sales run rate should improve sharply by Q419, turning both EBITDA and cash flow positive. The release of delayed San Quintin disbursements could boost Q4 cash flow by a further \$5m.

## Valuation: Substantial upside

In our view, Fluence's value is primarily underpinned by the long-term prospects for its SPS products. Demand for decentralised water and wastewater treatment solutions is rising and its proprietary technology has the potential to deliver higher-margin revenue streams with greater visibility. Our DCF-based valuation approach, which reflects long-term potential, falls to A\$0.70 per share (from A\$0.75/share) on lower forecasts, but still implies 50% upside to the current share price.

## General industrials

5 August 2019

**Price** **A\$0.46**
**Market cap** **A\$247m**

A\$0.709/US\$

Net cash (US\$m) at end 2018 38.4

Shares in issue 538m

Free float 60%

Code FLC

Primary exchange ASX

Secondary exchange N/A

## Share price performance



% 1m 3m 12m

Abs 6.9 3.3 20.8

Rel (local) 5.3 (2.9) 11.6

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

Q319 trading update October 2019

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## CES revenues should recover in H219

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We have highlighted in previous notes (see [Time for better treatment?](#)) the difficulty in accurately forecasting Fluence's business given its order book and revenues are dominated by large, lumpy custom engineered solution (CES) contracts. Q2 underlined this issue – delays at San Quintin reduced revenue by \$4.5m (c 30%). Here the cause was a minority equity partner on the project failing to contribute its share of capital, which, in turn, prevented disbursements from the project finance facility run by the North American Development Bank. To resolve the situation, Fluence has agreed in principle to contribute \$8.5m to raise its stake in the project to 94%, using funds provided by an additional loan facility from Generate Capital. Finalisation of this agreement is expected by early Q419, with the release of disbursements expected to boost cash flow by \$5m.

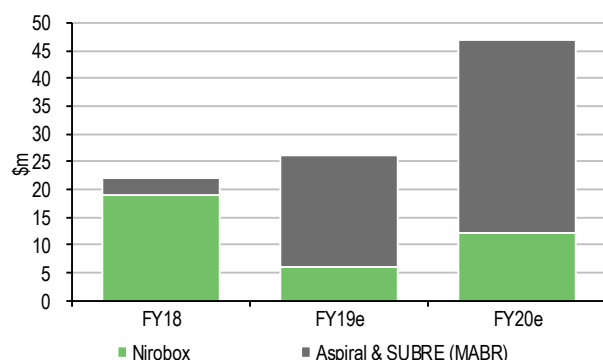
Nevertheless, with an order backlog at record levels (\$278m, 2.2x FY19e sales), revenue should recover in H2. Resumption of San Quintin payments, plus revenue from the desalination contracts in Brazil and Egypt, should drive improved financials. Timing of the ramp in the €165m Ivory Coast contract is likely to be a big swing factor (see ["Landmark" €165m contract win](#)). Assuming financial close by the end of Q3, Fluence expects to recognise 'up to' \$20m of revenue in Q419 and \$80m in FY20. While additional deals are expected to be signed by the year end, these are unlikely to be revenue generating until FY20.

## Nirobox shortfall

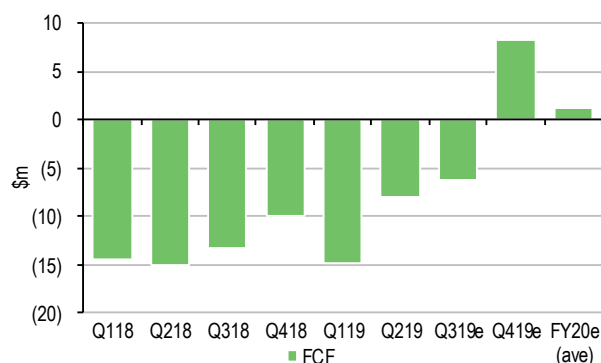
Fluence's proprietary containerised water treatment product, Nirobox, has enjoyed significant success over the last 18 months. It has been deployed in the US, Egypt, the Bahamas and South Africa, and generated revenues of c \$19m in FY18. However, much of its growth in FY19 was predicated on Fluence securing recurring revenue contracts particularly in the industrial sector. A shortfall in deals and the fact that the \$10m Brazilian desalination contract (see our flash note, [\\$10m desalination contract win](#)) will now use a customised solution has had an impact on sales. The acknowledgment that some customers continue to prefer bespoke solutions for these larger projects suggests the broader market for containerised solutions will take time to evolve. The introduction two new variants of Nirobox (EcoBox and Niroflex) aims to broaden its appeal, but is unlikely to address the shortfall in the near term.

## MABR growth fuelled by Aspiral and China

Growth expectations for Fluence's membrane aerated biofilm reactor (MABR) based wastewater treatments such Aspiral and SUBRE are unchanged. Following the launch of SUBRE earlier this year and follow-up orders of Aspiral with ITEST in China, we expect revenue to grow more than sixfold in FY19 (Exhibit 1). Fluence indicates that it is close to signing additional multi-year contracts in new Chinese provinces for Aspiral, which may include establishing some final assembly capacity locally. It also expects to increase production substantially by moving to full capacity on the single operating line in its existing Changzhou manufacturing site. The company estimates that at full capacity this line has the potential to generate 7,500 MABR modules annually – equivalent to at least \$75m in sales. We forecast MABR sales reaching \$35m in FY20.

**Exhibit 1: SPS revenue forecast**


Source: Fluence data, Edison Investment Research

**Exhibit 2: Reducing cash consumption**


Source: Fluence data, Edison Investment Research

## Forecast changes

The combination of delays to San Quintin and signing new recurring revenue contracts (with a Nirobox element) leads us to cut our FY19 and FY20 sales forecast by 21% and 22%, respectively (see Exhibit 3). Even with these cuts, we forecast revenues to more than double from FY18 levels by FY20.

The resumption of San Quintin payments, revenue from the desalination contracts in Brazil and Egypt, and \$20m from the Ivory Coast should combine to drive a sharp improvement in the quarterly sales run rate by Q419. We estimate that revenue per quarter has to reach c \$44m to achieve EBITDA break-even and c \$48m to be free cash flow positive (see our initiation note, [Time for better treatment?](#), published on 25 September 2018). We forecast free cash flow of \$6m in Q4 and \$5m (\$1.2m per quarter) in FY20 (see Exhibit 2).

**Exhibit 3: Changes to forecasts**

\$m	FY19e			FY20e		
	Old	New	% change	Old	New	% change
Revenue						
■ CES	103.0	92.0	(10.6)	187.5	154.3	(17.7)
■ SPS	44.0	26.0	(40.9)	70.0	47.0	(32.9)
■ Recurring	5.0	2.0	(60.0)	9.0	6.0	(33.3)
<b>Total</b>	<b>152.0</b>	<b>120.0</b>	<b>(21.0)</b>	<b>266.5</b>	<b>207.3</b>	<b>(22.2)</b>
Adjusted EBITDA	(2.3)	(7.5)	N/M	23.0	5.7	(75.0)
<b>Adjusted EPS (c)</b>	<b>(0.8)</b>	<b>(1.8)</b>	<b>N/M</b>	<b>3.8</b>	<b>0.6</b>	<b>(84.2)</b>

Source: Edison Investment Research

**Exhibit 4: Financial summary**

	US\$m	2016	2017	2018	2019e	2020e
Year end 31 December		IFRS	IFRS	IFRS	IFRS	IFRS
<b>INCOME STATEMENT</b>						
Revenue		0.8	33.2	101.1	120.0	207.3
Cost of Sales		(2.0)	(27.2)	(66.5)	(89.7)	(159.7)
Gross Profit		(1.2)	6.0	34.6	30.3	47.5
EBITDA		(8.8)	(23.6)	(8.5)	(7.5)	5.7
Operating Profit (before amort. and except).		(9.1)	(24.3)	(11.0)	(10.1)	3.1
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)	(10.1)	3.1
Net Interest		(0.0)	2.6	0.5	0.3	0.1
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)	(9.8)	3.2
Profit Before Tax (reported)		(9.1)	(22.9)	(63.2)	(9.8)	3.2
Reported tax		0.0	(0.7)	(0.4)	0.0	0.0
Profit After Tax (norm)		(9.1)	(22.4)	(10.9)	(9.8)	3.2
Profit After Tax (reported)		(9.1)	(23.6)	(63.6)	(9.8)	3.2
Minority interests		0	0	0	0	0
Discontinued operations		0	0	0	0	0
Net income (normalised)		(9.1)	(22.4)	(10.9)	(9.8)	3.2
Net income (reported)		(9.1)	(23.6)	(63.6)	(9.8)	3.2
Average Number of Shares Outstanding (m)		214	320	440	538	538
EPS - basic normalised (c)		(4.3)	(7.0)	(2.5)	(1.8)	0.6
EPS - diluted normalised (c)		(4.3)	(7.0)	(2.5)	(1.8)	0.6
EPS - basic reported (c)		(4.2)	(7.4)	(14.5)	(1.8)	0.6
Dividend per share (c)		0	0	0	0	0
Revenue growth (%)				204.7	18.7	72.7
Gross Margin (%)		-147.5	18.0	34.2	25.2	22.9
EBITDA Margin (%)		(1,089.3)	(71.1)	(8.4)	(6.3)	2.8
Normalised Operating Margin		(1,126.1)	(73.1)	(10.9)	(8.4)	1.5
<b>BALANCE SHEET</b>						
Fixed Assets		3.2	72.7	43.8	43.6	45.0
Intangible Assets		2.1	60.2	5.6	5.6	5.6
Tangible Assets		1.0	7.1	14.8	14.6	16.0
Investments & other		0.1	5.5	23.4	23.4	23.4
Current Assets		24.4	131.9	97.7	148.4	138.9
Stocks		0.5	18.5	18.9	37.0	24.8
Debtors		0.7	26.7	33.5	81.6	74.4
Cash & cash equivalents		22.9	75.2	38.7	23.3	33.1
Other		0.3	11.5	6.5	6.5	6.5
Current Liabilities		(2.5)	(95.9)	(78.7)	(139.0)	(127.6)
Creditors		(1.4)	(27.8)	(47.5)	(79.2)	(74.4)
Tax and social security		0.0	(0.1)	(0.9)	(0.9)	(0.9)
Short term borrowings		0.0	(1.1)	(0.4)	(12.2)	(17.2)
Other		(1.1)	(66.9)	(30.0)	(46.7)	(35.1)
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	41.3	44.5
Minority interests		0.0	0.2	1.2	1.2	1.2
Shareholders' equity		24.1	103.8	52.3	42.5	45.7
<b>CASH FLOW</b>						
Op Cash Flow before WC and tax		(8.8)	(23.6)	(8.5)	(7.5)	5.7
Working capital		1.7	(4.8)	(44.1)	(17.0)	3.8
Exceptional & other		0.0	0.2	0.1	0.0	0.0
Tax		0.0	(0.9)	(0.2)	(0.4)	(0.4)
Net operating cash flow		(7.2)	(29.0)	(52.6)	(24.9)	9.1
Capex		(0.4)	(3.7)	(2.8)	(2.3)	(4.0)
Acquisitions/disposals		(1.0)	50.6	(1.8)	0.0	0.0
Net interest		0.0	0.5	2.7	(0.1)	(0.3)
Equity financing		22.9	31.3	26.2	0.0	0.0
Dividends		0.0	0.0	0.0	0.0	0.0
Other		(0.2)	1.1	(2.4)	0.0	0.0
Net Cash Flow		14.2	50.8	(30.6)	(27.3)	4.8
Opening net debt/(cash)		(8.5)	(22.9)	(74.0)	(38.4)	(11.0)
FX		0.2	2.1	(4.3)	0.0	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)	(11.0)	(15.9)

Source: Company accounts, Edison Investment Research

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