



ITM Power update note

28th February 2017

Full steam ahead post fund raising

Since our initiation of coverage in August 2016, renewable energy specialist ITM Power has made good operational progress in its two divisions, with the wider hydrogen energy industry continuing to attract investment from governments and industry across its target markets.

■ £5.7 million fundraising completed to support growth

ITM's cash position of £1.7 million as at 31st October 2016 was recently boosted by the proceeds of a £5.7 million firm placing. The funds will be used for working capital to support the growing order book, to strengthen the balance sheet and drive the move towards positive cash flow.

■ Power-to-Gas division scaling up

In the Power-to-Gas division, ITM has announced three further contracts for the supply of electrolyzers, including for a landmark UK trial. The focus now is upon scaling up its electrolysis equipment to serve larger markets.

■ Developing relationship with Shell in Clean Fuel

In collaboration with industry partners, including energy giant Shell, ITM has continued with the successful roll-out of its hydrogen refueling stations across the UK. Driving the monetisation of its estate, six further fuel contracts with fleet operators have been signed over the past six months & more expected.

■ Valuation suggests significant upside from current levels

With ITM continuing to trade in line with expectations we maintain our forecasts as set out in our initiation of coverage note. **Accounting for the increased number of shares in issue following the placing our fair value target moves to 37.9p from 43.8p. With this implying 110% upside from the current share price of 18p, we maintain our Conviction Buy stance.**

Table: Financial overview

Year to end April	2015A	2016A	2017E	2018E
Total income (£m)	5.06	8.19	10.87	15.11
PBT (£m)	(5.71)	(4.36)	(2.81)	(1.50)
EPS (p)	(3.39)	(2.17)	(1.25)	(0.65)

Source: Company accounts & Align Research

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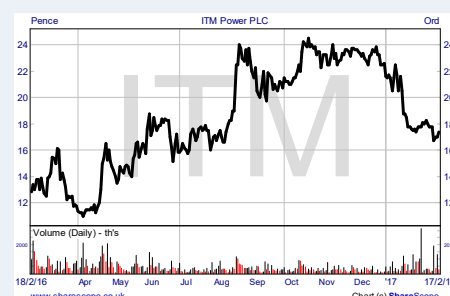
CONVICTION BUY



Key data

EPIC	ITM
Share price	18p
52 week high/low	24.5p/11p
Listing	AIM
Shares in issue	250,613,176
Market Cap	£45.11m
Sector	Energy

12 month share price chart



Analyst details

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Divisional progress

POWER-TO-GAS ENERGY STORAGE

ITM's Power-to-Gas division provides utility companies with electrolysis units (electrolysers) designed to meet the requirements for grid balancing and energy storage services. Providing a significant competitive advantage, it can offer sub-one second response times for full system turn on and turn off and pressure up to 80 bar. The company's first reference plant in the Power-to-Gas market, in Frankfurt, for the Thüga Group, has been in operation for over three years, with Thüga continuing to report "better than expected" results.

Since our initiation note of 11th August three further electrolyser sales have been announced.

Landmark UK hydrogen injection trial with major medium term potential

Perhaps the most significant deal in terms of the long-term potential for the Power-to-Gas business was announced at the end of November last year. As part of a consortium of industry bodies (named HyDeploy), ITM Power was awarded a contract to supply a 0.5MW electrolyser to a programme which is looking to demonstrate the use of blended hydrogen in the UK gas grid.

Funded by UK gas & electricity regulator Ofgem, as part of its Network Innovation Competition, and led by National Grid, the £6.8 million project is looking to establish a framework for hydrogen gas-grid injection in the UK. **Beginning this year, the results will be used to inform a further public trial of the use of hydrogen blended natural gas in the UK gas grid, with the intention of then rolling out the use of hydrogen blends nationwide and open up a new UK Power-to-Gas market.**

The logo for National Grid, featuring the words "nationalgrid" in a blue sans-serif font, with "national" in lowercase and "grid" in a slightly larger, bold lowercase.The logo for Thüga, featuring a blue square with a white plus sign to the left of the word "thüga" in a bold, black, sans-serif font. Below "thüga" is the tagline "Das große Plus für alle" in a smaller, blue, sans-serif font.The logo for RWE, featuring the letters "RWE" in a large, bold, blue, sans-serif font. Below the letters is the tagline "The energy to lead" in a smaller, blue, sans-serif font.The logo for Northern Gas Networks, featuring a stylized sunburst icon above the words "Northern Gas Networks" in a blue, sans-serif font.

ITM Power's major power to gas collaborators

Further electrolyser deals add to order book

Also in November last year ITM revealed the signing of a contract to supply a 1.25 MW, 50-bar electrolyser unit at an ethylene production plant for a major EPC contractor - the contract value was not announced. This was followed up on 11th January with news of a €0.7 million electrolyser system sale to an un-named global specialty gas company, won by competitive tender. No further details announced but ITM commented that it looks forward to updating the market on progress from this “important partnership”.

Strategy develops to meet increased demand for larger electrolysis units

The size of these recently signed deals could be small in comparison to what’s to come over the next few years. ITM’s current strategy in the Power-to-Gas division is focused on the scaling up of its electrolysis equipment, which will enable it to serve larger markets. This has come in response to a “*dramatically*” increased number of enquiries from potential customers for larger scale industrial installations.

ITM has also been responding to enquires for much larger plant for bus and heavy goods vehicle refuelling stations in the 1MW to 10MW range and industrial applications ranging from Power-to-Gas, refineries and steel making in the 10MW to 100MW range. **In reaction, the company intends to launch designs for potential 100MW systems for applications in the chemical and large utility industry at the upcoming industrial sector conference, Hannover Messe, in April.** The scale up of the electrolyser systems is a relatively simple task given the modular nature of ITM’s systems.

CLEAN FUEL

ITM's Clean Fuel division provides infrastructure, such as hydrogen generation and fueling equipment, which is supporting the growth of hydrogen as a fuel for vehicles such as cars and buses. To date the company has won a number of contracts to supply hydrogen generation equipment for refueling stations located in both the UK and California, with partners including the likes of Shell, Toyota, engineering consultants Ove Arup & Partners and Hydrogène de France amongst others.



ITM refueling partners

Current and future hydrogen refuelling stations

In the table below we update the current status of ITM's hydrogen refueling station roll-out programme.

Project	Location	Dispenser	Build Status	Delivery
M1	Rotherham	350/700	Operational	Delivered
Riverside	USA	700	Operational	Delivered
HyFive 1	NPL - Teddington	350/700	Operational	Delivered
HyFive 2	CEME - Rainham	350/700	Operational	Delivered
HyFive 3	Shell Cobham	350/700	Operational	Delivered
Big Hit	Orkney	350	In design	April 2017
H2ME	Shell Beaconsfield	350/700	In build	August 2017
H2ME	Shell Gatwick	350/700	In build	August 2017
H2ME2 1	Swindon	350/700	Contract	March 2017
H2ME2 2	Birmingham	350/700	Contract	2017
H2ME2 3	TBC	350/700	Contract	2017

Source: ITM Power/Align Research

ITM's most recent update to the market confirmed that, under its siting agreement with Shell signed in 2015, the first hydrogen refueling station (HRS) to be situated on a forecourt in the UK has just been opened.

Located at Cobham services on the M25 in Surrey, the nation's busiest refuelling station, this is the first of three hydrogen stations Shell plans to open in the UK in 2017 in collaboration with ITM. It is ITM's fourth public hydrogen refuelling station to be opened in the country, adding to locations at Rotherham, Rainham, East London and Teddington, West London.



HRS at Shell Cobham. Source: ITM Power

Fuel contracts grow in importance to future revenues

In October 2015 ITM signed its first fuel deal with Toyota, covering green hydrogen fuel dispensed from the three HyFive refuelling stations. **Since the release of our initiation note ITM has signed six further fuel contracts with various fleet operators, covering hydrogen fuel dispensed across its growing network of refuelling stations** – see table below. We see this as an area of useful incremental revenue. The company believes that by the end of 2018 it will be able to dispense 1 tonne of fuel a day from its stations. At 100% utilisation and a price of £10/kg this would equate to revenues of c.£3.65 million per annum.

Date	Client	Price	Notes
23/08/2016	Commercial Group	£10/kg	Commercial Group is a pioneer in hydrogen fuelled fleet logistics.
26/08/2016	Arcola Energy	£10/kg	Follow-on agreement to that signed with Symbio FCell and Arcola Energy to provide an integrated package of zero emission commercial vehicles, on-site fuel and after-sales support for UK commercial fleet operators.
14/10/2016	Arval	£10/kg	Owned by BNP Paribas, Arval UK is a leader in the provision of vehicle funding and fleet management solutions.
04/11/2016	Hyundai Motor UK	£10/kg	For refueling Hyundai's iX35 Fuel Cell Vehicle fleet.
14/11/2016	Europcar UK	£10/kg	ITM will be providing fuel for Europcar's new fleet of Toyota Mirai fuel cell electric vehicles.
23/11/2016	Anglo American	£10/kg	The seventh fuel supply contract for refuelling fuel cell electric vehicles ITM has signed.

Table 1: Recent fuel contracts signed by ITM Power

Financials & Funding

£5.7 million placing to support continued growth

On 26th January ITM announced the successful raising of £5.7 million in a firm placing at a price of 17p per share. The raising was completed at a modest discount to the previous day's close of 17.62p per share but at a modest premium to the last funding round at 15p per share completed in January 2016.

The net proceeds of the raise, estimated at £5.45 million, will be used to support the working capital needs of the current projects under contract - many of ITM's projects require substantial upfront expenditure before the related income is received, typically towards the end of the contract. The funds will also be used to strengthen the balance sheet and support tender requirements, particularly in regards to obtaining upfront payment terms from customers.

CEO Dr. Graham Cooley took part in the placing, buying an additional 176,470 shares to take his total holding to 987,726, or 0.39% of the company. Major shareholder JCB Research also made a notable contribution, buying 11,764,705 new shares, taking its holding post admission to 12.36%, with Valebond Consultants (a company owned by JCB Director Jo Bamford) taking up 2,941,176 new shares to take its holding to 3.16%.

Interims financials suggest full year performance on track to meet expectations

For the six months to 31st October 2016 ITM recorded total income of £2.97 million, down from £3.45 million in the first half of the previous year. This was made up of £0.4 million of revenue recognised from project work, down 39%, and £1.62 million from grant income, up 18%. The 14% fall in total income was largely a result of ITM's projects remaining at the early stages of build, a time when only small amounts of revenues are recognised.

ITM continued to maintain a tight control on costs in the period, with the loss from operations down by 28% at £2.27 million and cash burn of £1.61 million down by 59%. At the period end net cash stood at £1.725 million. One notable line item on the balance sheet is trade & other receivables, which rose by 79% over 12 months to £9.2 million. This is predominantly related to grant income debtors, which can be slow at making payments.

Demonstrating the momentum seen over the year, calendar 2016 orders doubled to £15.68 million. This helped the order book at the results release date (26th January) to grow to £18.35 million (£16.98 million under contract and £1.37 million in the later stages of negotiation) **which gave the company confidence that it would post results for the full year in line with market expectations.**

Current order book

As at 22nd February, the date of the most recent announcement to the market, ITM's total order book amounted to £18.23 million, with £16.87 million being projects under contract and a further £1.36 million being in the later stages of negotiation.

Assessment

We believe that ITM Power has made good progress operationally over the past six months, with clear momentum being delivered across both divisions – **projects under contract are currently 74% higher than a year ago and 93% higher than two years ago.**

The funds raised in the recent placing put the company in a strong position to deliver on its order book, but the movement of the business to operational cash flow positivity remains a key challenge. ITM has done a good job in managing expenses so far this financial year and to improve the cash flow performance is seeking a move towards quoting for potential sales with upfront payment terms, thus reducing the initial working capital outlay required.

Should ITM successfully meet this challenge we see excellent long-term growth prospects for the company given its strong technical know-how and leading commercial position in a rapidly growing sector.

Demonstrating the growth of the hydrogen fuel sector, Shell recently announced it will be building seven hydrogen fueling stations in California in partnership with Toyota. This is in line with the US state's target of having 100 retail sites by 2024 where hydrogen fuel cell cars can refuel.

In addition, governments around the world continue to push the hydrogen agenda given energy and environmental challenges. For example, at the end of 2016 the European Union announced a package of proposed directives which are expected to have a significant positive effect on the uptake of Power-to-Gas (P2G) energy storage and green hydrogen fuel made by electrolysis across Europe.

Valuation

With ITM stating in its recent interim results that it remains confident of delivering full year results in line market expectations we maintain our forecasts as set out in our initiation of coverage note.

Our valuation method remains based on a private equity, discounted cash flow model approach, with forecasts extending out to 2028, which we believe captures the key growth phase for ITM and allows us to come to a prospective valuation. We use a terminal EBITDA multiple of 10 times and a very heavy discount rate of 20%.

With forecasts unchanged but accounting for the increased number of shares in issue following the recent placing, our fair value target moves to 37.9p from 43.8p. Accordingly, with this implying 110% upside from the current price of 18p, we maintain our Conviction Buy stance.

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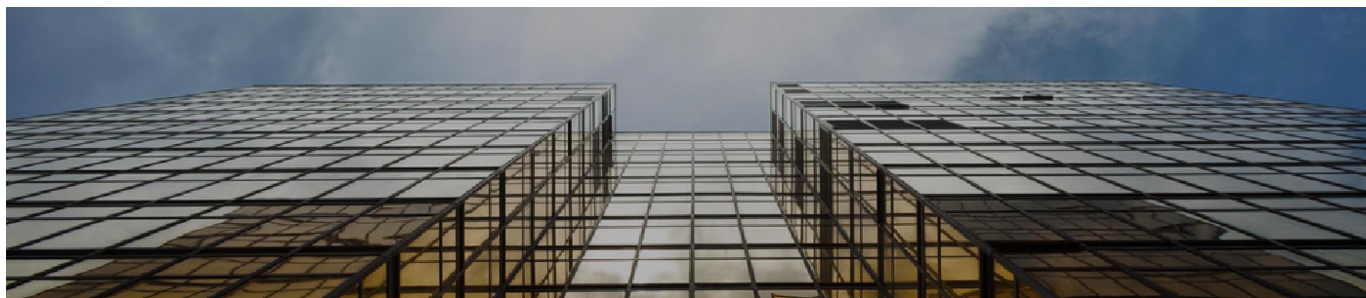
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