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# EQTEC – Valuation Update

16th July 2020

## Further commercial progress and financial strengthening prompts forecasts update

**EQTEC provides engineering and design services and sells its EQTEC Advanced Gasification Technology to waste-to-energy operators and enterprise partners. The company works together with multiple parties involved in W2E projects including the developers, waste owners, building contractors and funders with a view to ultimately providing its advanced gasification technology, associated engineering & design services and O&M services.**

### Further significant commercial progress in H1 2020

Since our last update on the company at the end of March, EQTEC has announced further operational and commercial progress on a range of projects across the UK, US and Europe**. In addition, 10 new commercial enquiries were received by EQTEC in Q1/early Q2 2020 and full detailed commercial offers, with an aggregate potential sales value of c.€120 million, were made during the period.**

### Financial position strengthened via debt re-profiling, warrant exercise & placing

On 1st June, EQTEC announced the re-profiling of its debt facilities with lenders Altair and Riverfort. Existing loans plus interest totalling €2.7 million had their maturity extended from 31st July 2020 to 30th June 2021, with interest rates reduced from 12.5% to 10%. Also in June, a total of £964,750 was received by the company via the exercise of certain warrants. Further, in July, EQTEC raised £10 million via a placing and subscription.

### Further progress prompts forecasts review

Given the commercial progress being made and increased pipeline of opportunities we have revisited our forecasts for the years 2020 to 2022. **At the top line we expect revenues to grow markedly over the forecast period as EQTEC delivers on its project pipeline.** Net profits are forecast at €5.3 million in 2021, rising to €8.6 million in 2022. We consider a multiple of 15 times earnings to be a justifiable figure to use for our valuation, which applied to our 2022 forecasts and discounted back to end June 2020 at a rate of 12% derives a price per share of 1.39p.

### Peer analysis supports valuation

Applying the average London listed alternative energy sector peer group enterprise value to EQTEC implies a market cap of £88.08 million, or 1.282p per share. We thus update coverage of EQTEC with an increased target price of 1.39p based on our earnings valuation and retain our stance of **Conviction Buy.**

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## CONVICTION BUY

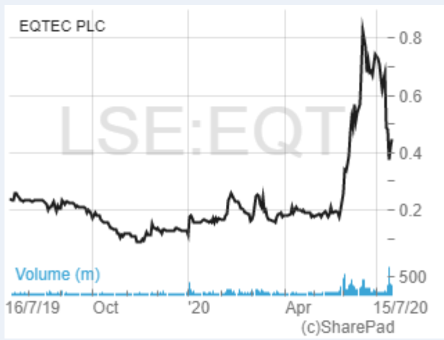
### Upgraded Price Target – 1.39p

EQTEC™

**Key data**

| | |
|---|---|
| EPIC | EQT |
| Share price | 0.45p |
| 52 week high/low | 0.825p/0.09p |
| Listing | AIM |
| Shares in issue | 6,868,712,306 |
| Market Cap | £30.91m |
| Sector | Alternative Energy |

**12 month share price chart**

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## Further commercial progress in H1 2020

Since our last update note on 24th March 2020, EQTEC has continued to make significant commercial and operational progress despite the global effects of the coronavirus pandemic. The main points were covered in a trading update released on 28th May.

In the UK, work for a full detailed quote for the grid connection at the Billingham Energy Project has been completed by grid operator, Northern Powergrid, and the quote has been received and accepted by EQTEC. A non-binding project finance term sheet has now been received, signed by EQTEC and is being assessed by a consortium of potential equity investors. The funding structure comprises both senior debt and mezzanine tranches and requires an equity contribution from the consortium of developers of 10% of the total project capex, estimated at £170 million. On 23rd June it was announced that the conditional Memorandum of Understanding with strategic partners COBRA Instalaciones Y Servicios and Scott Bros. Enterprises had its exclusivity period extended until 22nd September 2020.

In the US, at the flagship North Fork project in California, a detailed engineering plan was delivered by EQTEC to the EPC contractor and partner Phoenix Energy as planned in April 2020. A second milestone payment of €770,000 was received by the company in May. Preparation work at the site has commenced in-line with the project programme, including the requirement to have the equipment located at the firm's Newry site in Ireland being shipped to the US by no later than August 2020. Meanwhile, at the NAPA project in California, a full planning permit for the previously announced new location, initially to accommodate a larger 2MWe capacity power plant, is still in progress with some delays attributable to COVID-19. The client is evaluating the option of a larger installation and requested a full quote for an increased 3MWe plant which was provided by EQTEC.

At the company's initial project in Greece, first announced in March, a full project technical due diligence report has been completed by TUV Hellas, the nominated engineer of the local Greek bank offering the project finance. **On 9th July EQTEC confirmed that the bank has approved the funding for the project, subject to terms and conditions which will be incorporated in formal legal documentation. Subject to finalisation of legal documentation, this is now expected to enable financial close of the project**. Under the scope of the company's framework agreement with German EPC firm ewerGy, 13 potential new projects in the Balkan region have now passed the initial due diligence phase and fall under exclusivity.

**Elsewhere, 10 new commercial enquiries were received by EQTEC in Q1/early Q2 2020 and full detailed commercial offers, with an aggregate potential sales value of c.€120 million, were made during the period.** EQTEC has progressed discussions with a European infrastructure operator of district heating and waste to energy and the parties have selected three potential projects for financial due diligence, which has already commenced. Once completed, the intention is to develop these projects together under a new framework collaboration agreement.

Meanwhile, final results for the year to 31st December 2019 announced on 12th June revealed that contracted Q1 2020 revenues were €2.35 million, some 40% ahead of revenues made in the whole of 2019. There is said to be a high degree of earnings visibility for the rest of the year given contracted or near contracted sales of technology, with the full year numbers expected to be significantly weighted to the second half. The outlook is positive, with global demand for EQTEC's technology and services said to remain strong and with early indications showing demand increasing as more countries and companies seek sustainable green solutions to waste elimination and energy issues.

**Debt re-profiling, £10 million equity raise and debt conversion**

In terms of the recent financing, on 1st June, EQTEC announced the re-profiling of its debt facilities with lenders Altair and Riverfort. In summary, existing loans plus interest totalling €2.7 million had their maturity extended from 31st July 2020 to 30th June 2021, with interest rates reduced from 12.5% to 10%. June also saw a total of £964,750 received by the company via the exercise of certain warrants.

On 9th July, EQTEC further confirmed the raising of £10 million via the placing of 2 billion placing shares and subscription for 222,222,220 shares on the PrimaryBid platform, both at an issue price of 0.45p, a 33% discount to the previous day's price. In addition, Altair has agreed to convert £1,061,964, the outstanding principal amount of its loan and interest accrued to date, plus a re-profiling fee of £95,637, into shares at the issue price. Alongside the placing, directors David Palumbo, Gerry Madden and Yoel Aleman and non-exec Thomas Quigley agreed to reinvest 40% of their salaries and fees for the 12 months to 30th June 2021 into shares at the issue price.

The funds will mainly be used for:

- specific project development capital to be deployed to accelerate the timing of identified projects, using RDF in the UK and Ireland and Biomass in Europe, to financial close and invoicing by EQTEC;

- the settlement of outstanding principal, interest and fees due to the Riverfort Lenders, up to an amount of approximately £311,000.

- further IP development, contract suite improvement, IoT software development and additional human resource.

- working capital.

**US legal complaint**

On 13th July 2020, EQTEC confirmed that lawyers acting for Aries Clean Energy have filed a complaint in a Californian court, against the company and others, alleging patent infringement through the use of the group's advanced gasification technology in the North Fork Community Power plant. The complaint is specific to the US only and does not extend to activities in the UK and Europe.

**EQTEC is being advised by its expert US legal counsel and refutes any allegation that its technology infringes any valid US patent and will vigorously defend it.** It is the strongly held belief of the board that the Aries claim as filed is without merit and opportunistic, coming perhaps not co-incidentally on the same day that the £10 million placing was announced. The company intends to strongly and robustly defend against what it believes are unfounded and vexatious actions and any such similar actions in the future and will seek redress where applicable. **It will also progress with its US pipeline of projects as planned.**

## Forecasts update

At the time of our last update on 24th March 2020 our forecasts were conservative, only considering projects announced to the market at the time. **Working with management we have now updated our numbers for 2020 to 2022, adding in additional projects while using largely the same assumptions as before.**

Again we assume four equal payments are made over the life of each project, one in the month of commencement, one in the month following completion and the remaining two at equal intervals over the project period. Gross margins on the projects are assumed to be 20%. We do not consider any revenues from O&M services or income from equity interests (as in the case of North Fork).

Interest expenses are calculated on the Altair and Riverfort facilities in line with the revised terms. We assume these are non-cash and that the loan is paid back on the due date on 30th June 2021. Interest payments on other bank borrowings are assumed to be paid in cash.

Administration expenses in 2020 are forecast to be €2 million (lower than in 2019 due to cost saving initiatives) rising by 10% in the remaining two years. Given historic losses, we assume a zero tax rate for 2020 and 2021 but a rate of 20% in 2022. For simplicity we assume no major change in PPE or intangibles on the balance sheet as the revenue assumptions above are based on a capex light model. For working capital we expect inventories to remain flat as they are not relevant to the technology sale business which is project specific. For debtors, we assume it takes an average of 30 days for the payments to be received, with days' payable also at 30.

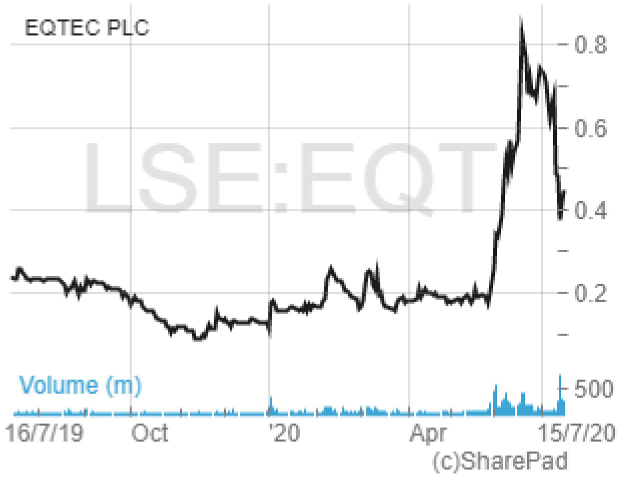
The key P&L figures from our updated model are presented below:

| **€** | **2020** | **2021** | **2022** |
|---|---:|---:|---:|
| Revenues | 6,955,000 | 38,489,000 | 65,994,000 |
| COGS | -5,564,000 | -30,791,200 | -52,795,200 |
| **GROSS PROFIT** | **1,391,000** | **7,697,800** | **13,198,800** |
| Admin expenses | -2,000,000 | -2,200,000 | -2,420,000 |
| **EBITDA** | **-609,000** | **5,497,800** | **10,778,800** |
| Interest | -325,269 | -165,294 | -14,769 |
| **PRE-TAX PROFIT (LOSS)** | **-934,269** | **5,332,506** | **10,764,031** |
| Tax | 0 | 0 | -2,152,806 |
| **NET PROFIT (LOSS)** | **-934,269** | **5,332,506** | **8,611,225** |
| | | | |
| **EPS (p)** | **-0.0149** | **0.0683** | **0.1103** |

At the top line, we expect revenues to grow markedly over the forecast period as EQTEC delivers on its project pipeline. **Notable in 2021 is the expected commencement of the Billingham RDF project which is expected to deliver €40 million in revenues over the life of the contract, contributing €26 million in 2022.** We expect a strong operational gearing, with administration costs at the group level being relatively low and sufficient to support forecast levels of growth. **At the bottom line we are expecting a small loss for 2020, with net profits rising to €5.33 million in 2021 and to €8.6 million in 2022.** We again note that our forecasts remain highly sensitive to timing issues and potential project delays, with these being a major risk to the investment case.

## Valuation

Shares in EQTEC performed well in H1 2020 as the market reacted to the stream of good newsflow and the exiting of some overhanging legacy shareholders. Since bottoming out at 0.09p in November 2019 they rose to a peak of 0.825p in May before coming back down to the current 0.45p. Following the issue of shares associated with the placing and related events the market cap is £30.91 million at the current price.




With EQTEC expected to grow strongly over the coming years, moving into profit at the operating level in 2021, we consider that a multiple of 15 times earnings is a justifiable figure to use for our valuation. **On our 2022 forecast for 0.1103p of earnings, discounted back to end June 2020 at a rate of 12%, this gives a price of 1.39p per share. This gives an indication, subject to management execution, of what is up for grabs to investors in this currently hot sector.**

**Peer comparison**

A number of companies in the wider London listed alternative energy sector have performed well in H1 2020 alongside EQTEC. This is despite many continuing to be loss making and being pre-revenue. To apply a supporting value to EQTEC shares we have taken a look at the peer group, comparing on an enterprise value basis given the lack of profit figures. For analysis purposes we remove ITM Power (ITM) and Ceres Power (CWR) due to their respective market caps of £1.5 billion and £981 million being outliers.

| Name | Market Cap (m) | Close (p) | Net cash/ (debt) (£m) | Enterprise value (£m) | Historic revenues | Historic net profit/ (loss) £m |
|---|---|---|---|---|---|---|
| Inspired Energy | 114.24 | 16 | -33.40 | 147.64 | 49.30 | 11.78 |
| AFC Energy | 143.20 | 24.95 | 34.33 | 108.88 | 0.00 | -2.85 |
| Velocys | 41.84 | 6.5 | 8.13 | 33.71 | 0.70 | -19.67 |
| Simec Atlantis Energy | 83.67 | 19.5 | -37.61 | 121.28 | 2.20 | -24.00 |
| Powerhouse Energy Group | 147.28 | 4.19 | 0.10 | 147.18 | 0.00 | -0.87 |
| Good Energy | 34.62 | 208 | -41.60 | 76.22 | 124.30 | 1.22 |
| Active Energy Group | 10.19 | 0.8 | -14.91 | 25.10 | 1.54 | -1.05 |
| Verditek | 36.49 | 12.5 | 0.65 | 35.84 | 0.00 | -2.65 |
| Hydrodec Group | 1.06 | 3.75 | -6.13 | 7.20 | 12.38 | -5.48 |
| Prices as at 15th July 2020 | | | **AVERAGE** | **78.12** | | |

**Applying the average peer group enterprise value to EQTEC implies a market cap of £88.08 million, or 1.282p per share.** We believe that this is a reasonable approach given EQTEC's commercial progress and pipeline in comparison to other companies in the sector.

It is worth mentioning here the discrepancy in valuations between EQTEC and ITM Power, the hydrogen specialist and highest valued alternative energy company on AIM*. ITM Power has a current market cap some 45 times higher than EQTEC's while its historic revenues (less grants) were just £2.4 million in the six months to 31st October 2019.* This is only just ahead of the €2.35 million (£2.1 million) contracted revenues EQTEQ made in Q1 2020 alone. **EQTEC's recently announced €120 million (£107 million) pipeline from 10 new commercial enquiries contrasts to ITM Power's "higher quality tender opportunity pipeline" of £263 million, and while this is 2.5 times larger it doesn't seem to justify a market cap over 50 times higher.** Also, ITM expects to make an EBITDA loss for the year ended 30th April 2020 of £17.5 million.

Perhaps EQTEC's closest listed peer in terms of technology is **Powerhouse Energy (PHE).** PowerHouse has developed a technology known as DMG® (Distributed Modular Gasification) which can take waste and convert it into a synthesis gas (syngas) from which a range of products can be produced. While problems with the technology seem to have been solved over recent years, its commercialisation however remains slow. While no figures have been released regarding a commercial pipeline, Powerhouse recently signed an option to enter into an exclusive agreement for the development of DMG® Technology in the UK with waste infrastructure developer Peel Environmental, under which it could receive £0.5 million as a one-off fee and then on an ongoing basis receive an annual licence fee of c.£0.5 million for each DMG® plant that Peel develops. **Despite the lack of commercial pipeline figures, Powerhouse's enterprise value of £147.18 million (post the admission of shares issued for its acquisition of Waste2Tricity – expected on 15th July) is some seven times higher than our estimation of EQTEC's current EV (£20.95 million) following the receipt of the placing proceeds.**

An interesting fact that we found out from discussions with Dr. Yoel Aleman, CTO of EQTEC, is that the company has been successfully gasifying plastics since 2007 for many applications. In fact, Dr. Cesar Berrueco, one of the leading Chemical Engineers at EQTEC, wrote his PhD research paper about the subject. Mr. Aleman stated that gasification of plastics using EQTEC technology is quite simple and produces a syngas very low in ash content and with a very high LHV (Lower Heating Value). As a polymer, the composition of the produced syngas is mainly Carbon Monoxide (CO) and Hydrogen (H). He also stated that this type of hydrogen is considered 'Grey Hydrogen' as plastics are derived from fossil fuels. On the other hand, the Hydrogen extracted from the Syngas produced from organic feedstock using EQTEC technology, albeit not rated yet, would be considered 'Green Hydrogen'.

## Conclusion

EQTEC goes into the rest of 2020 with a strong pipeline of projects and, following the recent corporate activities, a significantly stronger balance sheet. With the success seen at North Fork in the US, the company now has a reference case project and a partner whom looks committed to working on finding new deals in the country. Elsewhere in the world, especially the EU and UK, further projects and partnerships with key industry players set the scene nicely for growth over the coming years.

As discussed, there is substantial execution risk involved in meeting our forecast figures, with the potential for projects to be delayed being a major constituent of this. However, as we have seen in the past, EQTEC shares have been responsive to positive announcements to the market and new CEO David Palumbo is proving to be more than capable of executing on sales and has done a fantastic job in our opinion in cleaning up legacy issues in the company and transforming the balance sheet. **With the potential for a strong flow of news we therefore see a number of possible catalysts for the shares.**

We update coverage of EQTEC with an increased target price of 1.39p and reiterated **Conviction Buy.**

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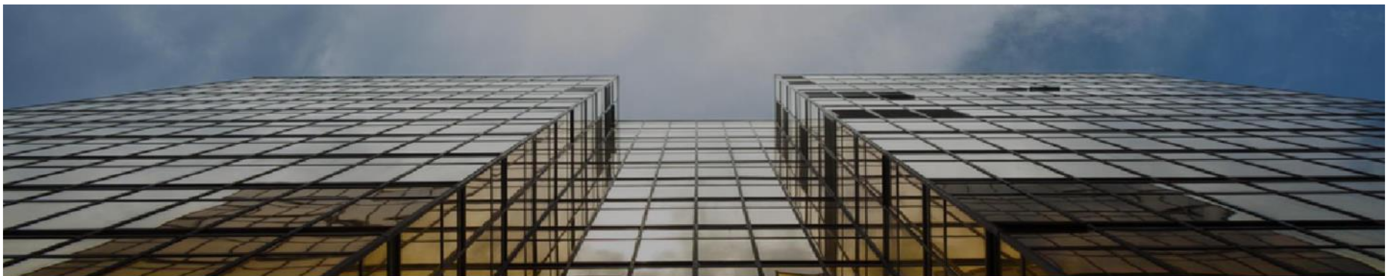

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