EDISON

Windar Photonics

Interim results

Facing headwinds

Alternative energy

Windar Photonics' H116 results show that customer engagement is intensifying, but is not translating into revenues at the rate management had hoped for. The company has taken action to reduce cash burn and speed up the sales cycle. Management notes that these delays will affect H216 and FY17, so we have revised our estimates and indicative valuation.

Year end	Revenue (€m)	EBITDA (€m)	PBT* (€m)	EPS* (€)	DPS (€)	P/E (x)
12/14	1.0	(1.5)	(2.0)	(0.05)	0.0	N/A
12/15	0.9	(2.8)	(3.3)	(0.08)	0.0	N/A
12/16e	2.5	(1.5)	(2.0)	(0.05)	0.0	N/A
12/17e	17.3	6.7	6.1	0.12**	0.0	6.0

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments. **Calculated by applying normalising tax rate

H116 revenue growth solid, but below expectations

At €0.8m H116 revenues were almost as high as the €0.9m achieved in FY15. Adjusted EBITDA losses totalling €1.3m were less than half that incurred in FY15. (€3.2m). However, while strong, revenue growth was lower than management expectations because of delays in moving from the successful completion of trials in the retro-fit segment to wider deployment. Cash consumption totalled €1.3m, offset by a placing in May raising €1.0m (net). Management has responded to these delays by instigating a cost-reduction programme, restructuring the board so that the former CEO is now focused exclusively on sales activities and raising a further £0.5m (gross) through a placing completing in October. We have revised our estimates to reflect the delays. Noting that the factoring facility (<€1.5m) arranged in May has not yet been used, our estimates show that Windar has sufficient cash until it reaches EBITDA break-even expected in late FY16/early FY17.

Direct integration of WindEye accelerates sales cycle

One of the issues affecting the length of the sales cycle was the time taken for potential customers to evaluate Windar's LiDAR preparatory to installing volumes of units across their wind turbine portfolios. Windar has recently launched a direct turbine integration focused on four specific models with a potential installed base of 11,000 turbines internationally. Windar will be selling the system with the support of the respective OEMs and turbine controller manufacturers, giving potential customers increased confidence in this unfamiliar technology.

Valuation: Contract news to drive share price

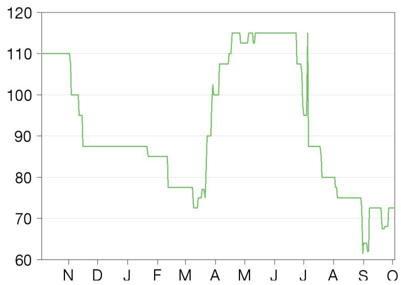
Our updated valuation range of 78-228p/share is based on a DCF analysis, reflecting a series of potential outcomes related to market penetration and consequent volume benefits. The share price has declined from a high of 115p in June and is now below the lower bound of our indicative valuation range. This downwards movement began to reverse in early September following the news of orders for the new-build 100MW Aidu windfarm in Estonia. Receipt of further volume orders should enhance investor confidence and provide support to the share price.

4 October 2016

Price	**72.5p**
Market cap	**£29m**

Net cash (€m) at end June 2016, excluding long-term deposits, Growth Fund loan and placing raised £0.5m (gross) on 3 October	0.25
Shares in issue (following admission of shares from October placing)	39.8m
Free float	38.0%
Code	WPHO
Primary exchange	AIM
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	13.3	(23.7)	(34.1)
Rel (local)	11.9	(28.7)	(41.7)
52-week high/low		115.0p	61.5p

Business description

Windar Photonics is a UK-registered, Copenhagen-based developer and manufacturer of an innovative low-cost light detection and ranging (LiDAR) system. Approaching wind direction and speed is measured ahead of a wind turbine, allowing appropriate yaw alignment, increasing efficiency.

Next event

Prelims	Q217

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Windar Photonics is a research client of Edison Investment Research Limited

Operations: Commercial and R&D progress

LiDAR deliveries in all three key geographies

Windar shipped an estimated 50 LiDAR units during H116, predominantly for deployment in retrofit applications. The shipments included deliveries to two large scale utilities in North America with an aggregate installed capacity of 3,500MW, as well as for a number of trials being conducted by windpark operators. The remaining units were for trials being conducted by OEMs, including 15 for direct integration into Goldwind turbines. The Goldwind order was significant because it was the first material contract since management decided to start selling directly into China rather than through a distributor. The majority of revenues were derived from customers in North America and Asia (broadly similar revenues attributable to both geographies), with a meaningful proportion derived from utilities in Europe.

Continued development for both OEM and retrofit segments

During H116, Windar continued to work with selected OEMs and wind turbine control manufacturers to make it easier to integrate its systems with both installed and new turbines.

For the retrofit market, Windar worked with four OEMs and wind turbine controller manufacturers to help modify their control software so that it could take wind information directly from a Windar LiDAR. The data is then used by the control software to 1) optimise yaw control, thus improving electrical generation efficiency; and 2) take defensive action to minimise the effect of incoming gusts of wind. The initial product offer is designed for use with four popular turbine models that represent a potential installed base of around 11,000 turbines internationally. This new system is easier to install than the previous solution for integrating LiDAR output with the turbine controller as all it requires is an update to the turbine controller software rather than integrating hardware. Importantly, the software has been developed in conjunction with the OEMs and controller manufacturers and will be sold in partnership with them. This will give customers greater confidence in the system and is expected to reduce the time taken for customers to trial the product. The sales effort will now focus on wind parks with these four turbine types.

Windar has also worked with several major OEMs on the direct integration of its LiDAR devices into new turbines. The first direct integration is complete. This is with new market entrant Eleon at its windfarm in north-eastern Estonia, which is currently under construction. On completion, which is scheduled for 2018, this wind-farm will hold 30 Eleon wind turbines. Other direct integration trials are at an advanced stage. Management estimates that collectively these integrations into new turbines represent an available market of over 20k units per annum.

Management changes

Martin Rambusch has stepped down as CEO and from the board to focus completely on sales related activity as chief commercial officer. Founder and part-time CTO, Jørgen Korsgaard Jensen, has become interim CEO until a new CEO is identified.

Financials: Contract delays cause estimates revision

H116: Revenues solid but not as high as expected

At €0.8m H116 revenues were almost as high as the €0.9m achieved in the whole of FY15. Although strong, revenue growth was lower than management expectations because of delays in moving from the successful completion of trials to wider deployment. Gross margin was 51.5% (28.2% FY15). This is higher than our previous FY16 estimate of 48.3%, reflecting higher pricing associated with the 4-beam LiDAR introduced in late FY15. After stripping out €115k provision for bad debts, €154k (€117k H115) warrant expenses and €195k amortisation and depreciation (H116 €217k), administrative expenses rose by €0.3m (19%) year-on-year to €1.7m. The increase related to costs incurred building up the sales pipeline and developing variants of the first generation products that are easier to deploy and meet more sophisticated user requirements. This incremental development work is inevitable as end-users become more engaged with the technology. The enlarged cost-base was more than offset by rising revenues. Adjusted EBITDA losses totalling €1.3m were less than half that incurred for the whole of FY15 (€3.2m loss). We understand that bad debts are likely to be negligible in future due to stricter credit conditions under the new factoring agreement, which requires adequate letters of credit to be in place before deliveries can be made.

H116: Cash consumption supported by equity raise

Cash consumption totalled €1.3m during the period. This benefitted from a €0.3m reduction in working capital. The €0.3m (€0.1m H115) charge for capitalised R&D was higher because of the increased level of development activity. Capex was minimal (€0.01m) as the investment required in production capacity and other infrastructure to support rising sales volumes was made during FY15. Cash consumption was offset by the equity raise in May at 110p/share which raised €1.0m (net), leaving €0.3m net cash at the end of June.

Estimate revisions triggered by contract delays

Exhibit 1: Revised estimates

	FY16e			FY17e			FY18e		
	Old	New	% change	Old	New	% change	Old	New	% change
Revenues (€m)	6.4	2.5	-61	27.1	17.3	-36	62.6	39.4	-37
PBT (€m)	(0.5)	(2.0)	-300	9.5	6.1	-36	29.1	17.3	-41
EPS (€)	(0.01)	(0.05)	-400	0.24	0.12*	-50	0.58	0.34	-41
Net cash (€m)	0.2	0.8	+300	7.6	5.3	-30	25.0	17.9	-28

Source: Edison Investment Research. Note: *Calculated by applying normalising tax rate.

The interim results note three factors which combine to trigger a downwards revision to our estimates. The first factor is the delays in progressing from trials to wider deployments. For one major project, the delay is due to corporate activity and is thus outside Windar's control. For others, having former CEO Martin Rambusch dedicated exclusively to sales should help move projects over the line. Importantly, the direct integration initiative should speed up trials for those potential customers which have one of the four selected turbine types, especially as the sales activity will be undertaken in association with the respective OEM or controller manufacturer. These customers have been identified and are the focus of sales going forward. The increasing availability of new turbines with built-in LiDAR as the several ongoing programmes with OEMs complete successfully should also help speed up the customer evaluation process.

The second factor is cash conservation. Management intends to work through existing inventory, which it estimates is sufficient to support at least €2.7m revenues. Once this is done, management intends to order product on receipt of a contract. This will slow down recognition of revenues by an estimated 12 weeks, which means that some orders received in FY16 will be recognised in FY17.

The third factor is specific to the €0.9m US order received in H215 that management expected to ship during FY16. Unfortunately, the controller manufacturer involved has withdrawn from the market. Windar and the customer are working on an alternative solution to facilitate delivery. Our estimates assume that deliveries under this contract will occur in FY17 rather than FY16.

Windar's cost-base was expanded during FY15 to support annual sales of c €50m in anticipation of a faster ramp-up in sales than was achieved. During H116 management re-aligned the cost-base, by reducing staff numbers from over 30 to 23 and adopting a more focused approach to sales and marketing expenses. This has reduced the break-even point by an estimated €100k/month to €300k. If revenues grow as shown in our estimates, management expects Windar to reach a break-even position towards the end of FY16/early FY17.

We have revised our estimates to show the effect of these delays and the cost reduction programme. We assume that the delays in closing contracts and the change to inventory management will affect FY16 and FY17, with a knock-on effect extending into FY18.

Cash conservation and fundraising expected to benefit H216

Our model shows minimal net cash consumption during H216 as revenues rise and the cost-base reduces, resulting in lower EBITDA losses. In addition, we expect working capital to reduce by €0.7m, as Windar works through inventory and uses the €0.4m factoring arrangement. We expect capital expenditure during H216 to be minimal, as sufficient investment was made during FY15 to support current revenue levels. We expect investment in capitalised R&D to be less than H116 as some of the development programmes are completed. This will be partly offset by grant funding. We expect cash consumption (excluding proceeds from equity fundraisings in May and October) to total €1.3m. After including an estimated €0.5m (net) from the placing in September (at 67.5p/share), we estimate that the group will have €0.8m net cash at end FY16. We expect increasing profitability during FY17 and FY18 to remove cash constraints and leave the group with €5.3m net cash at end FY17 and €17.9m at end FY18.

Valuation: Contract news to drive share price

We continue to use a DCF valuation out to 2025 based on a range of possible scenarios as our preferred valuation methodology. The base/medium case assumes the revenue development shown in our revised estimates. The low case models a more conservative level of sales based on smaller market share gains. The high case models an accelerated market penetration. We have updated our DCF model to reflect the changes in our estimates. The result is a reduction in our indicative valuation: from £35.9m (92p/share) to £31.2m (78p) for the low case; from £58.5m (150p) to £53.5m (135p) for the base/medium case; and from £109.0m (279p) to £90.8m (228p) for the high case.

Exhibit 2: Edison DCF valuation (£m) using a range of forecast scenarios

		Low case				Medium case				High case		
		Discount rate				Discount rate				Discount rate		
		30.0%	40.0%	50.0%		30.0%	40.0%	50.0%		30.0%	40.0%	50.0%
Terminal growth	0.0%	46.6	31.0	21.6	0.0%	78.7	53.1	37.8	0.0%	137.0	90.2	63.1
	1.0%	46.8	31.1	21.7	1.0%	79.1	53.3	37.9	1.0%	137.5	90.5	63.2
	2.0%	47.1	31.2	21.8	2.0%	79.5	53.5	38.0	2.0%	138.1	90.8	63.4
	3.0%	47.3	31.3	21.8	3.0%	80.0	53.7	38.2	3.0%	138.7	91.0	63.5
	4.0%	47.6	31.5	21.9	4.0%	80.4	53.9	38.3	4.0%	139.3	91.3	63.7

Source: Edison Investment Research

The share price has declined from a high of 115p in June, probably reflecting the absence of any newsflow regarding material orders. It is now below the lower bound (78p/share) of our indicative valuation range. This downwards movement began to reverse in early September following the news of orders for the new-build 100MW Aidu windfarm in north-eastern Estonia. Receipt of further volume orders should give investors confidence and act as a catalyst towards our mid-case fair value of £53.5m (135p/share).

Exhibit 3: Financial summary

€'000	2014	2015	2016E	2017E	2018E
Year-end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue	1,039	946	2,533	17,308	39,389
Cost of Sales	(678)	(679)	(1,218)	(8,367)	(16,504)
Gross Profit	361	267	1,315	8,941	22,886
EBITDA	(1,514)	(2,821)	(1,508)	6,666	17,881
Operating Profit (before amort. and except.)	(1,841)	(3,217)	(1,898)	6,226	17,381
Intangible Amortisation	0	0	0	0	0
Exceptionals	(669)	(223)	(115)	0	0
Warrants	0	(365)	(309)	(309)	(309)
Operating Profit	(2,510)	(3,805)	(2,322)	5,917	17,072
Net Interest	(175)	(100)	(100)	(100)	(50)
Profit Before Tax (norm)	(2,015)	(3,318)	(1,998)	6,126	17,331
Profit Before Tax (FRS 3)	(2,684)	(3,906)	(2,422)	5,817	17,022
Tax	70	121	90	0	(3,745)
Profit After Tax (norm)	(1,945)	(3,197)	(1,908)	4,778**	13,586
Profit After Tax (FRS 3)	(2,614)	(3,785)	(2,332)	5,817	13,277
Average Number of Shares Outstanding (m)	38.2*	38.2*	38.9	39.8	39.8
EPS - normalised (c)	(5.1)	(8.4)	(4.9)	12.0**	34.2
EPS - normalised fully diluted (c)	(5.1)	(8.4)	(4.9)	12.0**	34.2
EPS - (IFRS) (c)	(6.8)	(9.9)	(6.0)	14.6	33.4
Dividend per share (c)	0.0	0.0	0.0	0.0	0.2
Gross Margin (%)	34.7	28.3	51.9	51.7	58.1
EBITDA Margin (%)	N/A	N/A	N/A	38.5	45.4
Operating Margin (before GW and except.) (%)	N/A	N/A	N/A	36.0	44.1
BALANCE SHEET					
Fixed Assets	1,195	1,363	1,344	1,504	1,629
Intangible Assets	1,148	1,120	1,138	1,118	1,043
Tangible Assets	32	144	108	288	488
Investments	15	98	98	98	98
Current Assets	6,656	2,632	2,459	9,025	30,756
Stocks	248	770	470	1,420	5,120
Debtors	845	1,072	972	2,072	7,472
Cash	5,549	594	821	5,337	17,968
Other	14	197	197	197	197
Current Liabilities	(1,034)	(488)	(738)	(1,038)	(5,338)
Creditors	(1,034)	(483)	(733)	(1,033)	(5,333)
Short-term borrowings	0	(4)	(4)	(4)	(4)
Long-Term Liabilities	(717)	(827)	(827)	(827)	(827)
Long-term borrowings	0	(25)	(25)	(25)	(25)
Other long-term liabilities (Loan from Growth Fund)	(717)	(801)	(801)	(801)	(801)
Net Assets	6,100	2,681	2,239	8,665	26,221
CASH FLOW					
Operating Cash Flow	(2,142)	(4,923)	(973)	4,916	13,081
Net Interest	(175)	(14)	(100)	(100)	(50)
Tax	118	70	90	0	0
Investment in intangible & tangible assets	(230)	(484)	(297)	(300)	(400)
Acquisitions/disposals	0	0	0	0	0
Financing	7,071	0	1,507	0	0
Dividends	0	0	0	0	0
Net Cash Flow	4,643	(5,351)	227	4,516	12,631
Opening net debt/(cash)	(249)	(5,549)	(564)	(791)	(5,307)
HP finance leases initiated	0	0	0	0	0
Other	657	367	0	0	0
Closing net debt/(cash)	(5,549)	(564)	(791)	(5,307)	(17,938)

Source: Edison investment Research. Note: *Based on number at Admission to AIM. **Calculated by applying normalised tax rate.

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