Leclanché

Interim results

Brakes off

Alternative energy

Now that it has solved its financing issues, Leclanché has started delivering on its pipeline of projects to supply battery energy storage solutions for utility-scale, microgrid and e-transport applications. Revenues more than doubled during H118. However, some significant contracts that were pending at end June have been delayed while third parties await project funding, so we revise our FY18 estimates downwards and cut our indicative valuation from CHF2.51/share to CHF2.33/share.

Year end	Revenue (CHFm)	EBITDA (CHFm)	PBT* (CHFm)	EPS* (CHF)	DPS (CHF)	P/E (x)
12/16	28.1	(27.4)	(36.8)	(0.9)	0.0	N/A
12/17	11.7	(31.2)	(37.9)	(0.7)	0.0	N/A
12/18e	42.5	(34.3)	(39.4)	(0.5)	0.0	N/A
12/19e	99.6	(9.4)	(16.6)	(0.2)	0.0	N/A

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

Revenue growth driven by utility-scale generation

Group H118 revenues (including other income) more than doubled to CHF22.3m as access to finance enabled the company to start delivering against the pipeline of contracts already received for delivery during FY18. These total over 50MWh of capacity, primarily for utility-scale projects. Stripping out exceptional costs, normalised EBITDA losses widened by CHF7.5m to CHF17.1m. Management continued with its financing programme, which resulted in convertible loans (excluding CHF20.0m that has yet to be provided) reaching CHF46.6m, all of which are now owned by majority holder FEFAM. While this is potentially highly dilutive (see below), management notes that it now has sufficient funding to fully finance the company through to FY20, when it expects to be EBITDA positive.

Estimates underpinned by big e-transport contracts

Our previous estimates assumed that additional utility-scale orders would be confirmed for delivery in H218. These have been delayed, leading management to note at the interim stage that the company was on track to double revenues during FY18, ie to at least CHF36m. We therefore cut our FY18 revenue estimate by 32% to CHF42.5m. We leave our FY19 and FY20 revenue estimates broadly unchanged as these are partly underpinned by framework contracts for e-transport solutions with Skoda Electric and Sun Mobility. In both cases, Leclanché's modules need to be certified before volume deployment. While there remains a risk that individual utility scale projects may be delayed going forward, the number of projects in the pipeline reduces the risk to our estimates.

Valuation: Dependent on execution of projects

Our valuation is based on a DCF calculation, taking the growth rate adopted in our estimates and applying a terminal growth rate of 3% and WACC of 10.0%, as set out in our June note, since both the technology and Leclanché's ability to execute on large projects are proven. This gives an indicative valuation of CHF2.33/share (previously CHF2.51/share).

10 October 2018

Price	**CHF1.88**
Market cap	**CHF152m**

Net debt (CHFm) at end June 2018 (including CHF46.6m convertible loan)	50.0
Shares in issue	80.7m
Free float	52%
Code	LECN
Primary exchange	SIX
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(1.6)	(2.1)	(14.9)
Rel (local)	(2.9)	(4.3)	(12.1)
52-week high/low		CHF2.7	CHF1.5

Business description

Leclanché is a fully vertically integrated energy storage solution provider. It delivers a wide range of energy storage solutions for homes, small offices, large industries and electricity grids, as well as hybridisation for mass transport systems such as bus fleets and ferries.

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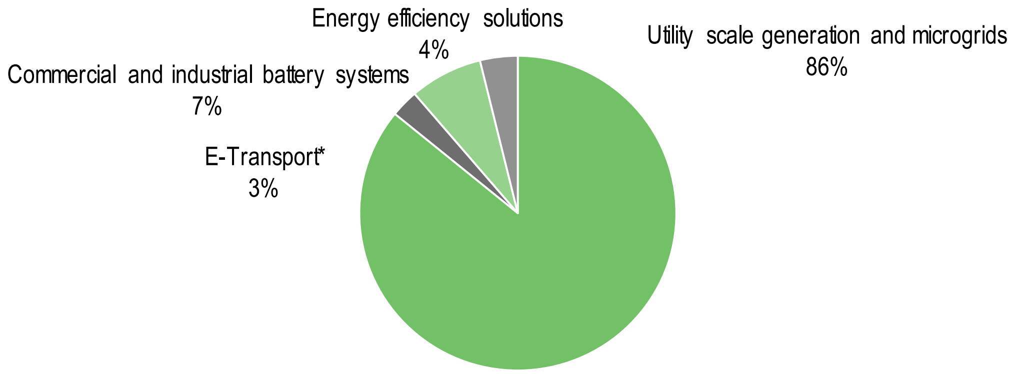
Segmental analysis

Exhibit 1: H118 revenues by segment



Source: Company data

Utility-scale generation and microgrids

While the ramp-up in growth in large-scale energy storage systems was held back by working capital constraints during FY17, the successful sourcing of finance (see below) meant this was no longer an issue during H118. Segmental revenues totalled CHF19.0m compared with only CHF1.4m in H117, as the company delivered on several major projects. These included a 34.8MWh battery energy storage plant in Cremzow, Germany; a 15MWh project for SWB in Bremen, Germany and a 19.5MWh project in Marengo, US. Segmental EBITDA losses widened from CHF2.0m to CHF5.2m. Profitability was affected by the switch to the IAS 15 standard for recognising revenues, which led to the business incurring costs on some projects that are not matched against revenues as these will not be recognised until H218 (the standard has not been applied retrospectively). Additionally, there was a big increase in personnel costs as the business unit worked on multiple large projects in parallel.

Management notes that it is on track to deliver a cumulative total of 100MWh of operational projects by the year end, thus doubling the installed base in the space of a year. However, several major projects, including one in the Caribbean on which management had expected to be working during H218, have been delayed for an unspecified period because the third parties involved have not yet secured the project financing required. We therefore reduce our FY18 delivery estimate from 70MWh to 46MWh. Management does not expect the delay in this individual project to affect FY19 deliveries as there are so many utility-scale projects in the pipeline, reflecting the increasing popularity of battery energy storage systems to smooth out the fluctuating output from renewable energy sources. We therefore leave our delivery estimates for FY19 and FY20 unchanged at 100MWh and 150MWh respectively. (See Exhibit 3 for a summary of the changes to revenue estimates for each business unit.)

E-transport

Segmental revenue rose from CHF0.1m in H117 to CHF0.6m as the company worked on the test phases of programmes for electric bus battery packs with Sun Mobility in India and Skoda Electric in Europe. Segmental EBITDA losses widened from CHF0.6m in H117 to CHF3.2m, partly as a result of IAS 15 adoption, partly as a result of increased staffing levels ahead of volume deliveries. These are for battery rack systems for 12 vessels and offshore rigs collectively totalling more than 50MWh for Kongsberg Maritime, as well as the Sun Mobility and Skoda Electric projects.

Noting the new order from Kongsberg and the progress on the programmes with Skoda Electric and Sun Mobility, we leave our segmental estimates unchanged. These assume volume deliveries on the Skoda Electric programme from FY19 onwards and on the Sun Mobility programme from FY20 onwards. Management anticipates that the Skoda Electric agreement will require deliveries of c 100MWh energy storage over a four-year period and the Sun Mobility programme annual volumes of 90-150MWh. The design for Skoda has been completed and Leclanché is constructing the battery packs required for independent certification. The first electric bus deploying the solution is scheduled to commence regular commercial service in December 2018. Leclanché has already delivered battery modules to Sun Mobility for certification including road trials. Management expects to announce the results of this phase by end FY18.

Commercial & industrial battery systems

Segmental revenues halved to CHF1.6m while EBITDA losses widened from CHF0.6m to CHF2.2m. This reflects the cost of working on projects for the Swiss army, where revenues will not be recognised until H218, together with delays in fulfilling materials handling-related work. Since we do not expect the business unit to catch up on this lost revenue during the second half of the year, we reduce our FY18 segmental revenue estimates but leave our FY19 and FY20 segmental revenues unchanged.

Energy efficiency solutions

Segmental revenues declined from CHF1.2m to CHF0.9m, while EBITDA losses widened from CHF0.1m to CHF0.2m. Initiatives to expand both the portfolio of third-party batteries it distributes and the sales channels have not yet succeeded in delivering any segmental growth. We therefore reduce our segmental revenue estimates for FY18, FY19 and FY20.

Group revenue growth driven by utility-scale generation

Group revenues (including other income) more than doubled to CHF22.3m. Raw materials and consumables used remained close to revenue levels, as the breakthrough in energy efficiency that would materially change this metric is not expected to be implemented in commercial battery cells until FY19. Personnel costs grew by 12% year-on-year, reflecting the recruitment of more than 45 people (now c 155 staff) in production, R&D, project management, and energy storage system design. This investment is necessary to support increased cell and module output volumes for the large projects on which Leclanché is working and to carry out engineering, procurement and construction (EPC) activities for some of these projects. Other operating expenses almost doubled to CHF11.5m, distorted by CHF5.7m exceptional costs, which are primarily related to financing activities. Stripping out these exceptional costs, EBITDA losses widened by CHF7.5m to CHF17.1m.

Financing programme completed in June 2018

Management continued with its financing programme (see Exhibit 2). Net debt increased from CHF19.5m (including CHF22.7m convertible loans) at end FY17 to CHF50.0m (including CHF46.6m convertible loans) at end H118. Key items include a CHF13.6m increase in working capital linked to revenue growth, the large (CHF25.2m) loss for the year and CHF2.2m capex. This was invested in the R&D facility, production capacity in Germany ahead of volume ramp-up in FY19 and completion of the module assembly line. Management notes that it has sufficient funding to fully finance the company through to FY20, when it expects to be EBITDA positive.

As a result of this financing activity, FEFAM has substantially increased its stake in the company. (FEFAM is AM INVESTMENT SCA, SICAV-SIF - Liquid Assets Sub-Fund, together with FINEXIS EQUITY FUND - Renewable Energy Sub-Fund, FINEXIS EQUITY FUND - Multi Asset Strategy

Sub-Fund and FINEXIS EQUITY FUND - EMoney Strategies Sub-Fund (also called Energy Storage Invest).) At the end of H118, FEFAM held a 48% stake. It now holds all of the convertible loan notes, including CHF20.0m not on the balance sheet at the end of June 2018, (this is the additional funding that FEFAM agreed to provide in June). If this CHF66.6m of loan notes was all converted to equity, it would give FEFAM a 68% stake in the company. FEFAM has confirmed its plans to convert CHF54m of its debt to equity later this year (this is in addition to the CHF16.5m converted in February). A further takeover waiver is being sought to cover this transaction.

Exhibit 2: Recent financing activity

Transaction	Value	Number of shares
Talisman – warrants exercise	CHF0.3m March 2017	0.2m new shares issued
Bridge loan – FEFAM	CHF2.7m March 2017	1% per month, maturity date extended to March 2020
Baring Asset Management – capital increase	CHF2.5m April 2017	1.0m new shares issued
Capital increase	CHF3.4m July 2017	1,750,001 new shares issued @CHF2.0/share
Mandatory convertible loan note – Bruellan	CHF 1.0m July 2017	Converted to 666,668 shares @ CHF1.50/share
Mandatory convertible loan note – Trialford	CHF0.5m July 2017	Converted to 333,334 shares @CHF1.50/share
Convertible Loan – ACE/JADE/LECN	CHF12.0m end H117 CHF11.8m end H117	Transferred to FEFAM, converted to 7,333,333 shares @ CHF1.50 in September. Transferred to FEFAM during H118. Maturity date extended to 30 June 2020
Mandatory convertible loan note – FEFAM	CHF12.0m July 2017	Converted to 8,000,000 shares @ CHF1.50/share in September 2017
Mandatory convertible loan note – Bruellan	CHF3.0m July 2017	Converted to 2,000,00 shares @ CHF1.50/share in September 2017
Convertible loan –FEFAMJADE/LECN	CHF11.0m Sept 17	New agreement. 8%, maturity date September 2020
Mandatory convertible loan note – FEFAM	CHF16.5m Dec 2017	Converted to 11.0m shares @ CHF1.50/share in February 2018
Convertible loan – FEFAM	CHF40.5m Feb 18	CHF34.1m drawn down end June. CHF5.0m drawn down July 2018. CHF24.0m of this to be converted to equity, subject to takeover waiver
Convertible loan – FEFAM	CHF20.0m June 2018	To be provided by end H119.
Conditional facility –FEFAM	CHF50m June 2018	Facility provided for acquisitions and JVs on a ‘right-of-first-offer’ basis for FEFAM <CHF20m allocated for Indian JV to manufacture modules for Sun Mobility programme. CHF4.0m drawn down August 2018. CHF3.6m drawn down September 2018.

Source: Edison Investment Research

Revisions to estimates

At the end of June 2018, management noted that the company was working on a confirmed order book of over 50MWh, which it expected would contribute CHF40-50m revenues in FY18. It did not provide explicit guidance at the time. Our estimates assumed that additional utility-scale orders would be received for delivery in H218, given the size and likely timescales of projects in the pipeline, raising revenues above the CHF40-50m level. However, several contracts relating to utility-scale projects have been delayed because the third parties involved are still in the process of securing project finance. As a result, Leclanché’s management noted at the interim stage that the company was on track to double revenues during FY18. If we treat ‘Other income’, which includes grants for developing an energy storage system for an e-ferry, as revenues, this is equivalent to guidance of at least CHF36m. We therefore revise our estimates to reflect:

- delays in third parties securing financing for several major utility-scale projects during FY18;
- delays in Leclanché completing materials handling projects in FY18;
- slower than expected development of the distribution business affecting FY18, FY19 and FY20;
- high levels of exceptional costs in H118; and
- lower interest charges on convertible loans in line with H118 actuals.

Exhibit 3: Changes to estimates

	FY17	FY18e			FY19e			FY20e		
	Actual	New	Old	% change	New	Old	% change	New	Old	% change
Utility-scale revenues (CHFm)	3.1	31.1	47.3	-34.3%	67.5	67.5	0.0%	101.3	101.3	0.0%
e-transport revenues (CHFm)	0.3	1.0	1.0	0.0%	16.9	16.9	0.0%	17.9	17.9	0.0%
Commercial & industrial revenues (CHFm)	6.0	8.7	10.7	-18.4%	13.3	13.3	0.0%	14.0	14.0	0.0%
Energy efficiency revenues (CHFm)	2.2	1.8	3.2	-43.8%	2.0	3.5	-43.8%	2.2	3.9	-43.8%
Group revenues (CHFm)	11.7	42.5	62.1	-31.5%	99.6	101.2	-1.5%	135.3	137.0	-1.2%
Group EBITDA (CHFm)	(31.2)	(34.3)	(18.5)	84.8%	(9.4)	(8.8)	6.1%	0.1	0.1	-2.2%
Group PBT (CHFm)	(37.9)	(39.4)	(29.7)	32.7%	(16.6)	(21.1)	-21.4%	(7.2)	(12.1)	-40.3%
EPS (CHF)	(0.7)	(0.5)	(0.4)	31.3%	(0.2)	(0.3)	-21.4%	(0.1)	(0.2)	-40.3%
Net debt at year end (CHFm)	19.5	55.3	37.3	48.2%	82.8	69.7	18.8%	97.3	93.9	3.6%

Source: Edison Investment Research

Valuation

Exhibit 4: DCF analysis, CHF/share

		Low case			Base case			High case		
		Discount rate			Discount rate			Discount rate		
	1.96	9.0%	10.0%	13.0%	9.0%	10.0%	13.0%	9.0%	10.0%	13.0%
Term growth	1.0%	1.83	1.32	0.33	2.19	1.63	0.55	3.46	2.74	1.33
	2.0%	2.22	1.60	0.45	2.61	1.94	0.68	4.01	3.13	1.50
	3.0%	2.74	1.96	0.60	3.18	2.33	0.85	4.74	3.64	1.71
	4.0%	3.47	2.45	0.78	3.97	2.86	1.05	5.76	4.32	1.97
	5.0%	4.56	3.12	1.01	5.15	3.59	1.29	7.29	5.27	2.29

Source: Edison Investment Research

Because Leclanché's transition from traditional battery manufacturer to vertically integrated battery energy storage system provider has not yet generated operating profits, the use of peer-based multiples is limited as a valuation methodology. Moreover, while management has good visibility of projects totalling over 1GWh of capacity, there still remains significant uncertainty as to how quickly it will be able to deliver on the projects. Given this level of uncertainty, we present a scenario analysis with the base case adopting the rate of revenue growth and costs as shown in our estimates from 2018 to 2020. Using this as our basis, we model potential revenues rising with a CAGR of 37% between 2018 and 2027, assuming that a substantial proportion of battery cell manufacture from FY20 onwards will be carried out by local partners for projects in China or India, thus reducing capex. Applying a terminal growth rate of 3% and WACC of 10%, (both unchanged since our June note), our base case gives an indicative valuation of CHF2.33/share (previously CHF2.51/share).

Clearly, there is no certainty that the individual projects contributing towards the revenue growth adopted in our valuation will progress as expected. However, we note that the technology being deployed is proven and Leclanché has already demonstrated that it can deliver on large projects. While there remains a risk that individual projects may not come to fruition, there is rising demand for battery energy storage for both stationary grid-related and e-transport applications, with very few companies able to offer the battery modules, energy management software and engineering, procurement and construction services that Leclanché can. This puts it in a good place to win work on alternative projects.

The current share price suggests the market is assuming a slower growth rate than that adopted in our estimates. Our reverse DCF calculation generates an indicative value similar to the current share price when revenues are scaled back by 3% across the forecast period. This indicates the potential for modest share price appreciation as Leclanché demonstrates it is able to convert the existing pipeline and achieve the growth rate shown in our estimates. Giving some view of what might happen to valuation if revenue growth is faster than the rate assumed in our base case, our ‘high’ case shows that scaling up revenues by 10% gives an indicative value of CHF3.64/share.

Exhibit 5: Financial summary

	CHFm	2016	2017	2018e	2019e	2020e
Year-end Dec						
PROFIT & LOSS						
Revenue		28.1	11.7	42.5	99.6	135.3
Cost of Sales		(26.2)	(15.7)	(32.3)	(70.0)	(94.8)
Gross Profit		1.9	(4.0)	10.1	29.6	40.4
EBITDA		(27.4)	(31.2)	(34.3)	(9.4)	0.1
Operating Profit (before amort. and except.)		(33.6)	(35.4)	(37.2)	(12.7)	(3.2)
Amortisation of acquired intangibles		0.0	0.0	0.0	0.0	0.0
Share-based payments		(1.0)	(0.7)	(0.7)	(0.7)	(0.7)
Exceptionals		0.0	0.0	0.0	0.0	0.0
Operating Profit		(34.5)	(36.1)	(37.8)	(13.3)	(3.8)
Net Interest		(3.2)	(2.5)	(2.2)	(3.9)	(4.1)
Profit Before Tax (norm)		(36.8)	(37.9)	(39.4)	(16.6)	(7.2)
Profit Before Tax (FRS 3)		(37.8)	(38.5)	(40.1)	(17.3)	(7.9)
Tax		0.6	0.1	0.0	0.0	0.0
Profit After Tax (norm)		(36.3)	(37.8)	(39.4)	(16.6)	(7.2)
Profit After Tax (FRS 3)		(37.2)	(38.5)	(40.1)	(17.3)	(7.9)
Minority interest		0.0	0.0	0.0	0.0	0.0
Net income (norm)		(36.3)	(37.8)	(39.4)	(16.6)	(7.2)
Net income (FRS 3)		(37.2)	(38.5)	(40.1)	(17.3)	(7.9)
Average Number of Shares Outstanding (m)		42.7	55.3	76.0	80.7	80.7
EPS - normalised (CHFc)		(85.0)	(68.4)	(51.8)	(20.6)	(9.0)
EPS - normalised fully diluted (CHFc)		(85.0)	(68.4)	(51.8)	(20.4)	(8.9)
EPS - FRS 3 (CHFc)		(87.2)	(69.6)	(52.7)	(21.2)	(9.7)
Dividend per share (CHFc)		0.0	0.0	0.0	0.0	0.0
Gross Margin (%)		6.8	(33.9)	23.9	29.7	29.9
EBITDA Margin (%)		N/A	N/A	N/A	N/A	N/A
Operating Margin (before GW and except.) (%)		N/A	N/A	N/A	N/A	N/A
BALANCE SHEET						
Fixed Assets		16.9	16.6	27.7	30.0	32.3
Intangible Assets		6.9	4.5	3.9	3.3	2.7
Tangible Assets and Deferred tax assets		10.0	12.1	23.8	26.7	29.6
Current Assets		35.6	52.1	33.9	48.3	48.5
Stocks		9.6	12.7	9.3	19.1	24.1
Debtors		21.5	32.8	8.1	16.4	22.2
Cash		4.5	6.6	16.5	12.8	2.2
Current Liabilities		(46.2)	(35.7)	(7.4)	(16.7)	(22.6)
Creditors including tax, social security and provisions		(23.9)	(20.6)	(7.3)	(16.6)	(22.5)
Short term borrowings		(22.3)	(15.1)	(0.1)	(0.1)	(0.1)
Long Term Liabilities		(11.6)	(22.1)	(82.7)	(106.5)	(110.5)
Long term borrowings*		0.0	(11.0)	(71.7)	(95.5)	(99.4)
Retirement benefit obligation		(9.5)	(8.5)	(8.5)	(8.5)	(8.5)
Other long term liabilities		(2.1)	(2.6)	(2.6)	(2.6)	(2.6)
Net Assets		(5.3)	11.0	(28.4)	(45.0)	(52.3)
Minority interest		0.0	0.0	0.0	0.0	0.0
Shareholders’ equity		(5.3)	11.0	(28.4)	(45.0)	(52.3)
CASH FLOW						
Operating Cash Flow		(34.2)	(44.6)	(19.6)	(18.0)	(4.9)
Net Interest		(0.1)	(0.1)	(0.1)	(0.1)	(0.1)
Tax		0.0	0.1	0.0	0.0	0.0
Investment activities		1.6	(6.6)	(14.0)	(5.6)	(5.6)
Acquisitions/disposals		0.0	0.0	0.0	0.0	0.0
Equity financing and other financing activities		3.9	6.5	0.0	0.0	0.0
Dividends		0.0	0.0	0.0	0.0	0.0
Net Cash Flow		(28.7)	(44.7)	(33.7)	(23.7)	(10.6)
Opening net debt/(cash)		5.3	17.8	19.5	55.3	82.8
HP finance leases initiated		0.0	0.0	0.0	0.0	0.0
Other**		(16.2)	(43.0)	2.1	3.8	4.0
Closing net debt/(cash)		17.8	19.5	55.3	82.8	97.3

Source: Company accounts, Edison Investment Research. Note: *Treating all outstanding convertible loan notes as debt, including CHF54m where approval is sought from the Swiss Takeover Board for conversion. Excluding conditional facility from FEFAM. **Other relates to convertible note movements and accrued interest.

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