PITT STREET RESEARCH

Clean TeQ Water

CNQ continues to move ahead

Share Price: A$0.55

ASX: CNQ

Sector: Industrials

31 May 2022

Clean TeQ Water (ASX: CNQ) is a water technology company that develops and sells customised turn-key water treatment plants to customers globally. Its core-platform technology, Clean-iX, operates on the continuous ion-exchange principle. Based off Clean-iX, CNQ has built a portfolio of patented innovative technologies that seek to capitalise on a range of verticals.

We believe that CNQ is well placed to benefit from the growth in the water technology market as it has a strong project pipeline as well as high operating leverage. The company's footprints in the ground water treatment market are likely to improve after the recent bore water treatment contract with Power Water Corporation (PWC). Expansion of the footprints is likely to further open up opportunities for follow-up work in the Northern territory and beyond. The company also has been executing projects successfully across the municipal, industrial and mining sectors. It has a strong project pipeline of US$700m with 20% of the projects due for investment decision in next 12 months.

CNQ's win of bore treatment contract is a step forward

CNQ was recently awarded a contract with PWC to deliver a water treatment plant to one of the 72 remote communities in the Northern Territories of Australia. Valued at A$5m, the contract is amongst the largest in CNQ's water history in terms of contract value. The company will use its ion exchange resin technology to design and manufacture the treatment plant. The contract win is likely to provide more business opportunities for the company to deliver larger and more complex plants in a growing ground water treatment market.

NematiQ achieves manufacturing milestone for Graphene membrane

CNQ's 100% owned subsidiary NematiQ achieved a major milestone in March 2022 as it started manufacturing graphene membranes on an industrial commercial scale roll-to-roll coating machine. The membranes offer customers significant benefits in operation over conventional polymeric nano-filtration products.

Valuation range remains A$1.83-2.37 per share

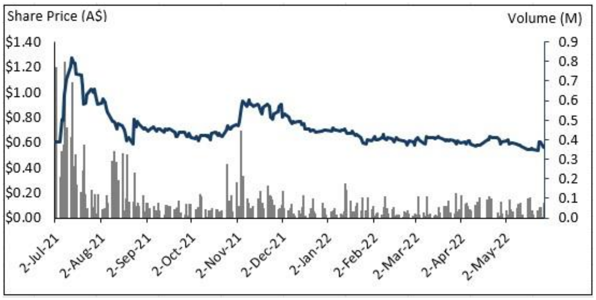
We reiterate our valuation of the company at A$1.83 per share in the base case and A$2.37 per share in the bull case, using a blended DCF/RV model.

Please refer to page 5 for details on target price catalysts and risks

Market cap. (A$m)	24.6
# shares outstanding (m)	44.7
# shares fully diluted (m)	49.7
Market cap full. dil. (A$m)	27.3
Free float	67.0%
52-week high/low (A$)	1.45/0.5
Avg. 12M daily volume (m)	0.08
Website	cleanteqwater.com

Source: Company, Pitt Street Research

Share price (A$) and avg. daily volume (m, r.h.s.)



Source: Refinitiv Eikon, Pitt Street Research

Valuation metrics	
Valuation per share (A$)	1.83-2.37

Source: Pitt Street Research

Analysts: Marc Kennis, Nick Sundich

Tel: +61 (0)4 3483 8134

Marc.Kennis@pittstreetresearch.com

Nick.Sundich@pittstreetresearch.com

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Table of Contents

CNQ bags contract for Bore Water Treatment Plant

Bore water treatment plant contract presents strong expansion opportunities for CNQ in the ground water treatment market

On 11 May 2022, CNQ was awarded a contract with Power Water Corporation (PWC) to supply a water treatment plant in Laramba. The treatment plant will remove pollutants from bore water and will treat 360 tons of water per day to meet the Australian drinking water guidelines. The contract is valued at approximately A$5m and will be the largest single contract value in CNQ's water history.

The Letter of Intent (LOI) was signed in March 2022 and the plant's practical completion date has been slated for 16th December 2022. The contract is already in the design phase. Due to early start of the design work under the LOI, no material conditions are required to be fulfilled before the legal enforcement of the contract.

About the Water Treatment contract

For the treatment plant, CNQ will use its ion exchange resin technology for the design, manufacture and delivery of the plant. Pollutants such as uranium and nitrate can be reliably and selectively removed, the volume of secondary waste can be minimized, and the necessary maintenance can be ensured by the resin technologies. Consequently, the resin technology is conducive for usage of groundwater treatment in remote locations.

The treatment plant is amongst the first under Northern Territory Government's A$28m programme that focuses on improving water security in local communities across the NT.

How the contract is beneficial for CNQ

In our view, the company's footprint in the ground water treatment market would significantly increase from the bore water treatment contract due to the rising demand for groundwater treatment technologies. Groundwater is becoming increasingly important for water security in the Northern Territory as temperatures are expected to rise as a result of climate change.

In general, the need for groundwater treatment technologies is increasing globally due to increased economic activity, climate change, declining ground water levels, and increasing pollution. Against this backdrop, CNQ could witness an expansion in its footprint for groundwater treatment market after the contract. It will also be better placed to deliver larger and more complex plants.

Bore Water Treatment contract succeeds Townsville update

CNQ's latest award of the contract for the Bore Water Treatment Plant comes after the recent update by Townsville City Council on December 03, 2021. This along with the possibility of a new tender by Townsville Council could bode well for its growth prospects. The Townsville City council notified CNQ of the possibility of a new tender issuance as there were changes made to the scope of the Recycled Water Treatment Facility project.

The tender specifications and scope released by the Council cover the construction of a pipeline and some packages for water treatment. However, they do not cover a recycling facility for producing industrial water which was a key component of the previous tender. The council indicated that the next phase would include the full recycling plant. CNQ plans to bid for the more restricted scope of water treatment in the current tender in cooperation with a civil contractor. CNQ's experience and understanding of the project make it optimistic on its likelihood of winning the new tender as it has conducted extensive testing on the site.

A glance at recent results

Integrated management structure, sound commercialization abilities and demerger from Sunrise contributed to robust revenue during the interim period

During the interim period (the duration from CNQ's date of incorporation February 15, 2021 to December 31, 2021), CNQ's revenues stood at A$7.3m, with 90% contribution from the sales and delivery of advanced water treatment equipment packages. The remaining 10% came from consumables and recurring revenues from operating plants. The solid revenue is driven by the setting up of an integrated management structure and strong commercial capabilities. The robust revenue generation also marks the successful completion of its demerger process. CNQ demerged from its parent company Sunrise Energy Metals Limited (Sunrise) on July 1, 2021.

In Q3 2022, CNQ's reported receipts from customers declined by 58% on a q-o-q basis to A$1.6m. The company's cash balance decreased from A$11.2m as of December 31, 2021 to A$8m as of March 31, 2022, mainly due to difference in timing in the receipt of project payments. Despite a decrease in cash balance, the company seems well placed to meet its financial obligations in the near term (~7.3 months).

Management remains confident on the prospects of the projects it is pursuing in the municipal, industrial and mining sectors. It has a strong project pipeline of US$700m with 20% of the projects due for investment decision in next 12 months.

Projects under implementation

CNQ is positioned for ongoing growth in the water technology market. It aims to achieve this through execution of its strong project pipeline at better operating leverage. Completion of projects currently in implementation is likely to fast track its growth.

Implementation of CNQ's existing contracts likely to lend a significant boost to the company's prospects

Over the quarter, significant strides were made in the implementation of existing contracts by CNQ. These included the HIROX project in the Middle East, BIONEX project in China, EVAPX project in New South Wales and Koumala drinking water project. Most of these contracts have moved into the final phases of shipping and construction. Substantial interest in the projects has been seen by potential clients due to their demonstration of the company's capabilities in several market sectors. CNQ's prospects in new regions and technology applications are likely to be enhanced due to successful delivery of the projects. Additionally, several metal recovery initiatives are underway. Test work is also being undertaken in vanadium and copper in particular.

NematiQ achieves commercial scale manufacturing of Graphene membrane

CNQ's wholly owned subsidiary, NemaTiQ, has developed a ground-breaking graphene membrane technology and has successfully printed 1000 metres of graphene membranes. Commercial scale manufacturing on industrial roll-to-roll coating machine was achieved in March 2022 and the company is currently preparing for field pilot studies. The membranes will now be incorporated into modules and will be used for field demonstration over the next few months.

Customers are likely to reap significant benefits from the operation of Graphene membranes over conventional polymeric nanofiltration products. The benefits consist of energy savings, improved water recovery rates, chemical-free processes, and improved quality of its by-products. Discussions are being conducted with potential customers on field demonstration in a number of verticals.

We believe that there is a huge market opportunity waiting for NematiQ as graphene membranes market for selectively removing micro pollutants is estimated to grow toA$5b annually.

Valuation: CNQ has significant upside potential

Using a relative, peer group valuation, we reiterate the valuation of the company at A$1.83 per share in the base case and A$2.37 per share in the bull case. This is derived from a blended DCF and relative valuation with the latter being based on peer comparison EV/Sales. As we outlined in our initiation report, published on 19 August 2021, we believe CNQ's water treatment business alone justifies its current value and that investors aren't ascribing much value (if any) for the Graphene Membrane business.

One might argue it did not deserve value back in August when it had not started manufacturing graphene membranes on a commercial scale yet. But now that CNQ has commenced manufacturing, we believe this does deserve value in its own right. We also believe that Clean-iX could help CNQ develop additional ion exchange solutions to exploit water treatment applications and verticals. This optionality provides upside potential to our fair value estimates but also act as a valuation buffer should any of the downside risks (as outlined below) eventuate.

Finally, turning back to CNQ's water treatment business, we think the expansion of the groundwater treatment market for the company from the contract by the Power Water Corporation will provide the necessary support to our rationale.

Catalysts

We have identified the following potential near-term events as important facilitators for share price

- Successful results from current pilot programmes
- A contract win from Townsville City Council
- Commencement of new pilot-scale projects in existing and new markets
- Faster-than-expected commercialization of the Graphene membrane

Risks

We see the following as key risks to our investment thesis:

- **Uptake risk:** There is a risk that CNQ may not be able to gain traction in its target markets. There is no guarantee that CNQ will be able to secure a specific number of customer contracts and thereby generate revenues over the short, medium and long term.
- **Delay risk:** Pilot programmes could take longer than expected to complete pushing back the timing of expected revenues and cash flows.
- **Commercial risk:** There is no guarantee that the completion of pilot programmes will lead to one or more large-scale projects. This risk can result in CNQ generating lower than expected revenues
- **Competition risk:** There is the "what if" scenario where new and/or existing competitors come up with better and cheaper products that seek

to address the same market opportunity as CNQ. If the risk materializes, it can hamper CNQ's market share growth and margins.

– **Regulation risk:** Demand for CNQ's products is highly sensitive to changes in the global regulatory environment. Although regulation currently works in favour of CNQ, any future changes could impact the business either positively or negatively.
– **Funding risk:** If one or more of the above risks eventuate, it could take CNQ longer to become operating free cashflow positive. This would mean CNQ could need to tap the equity and debt markets for additional capital.

Appendix I – Analyst Qualifications

Marc Kennis, lead analyst on this report, has been working as an equities analyst since 1997.

- Marc obtained an MSc in Economics from Tilburg University, Netherlands, in 1996 and a post graduate degree in investment analysis in 2001.
- Since 1996, he has worked for a variety of brokers and banks in the Netherlands, including ING and Rabobank, where his main focus has been on the Technology sector, including the Semiconductor sector.
- After moving to Sydney in 2014, he worked for several Sydney-based brokers before setting up TMT Analytics Pty Ltd, an issuer-sponsored equities research firm.
- In July 2016, with Stuart Roberts, Marc co-founded Pitt Street Research Pty Ltd, which provides issuer-sponsored research on ASX-listed companies across the entire market, including Technology companies.

Nick Sundich is an equities research analyst at Pitt Street Research.

- Nick obtained a Bachelor of Commerce/Bachelor of Arts from the University of Sydney in 2018. He has also completed the CFA Investment Foundations program.
- He joined Pitt Street Research in January 2022. Previously, he worked for over three years as a financial journalist at Stockhead.
- While at university, he worked for a handful of corporate advisory firms.

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