Clean TeQ Water Ltd

Continues to execute

Share Price: $0.89

ASX: CNQ
Sector: Industrials
5 November 2021

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 seeks to capitalise on a range of verticals with an estimated combined TAM of >US$45B.

Continues to win contracts

CNQ won two new contracts in 1Q FY22: 1) installation of a $3M HIROX plant for National Energy Services Reunited Corp (NASDAQ: NESR), an oilfield services provider in the Middle East and North Africa region, and 2) installation of a $1.6M EVAPX system at a processing facility in Australia.

We are encouraged by the signing of the HIROX project as it marks the first application of CNQ's HIROX technology in the Middle East. Once the plant is set up and running, we expect it to help NESR to achieve high water recovery. In turn, we believe this will result in NESR actively promoting HIROX to prospective customers in the Middle East region, which we expect to drive more contract wins in the near/medium term.

On the EVAPX project, we think it underscores the increasing significance of EVAPX's zero liquid discharge (ZLD) solution. Importantly, EVAPX is also energy efficient as the system can be powered and operated by waste heat energy and as such, results in a lower carbon footprint vs. conventional solutions. Given the push for sustainability and stricter environmental and discharge regulations, we anticipate more companies to transition towards ZLD. This should drive higher deployment of technologies like EVAPX in the coming years.

As CNQ grows and continues to prove up their technologies, we think the nexus between pilots and large-scale projects will likely weaken, meaning lesser customers will require field pilots/testing. This could shorten CNQ's sales cycle, which we expect to bring upside potential to its future cashflows.

Valuation upgraded to $1.83 per share

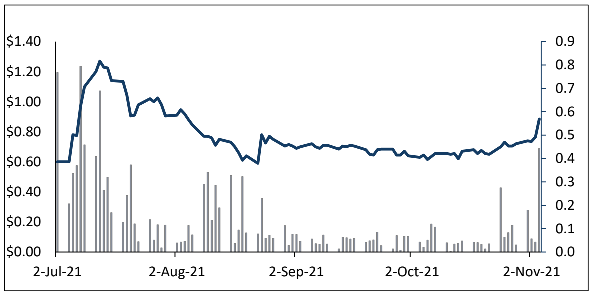
Based on our revised FY22e sales forecasts, we have re-run our relative valuation model, generating $1.83ps base case and $2.37ps bull case (previous: $1.65ps – 2.18ps). We have retained our target sales multiples for FY22e at 7.9x – 8.7x.

Please refer to page 4 for details on share price catalysts and risks.

Market Cap. (A$ m)	39.5
# shares outstanding (m)	44.7
# share fully diluted	44.7
Market Cap Ful. Dil. (A$ m)	39.5
Free Float	64.1%
12 months high/low	1.45 / 0.50
Average daily volume (m)	0.1
Website	cleanteqwater.com

Source: Company, Pitt Street Research

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



Source: CommSec, Pitt Street Research

Relative valuation	
Fair value (A$ per share)	1.83 – 2.37

Source: Pitt Street Research

Analysts: Cheng Ge, Stuart Roberts

Tel: +61 (0)447 247 909

cheng.ge@pittstreetresearch.com
stuart.roberts@pittstreetresearch.com

Sales momentum building

New contract wins

1Q FY22 saw CNQ landing two new contracts:

- **NESR HIROX contract** – Installation of a $3M HIROX plant for National Energy Services Reunited Corp (NASDAQ: NESR), a large oilfield services provider in the Middle East and North Africa (MENA) region. We view this project as significant for CNQ as it marks the first application of its HIROX technology in MENA. Once the plant is set up and running, we expect it to help NESR to achieve high water recovery. In turn, this should result in NESR actively promoting HIROX to prospective customers in MENA, which we expect to underpin further contract wins over the near/medium term.

Momentum in contract wins continuing to build…

- **EVAPX contract** – Installation of a $1.6M EVAPX system at a processing facility in Australia. We explained how CNQ's technologies function in our initiation coverage including EVAPX. We believe this project underscores the increasing significance of EVAPX's zero liquid discharge (ZLD) offering. Importantly, EVAPX is also energy efficient as the system can be powered and operated by waste heat energy and as such, results in a lower carbon footprint versus conventional solutions. Given the push for sustainability and stricter environmental and discharge regulations, we anticipate more companies to transition towards ZLD. This should drive an uplift in the deployment of technologies like EVAPX in the coming years.

Revision to FY22e sales forecast

We have revised sales forecast for FY22e to $8.6M base case and $10.6M bull case (previous: $7.4M – $9.5M).

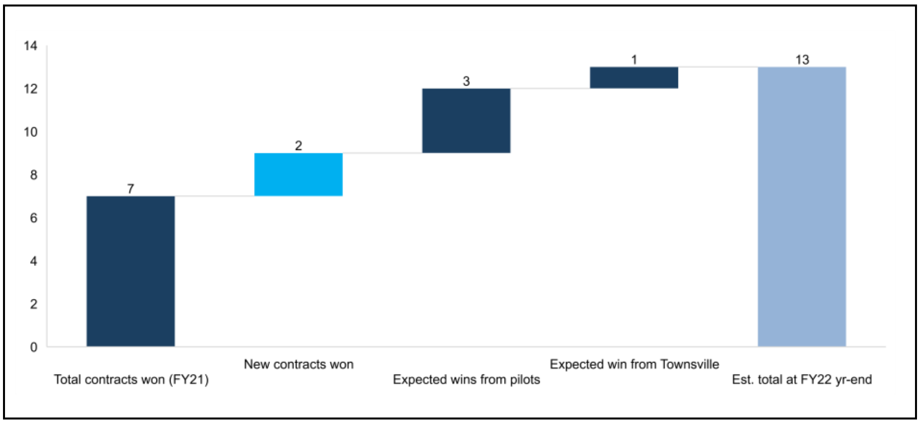
- **Direct sales**: We have added the two new contract values of $4.6M to our initial sales forecasts. This assumes both projects will become operational within FY22e.[1] On our initial expected contract wins (4 for base case[2] and 6 for bull case), we have realised there is a possibility that not all of those expected large-scale projects will be completed within FY22e and as such, CNQ might not realise the full contract values for those projects in FY22e. To be conservative, we have discounted our initial direct sales by 40-50%. Taken altogether, our revised direct sales of water solutions for FY22e are $8.1M base case and $10.0M bull case.
- **Consumable sales**: We have increased CNQ's cumulative no. of contracts by factoring in its two new contract wins. If we retain the assumption that sales of consumables constitute 2% of overall contracts, we would derive $0.5M base case and $0.6M bull case.

Valuation upgraded to $1.83 per share

Based on our revised sales forecasts for FY22e, we have re-run our relative valuation model. This has generated $1.83ps base case and $2.37ps bull case (previous: $1.65ps – 2.18ps). We have retained our target sales multiples for FY22e at 7.9x – 8.7x (Figure 3).

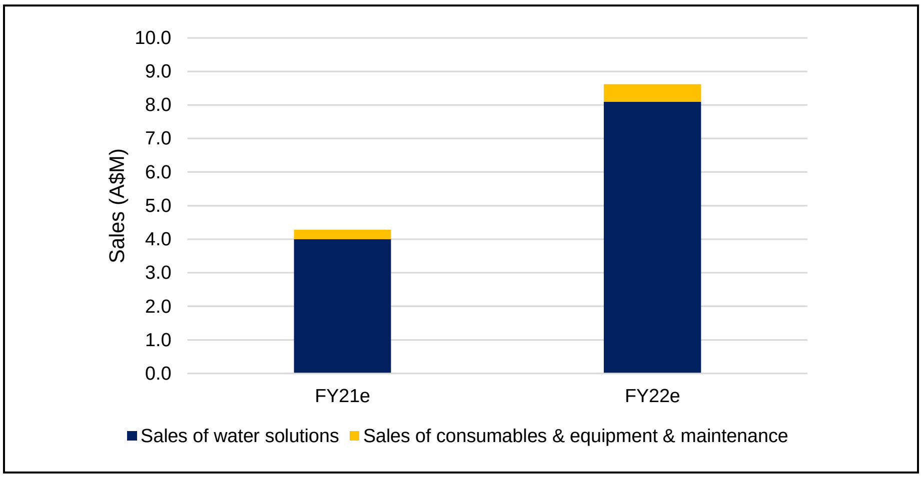
[1] CNQ stated that its new EVAPX project is scheduled to become operational in 2Q CY22e (i.e., 4Q FY22e).
[2] We have assumed 3 wins from pilots' conversion and 1 win from Townsville (see Figure 1).

Figure 1: Expected contract wins for FY22e



Sources: Pitt Street Research estimates

Figure 2: Sales profile



Sources: Pitt Street Research estimates

Figure 3: Relative valuation summary

BASE CASE

Equity value determination (AUDm unless specified otherwise)	EV/Sales
Target Sales Multiple	7.9
Sales FY22F	8.6
Implied EV	68.0
Net debt (cash)	(13.8)
Equity value	**81.8**
Shares outstanding	44.7
Implied price (AUD)	**1.83**
Current price (AUD)	0.89
Upside (%)	*107%*

BULL CASE

Equity value determination (AUDm unless specified otherwise)	EV/Sales
Target Sales Multiple	8.7
Sales FY22F	10.6
Implied EV	91.9
Net debt (cash)	(13.8)
Equity value	**105.7**
Shares outstanding	44.7
Implied price (AUD)	**2.37**
Current price (AUD)	0.89
Upside (%)	*167%*

Sources: Pitt Street Research

Catalysts

We have identified the following near-term events as important facilitators of moving the current stock price towards our fair valuation range:

- New contract wins;
- Successful results from current pilot programs;
- Contract win from Townsville City Council;
- Commencement of new pilot-scale projects in existing and new markets;
- Faster-than-expected commercialisation of Graphene Membrane.

Risks

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

- **Uptake risk**: There is a risk that CNQ may not 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 programs could take longer than expected to complete. This could push back the timing of expected revenues and cashflows.
- **Commercial risk**: There is no guarantee that the completion of pilot programs will lead to one or more large-scale projects. This risk can result in CNQ generating sales lower than our expectations.
- **Competition risk**: There is the "what if" scenario where new and/or existing competitors coming up with a better and cheaper product that seeks to address the same market opportunity set as CNQ. If this risk materialises, 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 acts in favour of CNQ, any future changes could impact on the business both positively and negatively.
- **Funding risk**: If one or more of the above risks eventuate, CNQ could take longer to reach the scale needed to generate internal cashflows to fund its operations. This means CNQ will need to tap the equity and/or debt markets for a capital raise.

Analysts' qualifications

Cheng Ge, lead analyst on this report, is an equity research analyst at Pitt Street Research.

- Cheng obtained a B.Com in Finance and LL.B from University of New South Wales, in 2013. He also completed all three levels of the CFA Program.
- Before joining Pitt Street Research, he worked for several financial services firms in Sydney, where his focus was on financial advice.
- He joined Pitt Street Research in January 2020.

Stuart Roberts has been covering the Life Sciences sector since 2002.

- Stuart obtained a Master of Applied Finance and Investment from the Securities Institute of Australia in 2002. Previously, from the Securities Institute of Australia, he obtained a Certificate of Financial Markets (1994) and a Graduate Diploma in Finance and Investment (1999).
- Stuart joined Southern Cross Equities as an equities analyst in April 2001. From February 2002 to July 2013, his research specialty at Southern Cross Equities and its acquirer, Bell Potter Securities, was Healthcare and Biotechnology. During this time, he covered a variety of established healthcare companies such as CSL, Cochlear and Resmed, as well as numerous emerging companies. Stuart was a Healthcare and Biotechnology analyst at Baillieu Holst from October 2013 to January 2015.
- After 15 months in 2015 and 2016 doing Investor Relations for two ASX listed cancer drug developers, Stuart founded NDF Research in May 2016 to provide issuer-sponsored equity research on ASX-listed Life Science companies.
- In July 2016, with Marc Kennis, Stuart co-founded Pitt Street Research Pty Ltd, which provides issuer-sponsored research on ASX-listed companies across the entire market, including Life Science companies.

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