

ESG Investor Spotlight on Climate Change and Water

As world leaders gather in Glasgow for the United Nations Climate Change Conference (also known as COP26) one has to be aware that as the world continues to suffer from more severe weather, some of the things we take for granted may become more costly and/or scarce. The impact of extreme heat and droughts could potentially affect the supply and availability of clean water for drinking, as well as for irrigation and our supply of fresh food. Albeit COP26 is primarily focused on mitigating greenhouse gas emissions, we need to look past that to what the consequences of a changing environment could have on humanity. For years, if not decades, clean water has been portrayed as a critical commodity whose time will come. Perhaps now that weather patterns appear to be getting more volatile, we may finally be seeing the start of this.

Today we are updating an InvestorIntel favorite – H2O Innovation Inc. (TSXV: HEO | OTCQX: HEOFF) which designs, manufactures and commissions customized membrane water treatment systems, provides operation and maintenance services for that equipment, and designs, manufactures and sells a complete line of OEM specialty products such as chemicals, consumables, couplings, fittings, cartridge filters and other components for multiple markets in the water treatment industry. For the last 20 years the company has designed and fabricated state-of-the-art, integrated water treatment solutions for municipal, energy production, and natural resource end users, specializing in applications for drinking water, water reuse, wastewater treatment and industrial process water. Developed in-house, the company's solutions are custom designed, adapted and built for all types of applications.

The Company breaks down its activities into three operating

segments: Water Technologies & Services (WTS), which designs and builds custom water, wastewater and water reuse systems; Specialty Products (SP), utilizing a global network of more than 100 distribution partners to manufacture and deliver specialty chemicals, components, and consumables to end-users, with a particular focus on membrane applications; and Operations and Maintenance (O&M), for contract operations for water, wastewater, water reuse treatment, collection, distribution systems, pumping stations, and associated assets for customers throughout North America.

At the end of September, the Company released its results for its fiscal year ended June 30, 2021, reporting record fiscal year 2021, revenues and profitability. Highlights included annual revenues reaching \$144.3 million, representing a \$10.7 million growth or 8.0 % year over year; net earnings of \$3.1 million, or \$0.039 per share, compared to a net loss of \$4.2 million, or \$0.061 per share, for the previous fiscal year; and a strong financial position with a net debt of \$0.5 million at year end, compared to a net debt of \$10.5 million as of June 30, 2020. On the M&A side, H2O Innovation completed two acquisitions complementing its O&M services in Texas, and expanded its reach in Spain and Latin America with the acquisition of Genesys Membrane Products, S.L., a specialty products marketing and sales network.

The Company fell a little short of market expectations, however, despite the positive results, and the stock lost 10% upon the announcement of its fiscal 2021 numbers. However, redemption may be right around the corner when Q1 results for the current fiscal year come out on Wednesday, November 10th. If we ask why an investor should be optimistic, the answer is that since June 30th H2O Innovations has announced an O&M contract for the City of Laurel, MS with a total value of \$10.4 million over 4 years; it has also been awarded six new capital equipment projects in its WTS business line, and reached completion on six others, with the new contracts

valued at \$4.8 million; its Piedmont business line secured new orders for fiber reinforced polyester cartridge filter housings and duplex stainless couplings totaling \$4.0 million along with the signing of five new distribution agreements in Latin America; and its SP business line has been selected to provide antiscalant to the world's largest seawater reverse osmosis desalination plant. This is important because one of primary focuses of H2O Innovations is building recurring revenues across its three business segments, and it has realized an 87% threshold. That suggests that all the above announcements should be additive to the upcoming Q1 results.

Thankfully the planet earth hasn't descended into the harsh, inhospitable environment of the desert planet, *Arrakis*, the setting of the latest version of the movie "*Dune*" based on the must-read book(s) by *Frank Herbert*. But as the reliability of fresh water becomes more of a concern, it's good to know that companies like H2O Innovations have our back. Perhaps we are finally starting to see the commoditization of water that could make the stewards of clean water, like H2O Innovations, which was Water Company of the Year at the 2020 Global Water Awards, very important and valuable. In the meantime, this Company with its recurring revenues, clean balance sheet and a market cap of just over \$200 million.

With 7 Analysts on board and up almost 140% in the past twelve months this attractive

water pure-play is a true ESG

On May 13, **H2O Innovations** (TSXV: **HEO** | OTC: **HEOFF** | FSE: **DB: H301**) announced fiscal third-quarter financial results for the month ending March 31, 2021.

The company started the year off strong with quarterly revenue up 8.6% year-over-year and net earnings hitting C\$2.1 million in the quarter, up from a loss of C\$3.1 million in the same fiscal period last year.

H2O beat analysts' consensus revenue and earnings estimates as revenue hit C\$39.2 million in the quarter, up from C\$36.1 million in the same quarter last year, with revenue increases coming from both organic growth and through acquisitions.

Gross profit margins remained strong at 28%, consistent with the margins last year, and adjusted EBITDA reached C\$4.5 million or 11.5% of revenues, compared to C\$3.8 million, or 10.5 % of revenues, for the same fiscal period last year.

Most importantly, operational cash flows hit a record C\$10.2 million in the quarter up from C\$0.9 million in the comparable quarter of the previous fiscal year.

Understanding H2O

H2O is a Canadian wastewater treatment solutions company that designs, builds, and supports facilities based on membrane filtration technologies for municipal, industrial, energy, and natural resources end-users.

H2O operates through three main business segments:

1. *Water Technologies and Services (WTS)*, which designs and builds custom water, wastewater, and water reuse systems and treatment plants, with more than 750 systems installed in North America;
2. *Specialty Products (SP)*, which develops specialized

chemicals and consumables from its subsidiaries, such as **Maple**, **PWT**, **Genesys**, and **Piedmont**, and distributes through a network of over 100 partners; and,

3. *Operation and Maintenance (O&M)*, which operates more than 275 facilities in 12 states in the U.S. and two Canadian provinces.

Figure 1: Three main business segments – Water Technologies and Services (WTS), Specialty Products (SP), and Operation and Maintenance (O&M)



Source:

Solid Pipeline of New Sales and Renewals

Earlier this month, **H2O** announced winning two new projects and renewed four operation and maintenance contracts in the O&M business segment, with a total value of C\$3.3 million. With these contracts, the total O&M backlog increased to C\$63.5 million.

The new contracts comprise the operation, maintenance, and management of a Municipal water treatment facility in Texas

and the operation and maintenance of an effluent treatment facility at an agriculture-food processing plant in Alberta, Canada.

H2O also renewed four municipal O&M contracts in Vermont with the first contract renewed for over five years, the second and third contracts extended for five years, and the fourth contract was renewed until March 2022.

M&A Driving Growth

As part of its 3-year strategic plan announced in December 2020, **H2O** commented that it intended to complete between two to four acquisitions within the next 30 months.

In February 2021, the company closed the acquisition of the remaining 76% of **Genesys Membrane Products (GMP)** in Spain that it originally had taken a 24% ownership stake in through the acquisition of **Genesys** in the United Kingdom in 2019.

GMP reported revenue of approximately €5.00 million (C\$7.75 million) in 2020 of which 24% was already accounted for in **H2O** financials.

GMP expands the company's specialty chemical products and laboratory services to an international distributor network that focuses on Latin America, primarily within the mining industry.

In July 2020, **H2O** announced a C\$3.7 million acquisition of **Gulf Utility Service (GUS)**, a U.S. water utilities company. **GUS** booked revenue of approximately US\$5.0 million and EBITDA of US\$0.6 million in 2019.

In the recent quarter, over 95% of the revenue growth was from its recent M&A activity; the **GUS** acquisition contributed C\$1.3 million in additional revenue and the acquisition of **GMP** in February contributed an additional C\$1.5 million in revenue.

Biden's Infrastructure Plan Adding Billions to a Hundred-

Billion-Dollar Market

In April, the U.S. legislators passed the “Drinking Water and Wastewater Infrastructure Act of 2021” that authorizes almost US\$35 billion over five years to a variety of programs focused on safe drinking water, wastewater treatment, sewer overflows, and stormwater management.

This Act is only the first part of President Biden’s US\$111 billion plan for water infrastructure improvements as a component of the American Jobs Plan.

In H2O’s recent quarterly conference call, CEO Frédéric Dugré stated, “we want to reiterate that we welcome very positively the \$30 billion water-related infrastructure plan announced earlier by President Biden at the end of April. We believe many opportunities will emerge from this stimulus plan, notably for new water reuse projects in order to fight back the growing water scarcity mode in Southern states.”

Even without these new U.S. government funding initiatives, the global water market is expected to grow from US\$854.0 billion this year to US\$914.9 billion by 2023, according to the latest report published by **Global Water Intelligence (GWI)**.

GWI’s Global Water and Wastewater Treatment market consist of both operating and capital expenditures by utilities and industrial water users on water and wastewater.

The Water and Wastewater Treatment market experienced renewed activity and high growth due to declining water qualities and growing demand for cost-efficient and environmentally friendly water technologies and services.

However, several challenges hinder the Water and Wastewater Treatment market, including high capital costs for equipment, outdated and inefficient water infrastructures. Companies such as **H2O** benefit as governments look to reduce costs by shifting

operations to third-party Water and Wastewater Treatment companies.

Final Thoughts

As Environmental, Social, and Governance (ESG) investing causes a shift towards finding long-term financial returns that are aligned with social values, H2O remains an attractive water pure-play with a strong balance sheet, a large sales backlog, and profits.

H2O's stock is currently trading at C\$2.40 per share, up almost 140% in the past twelve months. Seven analysts cover the company, all with a "Buy" rating, and price targets ranging from C\$3.25 to C\$4.00. Currently, H2O has a market cap of C\$197.4 million.

Dugré on H2O Innovation FY2020 Results, \$133.6M in Revenue and a 20th Anniversary

InvestorIntel's Peter Clausi speaks with Frédéric Dugré, President and CEO of H2O Innovation Inc. (TSXV: HEO | OTCQX: HE0FF), about H2O Innovation's record FY2020 fourth quarter results.

In an InvestorIntel interview that can also be viewed on our InvestorIntel YouTube channel, Peter and Frédéric discussed H2O Innovation's recently announced financial results which reported \$133.6 million in revenues. "85% of our

sales rely on recurring revenues,” Frédéric explains, and with a backlog of orders at \$125 million, he said it adds “predictability to our business.” He also explains the unique aspects of the company’s business model that have allowed it to navigate through the COVID-19 crisis in a “remarkable way” and have helped strengthen its balance sheet through acquisitions and organic growth.

To watch this interview, [click here](#)

To learn more about H2O Innovation Inc., [click here](#)

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H2O Innovation walks on water with \$133 million in revenue at year end

Water, water everywhere... Most of us have the luxury of not giving water much thought, but it is a business. Big business.

H2O Innovation Inc. (TSXV: HEO | OTCQX: HEOFF) is making waves in the world of water and wastewater solutions. The company’s just released results for fiscal 2020 (June 30 year-end) showed significant revenue growth in a year with the dominant headline being the global virus pandemic. Top-line revenue of \$133.6 million was up more than \$15 million from \$118 million the previous fiscal year – who knew water handling could be so lucrative? Many investors don’t even know the company exists, but results like these could make them sit up and take notice.

In addition to the impressive revenue growth in fiscal 2020,

the company also saw big improvements in financial performance:

- Gross profit margin before depreciation and amortization expenses represented 26.9% of the company's total revenues for fiscal year 2020, compared to 23.0% for the previous fiscal year;
- Adjusted EBITDA reached \$12.5 million, or 9.4% of revenues, for this fiscal year compared to \$7.2 million, or 6.1% of revenues, for the previous fiscal year;
- Earnings of \$0.9 million before impairment and restructuring costs for the 2020 fiscal year, compared to a loss of \$2.2 million before impairment and restructuring costs of nil for the previous fiscal year;
- Net earnings of \$0.8 million for the fourth quarter of fiscal year 2020, compared to a net loss of \$1.2 million for the comparable quarter of the previous fiscal year; and,
- Cash flows from operating activities generated \$12.3 million in cash for this fiscal year, compared to \$5.8 million of cash flows from operating activities generated during the previous fiscal year

As highlighted in a recent new equity analyst research report by Desjardins Securities (the company now has research coverage by a total of six brokerage firms in Canada and one in the US), H2O Innovation's "business has been highly resilient amid COVID-19 given its status as an essential service provider. Published results have been solid and the backlog remains healthy. We have a high degree of confidence that the company would be able to navigate a potential second wave." 

H2O Innovation provides solutions for drinking water, wastewater and water reuse applications in several market segments, including municipal, oil & gas, and food & beverage. It designs, manufactures and commissions customized membrane

water treatment systems and provides operation and maintenance services as well as a complete line of specialty products such as chemicals, consumables, couplings, fittings and cartridge filters for multiple markets. The company also designs, manufactures and implements digital solutions for automation and control technology.

Water in the “first world” is something that most people take for granted – it’s clean and readily accessible. But in many instances, that is a mistaken assumption as water supply and wastewater disposal systems age and infrastructure upkeep has not kept pace with population growth. Elsewhere, according to Hearts and Hands for Humanity, every minute a child under 5 years old dies from water-related disease in Africa. More than 40% of the African population has no access to clean water and over 60% of the population has no access to sanitation. That’s just one extreme example on one continent, but it puts the problem in context.

H2O Innovation does business around the world, but mostly in North America with almost 20% of business coming from other global sales. The company has three main business segments – Operating and Maintenance is the largest at approximately 48% of revenues, Specialty Products is the next largest at approximately 30%, with Projects & Aftermarket (Water Technologies & Services) accounting for the remaining 22%. The company has a very high percentage of recurring revenue (88% in Fiscal Q3) – more than double what it was five years ago – as a result of their business model, which promotes and encourages strong customer retention.



Source: H2O Innovation

H2O Innovation is now 20 years old and has a market capitalization of approximately \$100 million, so this is not an overnight success story. The company has grown both through

acquisition as well as organically as it competes in a highly fragmented market and is a market leader. For example, the company's water purification systems use both membrane technology and reverse osmosis, but are designed to use multiple suppliers' systems – allowing customers to choose the right solution.

Through acquisition and organic growth, the company has built a strong line of specialty chemical products for membrane treatment plants and has one of the largest distribution networks in the industry with global manufacturing capabilities. All-in-all, the company's three business segments provide a complete solution for customers in every segment and provide for cross-selling opportunities to enhance company revenue growth.

Looking ahead, the company sees the US as a very large potential market for growth as the US EPA estimates water infrastructure investments for the country in the tens of billions of dollars. Leading the four major regions is California (>US\$25 billion), with Texas, Florida and the most populous states in the eastern US all requiring \$5 – \$25 billion of investments. However, globally there will also be billions spent on desalination infrastructure primarily in the Middle East and North Africa (MENA) to respond to increasing demand in the region, providing another market with potential for H2O Innovation.

While H2O Innovation is not the largest in the market segment, it is small enough to be nimble but large enough to provide integrated solutions in a global network. The company continues to have a strong balance sheet, excellent customer retention and a market leading reputation for quality, innovation and service. With a growing backlog of orders, the company has no shortage of future business which should be good news for investors looking forward to the potential for future growth in a world that relies on clean water.