

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.