

BQE Water – Strong Q2; Recurring Segment Grows 79% YoY & 43% QoQ

Rating
BUY
Unchanged

Target Price
\$77.00
Prev. \$71.00

August 28, 2024

All figures in CAD unless otherwise stated

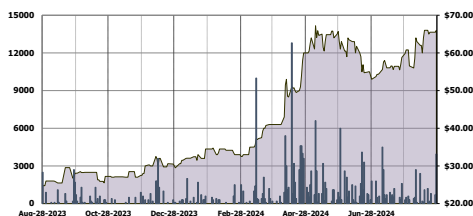
BQE Water Inc.	BQE:TSXV
Rating	BUY
Target Price	\$77.00
Return to Target	17%

Market Data	
Share Price	\$66.00
Average Daily Volume	440.0
FD ITM Shares (M)	1.3
Market Cap (\$M)	\$86.5
Cash (\$M)	\$7.8
Debt (\$M)	\$2.0
Enterprise Value (\$M)	\$80.7

FYE Dec 31	2023A	2024E	2025E
Proportional Revenue (\$M)	\$22.7	\$24.1	\$28.0
Revenue (\$M)	\$18.1	\$18.1	\$21.3
Gross Margin (%)	50%	49%	50%
Adj. EBITDA (\$M)	\$4.7	\$5.3	\$8.3
Adj. EBITDA Margin (%)	20%	22%	30%
Net Income (\$M)	\$2.7	\$3.3	\$6.0
EPS (Basic)	\$2.12	\$2.62	\$4.71
FCFF (\$M)	\$0.5	\$1.6	\$6.3

Valuation	2023A	2024E	2025E
EV/EBITDA	17.3x	15.3x	9.7x
P/E	31.1x	25.2x	14.0x
FCF Yield (%)	1%	2%	8%
EV/Sales	3.5x	3.3x	2.9x

Please refer to the applicable disclosures on the back page
Source: Atrium Research, CapitalIQ, Company Documents



BQE Water is a service provider specializing in water treatment and management for mining, smelting, and refining businesses. BQE Water invests in innovation and has developed unique intellectual property through the commercialization of several new technologies at mine sites around the world for organizations including Glencore, Codelco, Jiangxi Copper, Freeport-McMoRan and South32. BQE Water is headquartered in Vancouver, Canada.

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What you need to know:

- BQE reported Q2 financial results that beat our expectations on revenue and were in line on EBITDA. The quarter was once again led by the recurring operations segment which grew 79% YoY and 43% QoQ.
- Technical services revenue was soft again, but management expects a rebound in H2 as larger projects have been initiated in Q3.
- BQE's China JVs also posted excellent results, including a 68% YoY increase in revenue and 177% YoY increase in JV income.

BQE Water (BQE:TSXV, BTQNF:OTC) reported Q2 financial results yesterday after market close that beat our estimates on revenue and were in line on EBITDA. The highlight of the quarter was the 79% YoY increase in recurring operations revenue due to new plants coming online. BQE remains one of our highest conviction names at the moment because of the emergence of this segment. Technical services were softer than expected (similar to Q1), but management expects a rebound in H2. We recently published a management interview with CEO David Kratochvil and Chairman Peter Gleeson, that reiterates our investment thesis, watch it [here](#). **We are maintaining our BUY rating and increasing our target price to \$77.00/share based on 11.5x 2025E EBITDA (previously 11x).**

Key Highlights

- Prop. revenue came in at \$6.1M (+5% YoY) vs. our estimate of \$5.7M. This was comprised of operations services revenue of \$2.6M (+79% YoY, 42% of revenue), technical services revenue of \$0.9M (-69% YoY), and BQE's share of JV revenue of \$2.7M (+68% YoY). The operations segment was driven by U.S. selenium plants that posted \$1.6M compared to \$459K in Q2 last year.
- Gross margin of 47% vs. our expectation of 48% and 48% in Q2 last year (note that this is reported as operating margin before depreciation).
- Adjusted EBITDA was \$1.34M vs. our estimate of \$1.4M and \$1.5M in Q2/23. This equates to a 22% EBITDA margin, largely improving QoQ.
- BQE's share of JV net income was \$1.1M compared to our estimate of \$0.4M and \$0.4M last year. This was led by higher tonnages recovered and increased copper prices, compared to last year which had weather issues.
- Net income of \$0.6M vs. our estimate of \$1.1M and \$0.6M in Q2/23.
- BQE ended the quarter with \$7.8M in cash and \$2.0M in debt.

	Q2/24A	Atrium Est.	YoY
Proportional Revenue (\$M)	\$6.1	\$5.7	+5%
GAAP Revenue (\$M)	\$3.4	\$4.1	-18%
Gross Margin (%)	47%	48%	-134 bps
Adj. EBITDA (\$M)	\$1.3	\$1.4	-8%
Adj. EBITDA Margin (%)	22%	25%	-308 bps

Figure 1: Q2 Financials Summary

Outlook

In its outlook, management highlighted the rapidly growing recurring revenue segment and pointed to timing/delays causing the miss on technical services revenue. Management outlined that it has been working on smaller technical services contracts, which typically lead to larger multi-stage projects down the road. The team also mentioned that demand for engineering support and operator training is higher for new plants, meaning that resources were allocated to the operations segment rather than technical services. As for the JV, the rebound in copper production demonstrated that the decline in 2023 was due to climate rather than the depletion of metal in the stockpiles.

Management expects an even stronger H2, led by several new large projects being initiated in Q3 in the technical services segment. Furthermore, all of its water treatment plants are now fully operational and the China JV is expected to grow YoY, setting up BQE for several improved quarters which are already reflected in our model.

Contract Announcements

On June 4th, BQE announced the renewal of its operations services agreement with Glencore for the water treatment plant at its Raglan Mine in Nunavik, Quebec. In a JV with Nuvumiut Developments, BQE has been providing services at the Raglan Mine for 21 years. The JV oversees producing clean water for environmental discharge and meeting effluent quality standards that guarantee the health of the area's aquatic ecosystem, as per the provisions of the multi-year agreement with an option to extend. The scope of services under the new agreement remains unchanged from the previous contract.

On July 10th, BQE announced a new contract to perform lab testing and conceptual engineering for a non-biological selenium removal water treatment plant using the Selen-IX technology for a mine in Latin America. We remind readers that the Selen-IX technology is a patented and award-winning process for removing selenium from wastewater, achieving effluent limits well below 0.002 mg/L, eliminating reliance on dilution, and producing stable, non-hazardous solid residue suitable for reuse.

New Appointment to the Board

On August 9th, BQE announced the appointment of Richard Hubbard to its Board of Directors, increasing the board to six members. Mr. Hubbard brings over 40 years of experience in commercial leadership, corporate finance, capital markets, and investment banking, with a background spanning multiple industries, including mining, luxury goods, international wine distribution, consumer electronics, and healthcare.

Our Take

Q2 marked another strong quarter for BQE, beating our expectations on revenue and being in line on EBITDA. We found it incredibly impressive that BQE is continuing to post topline growth and roughly flat EBITDA growth albeit the major slowdown in technical services. Again, the highlight of the quarter and the crux of our investment thesis in BQE is the operations services segment. This segment grew 79% YoY and 43% QoQ, representing 42% of proportional revenue. As this segment continues to grow and the market takes notice, we expect BQE shares to re-rate to higher multiples.

While technical services disappointed once again, management highlighted a light at the end of the tunnel, with a rebound in H2. As such, we are largely maintaining our forecasts for 2024, including 10% YoY growth and 15% YoY growth for the technical services segment in Q3 and Q4 respectively. We will also note that these excellent results from BQE have yet to include a "Company Maker" project which could be a major catalyst for the operations segment beyond our model's assumptions (i.e., Seabridge's KSM Mine). We remain very confident in BQE and are adjusting our 2025 expectations upward slightly.

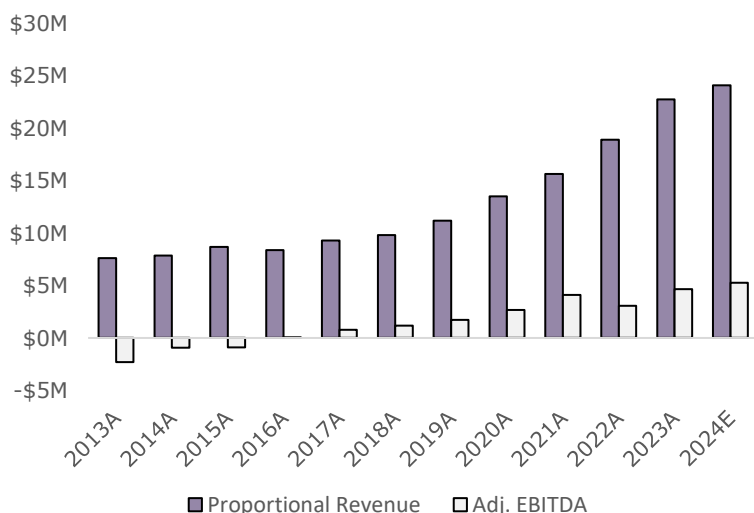


Figure 2: Revenue & EBITDA Growth

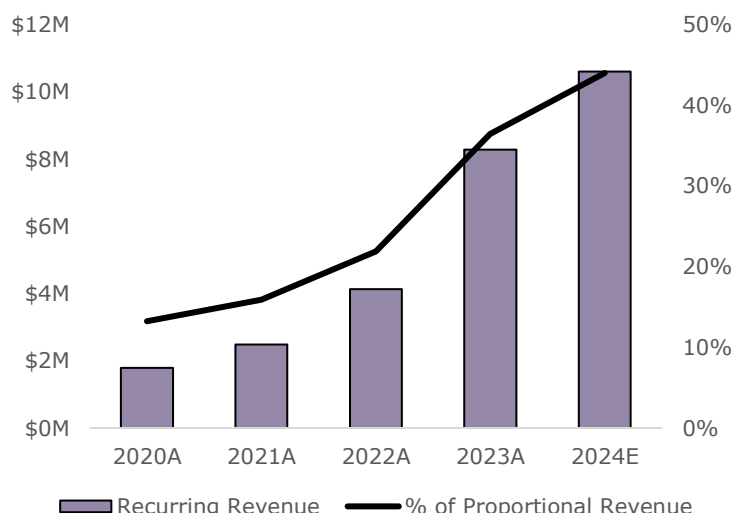


Figure 3: Recurring Revenue Improvement

Valuation

Following the continued strong performance in BQE stock (+89% since our initiation in March), the valuation now sits at 15.3x/9.7x 2024E/2025E EBITDA compared to engineering service firms at 14.4x/12.4x and water treatment firms at 12.8x/11.8x (all of which have lower growth). We remain confident that BQE can grow on an annual basis, especially given the increased copper price and potential to sign “Company Maker” projects. Given the execution in the recurring segment thus far in 2024, we are increasing our target multiple to 11.5x 2025E EBITDA (previously 11x), leading to an increased target price of \$77.00/share (previously \$71.00/share). The new target price is equivalent to a 6.6% FCF yield and 15.7x 2025E earnings. We will reiterate that the addition of a “Company Maker” project would drastically change our model and as such, our target price.

EBITDA Multiple Valuation	
2025E EBITDA (\$M)	\$8.3
<u>EV/EBITDA Multiple</u>	<u>11.5x</u>
Enterprise Value	\$95.5
(+) Cash	\$7.8
(-) Debt	\$2.0
Equity Value	\$101.3
Target Price (Rounded)	\$77.00
Upside	17%

Figure 4: Target Price Derivation

Why We Like BQE

- BQE has a growing stream of recurring revenue. Recurring revenue represented 13% of proportional revenue in 2020 and has grown to 36% in 2023.
- The Company has strong tailwinds in increasingly strict government regulations for water discharge and increasing mining capex globally.
- BQE Water has been steadily increasing its EBITDA margins from negative levels a decade ago to 20% in 2023. Given its asset-light business model, we expect this to continue scaling up.
- BQE has a clean balance sheet with a large cash position and no interest-bearing debt. The Company has not raised equity since 2018 and has three private investors owning 46%.
- BQE’s valuation is cheaper than water treatment and engineering service firms.

Catalysts

- Quarterly Financial Results & Increasing Recurring Revenue – Ongoing
- New Contract Announcements – Ongoing
- Share Repurchases – 2024

Estimate Revisions

	Q3/24E		Q4/24E		2024E		2025E	
	New	Previous	New	Previous	New	Previous	New	Previous
Prop. Revenue (\$M)	\$8.6	\$8.6	\$6.0	\$6.0	\$24.1	\$23.7	\$28.0	\$26.8
GAAP Revenue (\$M)	\$6.9	\$6.9	\$5.2	\$5.2	\$18.1	\$18.8	\$21.3	\$21.3
Gross Margin (%)	54%	55%	46%	45%	49%	49%	50%	49%
Adj. EBITDA (\$M)	\$2.7	\$2.8	\$1.4	\$1.3	\$5.3	\$5.4	\$8.3	\$7.8

Figure 5: Estimate Revisions

Tear Sheet

Market Data						Capital Structure						
Ticker	BQE:TSXV					Basic Shares Outstanding (M)	1.3					
Stock Price	\$66.00					Warrants (M)	0.0					
Rating	BUY					Options (M)	0.1					
Target Price	\$77.00					FD Shares (M)	1.3					
Upside	17%					FD ITM Shares (M)	1.3					
Market Cap (\$M)	\$86.5					Ownership						
Cash (\$M)	\$7.8					Management & Board	8%					
Debt (\$M)	\$2.0					Other Insiders	46%					
EV (\$M)	\$80.7					Retail	46%					
Financial Estimates												
	2022A	Q1/23A	Q2/23A	Q3/23A	Q4/23A	2023A	Q1/24A	Q2/24A	Q3/24E	Q4/24E	2024E	2025E
Revenue (\$M)	12.2	2.7	4.2	6.2	5.0	18.1	2.5	3.4	6.9	5.2	18.1	21.3
Proportional Revenue (\$M)	18.9	3.6	5.8	8.0	5.4	22.7	3.4	6.1	8.6	6.0	24.1	28.0
% YoY	21%	1%	12%	40%	21%	20%	-4%	5%	8%	11%	6%	16%
Gross Profit (\$M)	5.1	1.0	2.0	3.3	2.8	9.1	1.1	1.6	3.7	2.4	8.8	10.7
Gross Margin	42%	37%	48%	53%	55%	50%	44%	47%	54%	46%	49%	50%
Adj. EBITDA (\$M)	3.1	(0.1)	1.5	2.7	0.5	4.7	(0.1)	1.3	2.7	1.4	5.3	8.3
Adj. EBITDA Margin	16%	-2%	25%	34%	10%	20%	-4%	22%	31%	22%	22%	30%
Net Income (\$M)	1.2	(0.3)	0.6	2.1	0.2	2.7	(0.5)	0.6	2.2	1.0	3.3	6.0
EPS (Basic)	0.93	(0.27)	0.49	1.71	0.20	2.12	(0.39)	0.44	1.76	0.81	2.62	4.71
FCFF (\$M)	(0.5)	(0.4)	(0.6)	0.6	1.0	0.5	0.3	(1.9)	2.8	0.5	1.6	6.3

Figure 6: Tear Sheet

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RATING	COVERED COMPANIES
BUY	15
HOLD	0
SELL	0

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