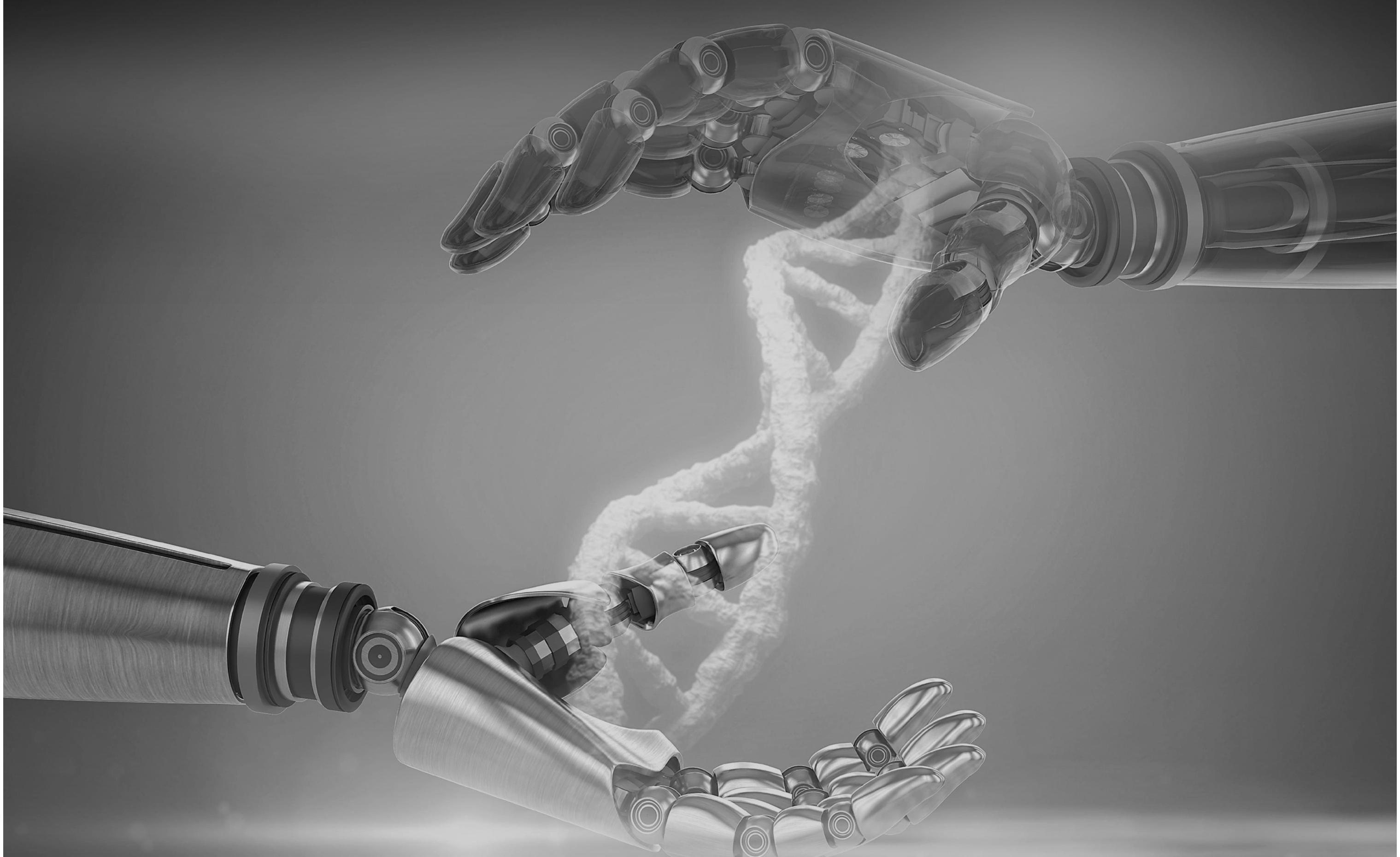
STOCKS DOWN UNDER

27 SEP 2022

Emerging Stocks Down Under

"If everything is important, nothing is."

- Patrick Lencioni (b. 1965), The Table Group executive & author



RUBICON WATER

Needs to find its flow again

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Stocks Down Under rating: ★★

ASX: RWL
Market cap: A$171.9M

52-week range: A$0.96 / A$1.84
Share price: A$1.00

Rubicon is the newest of the handful of ASX companies that are trying to address the scarcity of water and reduce its wastage. This company has irrigation automation technology that aims to help with water scarcity and improve the supply of water to farmers. Unlike many other companies that listed in 2021, it has been trading above its IPO price for the most part, but is down from its all-time highs. What does the future hold for this company?

Share price chart

Source: Tradingview

Managing water digitally

Rubicon was founded in 1995 and listed on the ASX in September last year. It sells a variety of software-based water management planning solutions, mostly to farms. These products help buyers manage their water more efficiently by precisely measuring how much water is needed. The software also helps farmers plan ahead by giving them in-depth insights into their current water situation.

The company has three platforms: Confluent, SCADAConnect and FarmConnect. Confluent allows utility providers to bill customers as well as communicate and manage their entire water distribution system. SCADAConnect is a mobile monitoring and management software suite that allows for complete water control and reporting of use across multiple sites. And FarmConnect allows farmers to monitor their crops while also providing insights into optimal watering protocols. And all of these can be managed through the web and via mobile.

The future lies in Asia

Rubicon Water has three divisions: ANZ, Asia and the Rest of the World (ROW). It is Asia that has been important to the company in recent times with the strongest revenue and EBITDA growth of any division. This continent is experiencing a sharp increase in water scarcity and all indications are that the situation will get worse before it gets better.

China and India are two countries in this region with water shortage problems. According to the World Bank, 33% of India's population lives in areas with either water scarcity or absolute scarcity while China has 36%. Australia, however, is not far behind. 29% of Australia's population lives in areas of water scarcity. And globally, the situation is not much better with 30% of the world's population living in water scarce areas.

Going backwards in FY22

In FY21, the company recorded $81.5m revenue growth and $14.1m in EBITDA, representing growth of 25% and 108% respectively. Unfortunately, this was not replicated in FY22. Revenue fell 20% (to $65.3m), underlying EBITDA fell over 90% to $1.3m and its bottom-line swung from an $8.2m profit to a $731,000 loss. And after paying a pre-IPO dividend of 10c a share, none was paid in FY22. Rubicon has a net debt position of $16m.

The company foreshadowed this drop in revenues two months earlier noting it was due to delays in signing contracts in Asia that would now occur in early FY23. Although management blamed the impact of restricted travel, we would question this given its solid result in FY21 when travel was also restricted. The company promised that FY23 EBITDA would deliver growth against FY21, i.e. exceeding $12m. With an EV of $208m, Rubicon's EV/EBITDA for FY23 is 17.3x.

Rubicon has also asserted that it has a pipeline of more than $1.8bn, which seems high to us given its current revenues. We note that despite a drop in Asian revenue (from $41.1m to $15.5m) and a drop in ANZ revenue (from $26.5m to $25.4m), Rubicon's revenue in the Rest of the World nearly doubled from $13.9m to $24.4m.

Harsh realities bite

If you look to Rubicon's cash flow statement, it paints a worse picture. Cash flow from operating activities was in the red by $10.5m in FY21 and by $16.8m in FY22. Although it finished with a far higher cash balance ($11m vs $4.8m in FY21), this was due to IPO proceeds. And the company mentioned that global supply chain issues were having an impact, particularly China's COVID-zero policy. The company has proactively increased holdings of component parts by $3.6m and hopes to achieve positive cash flow for FY23.

We also observe that the bulk of its project pipeline is in the long term with under $200m in the near-term, $600m in the medium term and ~$1bn in the long term. These 'terms' are not alluding to a specific time frame, but rather the stage that the company is at in engaging with would-be clients. 'Short term' clients are at the stage of negotiating a contract, 'medium term' clients are working through the details of the solution and 'long term' are at the early engagement stage.

Will FY23 be better?

We admire Rubicon's mission in helping reduce water wastage and that it is geographically diversified in terms of its client base and its supply chains – it has facilities in Australia, the USA, Asia and it has secured a lease on a proposed assembly facility in Chile.

Whether or not you want to invest in the company depends on whether or not you believe it can return to normality in FY23. Rubicon's management are confident but bear in mind that what occurred in FY22 was unexpected even by them. There are no analysts covering Rubicon, so there are no consensus estimates for FY23. The question as to whether or not you want to give it the benefit of the doubt is up to you.

We would prefer to see with certainty that the orders delayed into FY23 are actually coming in and that supply chain constraints are easing. Until then, we think Rubicon is two stars.

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