EDISON

Intelligent Energy Holdings

Interims

Strong year-on-year revenue growth

Alternative energy

Intelligent Energy Holdings' (IEH) interim results show strong revenue growth, driven by the DP&G division, which provides power asset management services for telecoms tower sites in India. The division has recently announced agreement in principle on a contract that will more than double the number of telecoms towers under management and substantially improve divisional margins. We leave our estimates unchanged and revise our valuation range to reflect a weakening in fuel cell share prices since our April initiation note.

Year end	Revenue (US$m)	PTP* (US$m)	EPADR ($)	DPADR ($)	P/E (x)	Gross yield (%)
09/14	21.2	(90.5)	(2.4)	0.0	N/A	N/A
09/15e	162.0	(115.2)	(2.9)	0.0	N/A	N/A
09/16e	369.0	(114.0)	(2.9)	0.0	N/A	N/A
09/17e	695.1	5.4	0.3	0.0	19.8	N/A

Note: Converted at £1/US$1.56 for the table above and throughout the note. Dividend yield excludes withholding tax. Investors should consult their tax advisor regarding the application of any domestic and foreign tax laws.

DP&G division drives strong revenue growth

Group revenues for H115 rose by £23.9m ($37.3m) year-on-year to £27.4m ($42.7m). The majority of this increase was attributable to the £23.7m ($37.0m) revenues from the DP&G division. It did not begin commercial power management activities until the very end of March 2014, yet had more than 10,000 telecoms towers under management by the end of March 2015. Revenues from the Motive division were 5% higher year-on-year at £3.7m ($5.8m). Revenues from the Consumer Electronics division, whose first product was launched in November, were not material. Group EBITDA losses, adjusted for an IFRS 2 charge and one-off fund-raising costs increased from £16.7m ($26.1m) to £23.7m ($37.0m).

Key strategic milestones reached

The first Consumer Electronic product, the Upp hand-held fuel cell for charging mobile devices, was launched in Apple's UK stores in November. After the period end, the Motive division announced a joint development agreement with an Asian OEM, increasing the number of active customer engagements to four. The DP&G division announced an agreement in principle with GTL to acquire long-term contracts to supply power to more than 26,000 telecom tower sites in India. This agreement underpins our FY15 estimates, more than doubling the number of sites under management and thus divisional revenues, and substantially improves divisional margins. Successful execution of this contract underpins our FY15 forecasts so we leave our estimates unchanged.

Valuation: Significant upside from royalties

Given the slight decline in fuel cell peer multiples, we adjust our sum-of-the-parts analysis to give a valuation range of $699m to $1,585m (previously $700m to $1,604m). This excludes any value associated with long-term royalties for the Motive or Consumer Electronics divisions.

21 May 2015

Price	**US$5.93***
Market cap	**US$223m**

*priced as at 19 May 2015.
*underlying GBP price converted at US$1.56
ADR/Ord conversion ratio 1:5

Net cash ($m) at end March 15	91
ADRs in issue	37.6m
Free float	66%
ADR Code	INGYY
ADR exchange	OTC
Underlying exchange	LSE
Depository	BNYM

Business description

Intelligent Energy develops efficient hydrogen fuel cell power systems for the distributed power and generation markets (DP&G division), global automotive (Motive division) and consumer electronics (CE division) markets.

Next event

Prelims	November 2015

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Divisional highlights

DP&G (£23.7m ($37.0m) revenues, £1.4m ($2.2m) EBITDA loss)

During H115 IEH managed power generation assets at more than 10,000 sites under a low-margin interim contract with GTL and a smaller number of sites for Ascend Telecom and Microqual.

In February IEH announced that it had reached agreement in principle with GTL to acquire long-term contracts to supply power to more than 26,000 telecom tower sites in India. When completed, this will replace the interim contract. The proposed transaction is important on several counts. Firstly, it takes the number of sites under management to more than 26,000, raising monthly revenues from c £4m (c $6m) to c £10m ($16m). Secondly, it will be immediately margin enhancing. The interim contract is operated at low margins. Management expects the EBITDA margins under the long-term contract to be 15% initially. This is expected to rise to 30-35% as IEH optimizes the efficiency of sites under management using its proprietary AMBIS software, deploys fuel cell technology at around 70% of sites and generates additional power for applications such as water purification at 20-30% of sites. (Our estimates show EBITDA margins approaching 30% in FY17.) Since GTL's sites represent the majority of the telecoms sites currently under management, the transaction is expected to have an immediate impact on the profitability of the division. Finally, the acquisition is a significant step towards management achieving its goal of having 125,000 to 135,000 telecoms sites under management in the medium term, acting as a powerful reference point for the telecoms industry. The transaction will be financed by a mix of locally sourced debt and cash from IEH's existing cash resources.

One of the elements of margin expansion is the replacement of worn-out diesel generators with fuel cells at those sites with prolonged power outages. It is therefore significant that IEH installed the first fuel cell at one of its sites under management in December 2014, confirming management's commitment to replace diesel generation technology with fuel cells over time.

Financials

This division generated £23.7m ($37.0m) revenues in total and £1.4m ($2.2m) EBITDA loss. The division did not generate any revenues during H114, as power management activities did not commence until the very end of March 2014. H115 EBITDA losses were similar to H114, reflecting increased head count and other costs now that power management activities are underway. The pending GTL transaction supports our assumption of 35,000 telecom tower sites under management by the current year end.

Consumer Electronics (£0.05m ($0.08m)revenues, £5.9m ($9.2m) EBITDA loss)

In November, Apple launched the Upp, IEH's first-generation, hand-held fuel cell for charging mobile devices, across its retail store network in the UK. This is IEH's first commercial step towards deploying embedded fuel cells in consumer electronic devices. This first-generation device uses refillable metal hydride fuel cartridges that can be replaced at Shell garages and other outlets. While the total volume of the first-generation device will be limited to c 30,000 units, the product awakens consumers to the possibility of off-grid charging. In addition, the associated Upp app collates information on each Upp location, energy usage, charging and fuel status. This is passed back to IEH, increasing the division's understanding of consumer energy usage and future product requirements.

In February IEH announced the acquisition of the portable fuel cell and disposable fuel cartridge assets of Société Bic for an initial consideration of $15m cash and a performance-related deferred consideration of up to $7m cash. The assets include fuel cell and disposable fuel cell cartridge IP, high-volume and manufacturing IP, pilot production technologies for disposable fuel cartridges and planar fuel cells and market understanding. This transaction supports IEH's transition to a fully embedded technology. Upp2, which will be smaller and cheaper than the first-generation product and use the BIC disposable cartridge technology, is scheduled for launch in late 2015. Upp3, which will use a more energy-dense fuel developed by BIC, is scheduled for launch in H116. Given the availability of a low-cost disposable cartridge production capability as a result of this acquisition, management decided to limit production of the first-generation devices to around 30,000 units. It had previously experienced contract yield manufacturing issues with the refillable fuel cartridges. Although the issues were resolved, substantial investment in capex and marketing would have been required to support the original production forecasts. Management decided to invest in disposable cartridge production capability instead.

Financials

The division did not generate any revenues during H114, as sales did not commence until late November following the launch in UK Apple stores. These generated a total of £0.05m ($0.08m) revenues during the period. Divisional EBITDA losses increased by £2.8m ($4.4m) to £5.9m ($9.2m). H115 losses included an exceptional charge of £1.7m ($2.7m) relating to the decision to discontinue production of the first-generation Upp and the cost of writing off product that did not meet specification. The remaining increase is attributable to production and marketing costs associated with the new Upp product. Although fewer than 1,000 first-generation Upp devices have been sold through Apple stores so far, IEH intends to sell the product in India, initially for use by telecomm tower maintenance engineers. A product enabling consumers to charge mobile devices off-grid is particularly attractive in India where there is a high incidence of power outages. This supports our estimate of sales of 20k Upp units during the current financial year.

Motive (£3.7m ($5.8m) revenues, £0.3m ($0.5m) EBITDA loss)

During H115 the division generated revenues from three joint development agreements. These are with Suzuki, a European premium car manufacturer and a second Japanese car manufacturer.

Interest in fuel cell technology in the automotive sector is high. In April Toyota announced that it intended to sell Model AA shares worth up to 50bn yen ($4.2bn) to fund research and development into fuel cell vehicles, as well as fuel-efficient vehicles and intelligent mobility technologies to support safe driving. In the announcement Toyota noted that it had taken 20 years to develop the Mirai, its first mass-produced hydrogen fuel cell vehicle, which was launched in December 2014. This emphasizes that car manufacturers which do not already have their own fuel cell technology will need to work with third parties such as IEH if they are to enter the market in a timely fashion. Shortly afterwards IEH announced that it had entered into a joint development agreement with another Asian OEM. Discussions with further OEMs interested in potential joint development activities are ongoing. Earlier in April IEH announced that it was leading a UK industry consortium to develop a new class of zero-emission light commercial vehicle. This three-year project costing £12.7m ($19.8m) overall, of which IEH will receive a portion, is to develop validated systems ready for volume manufacture.

Financials

Revenues grew by 5% year-on-year to £3.7m ($5.8m). The division reported a small (£0.3m/$0.5m) EBITDA loss compared with a break-even position in H114. The higher costs were attributable to the timing of different phases of the various contracts. Management expects the division to be EBITDA positive for the full year.

Group financials

H115 group revenues rose by £23.9m ($37.3m) year-on-year to £27.4m ($42.7m), reflecting the onset of commercial revenues from the DP&G division. Excluding the exceptional cost incurred in the Consumer Electronics division, R&D expenses grew by 4% year-on-year. Operational costs increased by £5.0m ($7.8m) to £12.7m ($19.8m) as a result of increased staffing levels to support the relatively new DP&G and Consumer Electronics operations, neither of which were generating commercial revenues during the previous corresponding period. Administrative costs rose by £2.1m ($3.3m) to £6.1m ($9.5m). The majority of this increase relates to the cost of being a listed company, including 34 additional staff. EBITDA losses, adjusted for an IFRS 2 share-based payments charge and one-off fund-raising costs increased from £16.7m ($26.1m) to £23.7m ($37.0m).

Working capital increased by £0.9m ($1.4m), attributable to Upp-related stock, which management expects will be sold over the remainder of the current financial year. Net capital expenditure on power generating assets, test rigs and chambers and other equipment for the commercialization programs totaled £4.2m ($6.6m), a £3.0m ($4.7m) increase on H114 levels. Investment in the patent portfolio grew from £1.1m ($1.7m) to £1.8m ($2.8m). Cash, cash equivalents and short-term deposits reduced from £88.9m ($138.7m) at the end of September 2014 to £58.2m ($90.8m) at the end of March 2015.

We leave our estimates unchanged. These show revenues rising to £445.5m ($695.1m) by FY17, with most of the growth generated from the DP&G division. Given the cautious growth trajectory assumed in our model, IEH is not expected to become profitable until FY17. The big hike in profitability shown in FY17 is partly attributable to our assumption that the Motive division will secure a major license deal in that year, contributing an estimated £42.8m ($66.8m) to group profits. Stripping that out, IEH would generate an estimated £52.8m ($82.4m) EBITDA in FY17.

The capital expenditure associated with the acquisition of telecoms tower power generation assets accounts for a high proportion of cash outflow. Any increase in cash consumption linked to DP&G expansion is matched to revenue generation and expected to be partially funded by asset finance (included in long-term borrowings in Exhibit 3). If DP&G continues to add telecoms sites at the rate modelled in our estimates, we assume that management will seek to raise additional finance to keep cash balances at healthy levels. We model this as £70.0m ($109.2m) short-term debt in 2016.

Valuation: Market cap less than value of DP&G division

We use a sum-of-the parts analysis as the basis for our valuation. This excludes revenues from longer-term activities such as royalties from IP licensing in Motive and Consumer Electronics, which are treated as upside.

Our analysis of a sample of listed peers engaged in the provision of power generation and other equipment to utilities and the construction sector and telecoms tower operators (American Tower) indicates that an EV/Sales ratio of 2.4x for Year 2 or FY16e is appropriate. Applying this multiple to a range of revenues extending from our base case for FY16e (£211.2m divisional revenues, $329.5m) to FY16e revenues realisable if management achieves its target of 135k telecoms towers under management by end FY17 (£295.7m divisional revenues, $461.3m) and beyond (150 sites) gives an implied market capitalisation of between £352m/$549m (base case as modelled in our estimates) to £634m/$988m. This implies that the base case value, taking only the DP&G division, is more than 100% higher than the current market cap. (We note that the IEH share price, in common with those of other fuel cell companies, has declined as the crude oil price has declined.)

Exhibit 1: DP&G division

	Market cap	Year 2 EV/Sales		Scenarios (m)				
				Base case			Mgmt. target	
Aggreko	£4,113m	2.7x	Number of sites under management end FY17e	80	100	120	135	150
American Tower Corp	£25,497m	10.2x	Number of sites under management end FY16e	65	70	80	95	105
APR Energy	£222m	2.7x	FY16 revenues (£m)	211.2	221.8	253.4	295.7	327.4
Ashtead Group	£5,939m	2.9x	Average EV/Sales for sample of peers	2.4	2.4	2.4	2.4	2.4
Bharti Infratel	£7,757m	5.2x	Implied EV (£m)	511.7	537.4	613.9	716.4	793.2
Cape	£305m	0.6x	Net debt end FY16 (£m)	(159.7)*	(159.7)	(159.7)	(159.7)	(159.7)
Speedy Hire	£377m	1.2x	Implied market cap (£m)	352.0	377.7	454.3	556.7	633.5
Toromont Industries	£1,311m	1.4x	Implied market cap ($m)	549.1	589.2	708.7	868.5	988.3
United Rentals Inc	£6,352m	2.8x						
Mean		**2.4x**						

Source: Edison Investment Research. Note: *Attributing all debt to the DP&G division. Shaded value excluded from mean. Prices at 15 May 2015.

We adopt a similar process for determining the incremental value associated with the Motive and Consumer Electronics divisions. This time we apply the Year 2 EV/Sales multiple (2.4 x) for a sample of listed companies involved in fuel cell development to a range of FY16e revenues, taking the level shown in our FY16 estimates as the base case for the Consumer Electronics division and extending the scenario to achieve sales of 5m Upps in FY17e, which is beyond the upper bound of management's 3-4m unit target. Since we assume that the Motive division will receive a sizeable licence fee (c £45m/$70m) every three years, we add one-third of this (£15m/$23m) to our FY16 divisional revenues. Combining the incremental market capitalisation associated with a range of outcomes for these two divisions with the implied market capitalisation associated with the DP&G division on its own gives a group valuation range of £448m/$699m to £1,016m/$1,585m. This analysis excludes any value associated with long-term licensing royalties for the Motive division.

Exhibit 2: Consumer Electronics and Motive divisions

	Market cap	Year 2 EV/Sales		Scenarios			
				Base case		Mgmt. target	
Ballard Power Systems Inc	£185m	3.1x	Upp units FY17e (m)	0.6	2	4	5
Ceres Power Holdings	£72m	64.7x	Upp units FY16e (m)	0.2	1.2	1.6	2
FuelCell Energy	£236m	1.2x	CE revenues FY16e (£m)	15	81.3	108.4	135.4
Hydrogenics Corp	£67m	1.4x	Motive revenues FY16e (£m)	25.3	25.3	25.3	25.3
ITM Power	£53m	5.9x	Total revenues FY16e (£m)	40.3	106.6	133.7	160.7
Plug Powerc	£290m	2.0x	EV/Sales multiple	2.4x	2.4x	2.4x	2.4 x
SFC Energy	£32m	0.6x	Implied EV (£m)	95.9	253.7	318.3	382.5
Mean		**2.4x**	Implied market cap* (£m)	95.9	253.7	318.3	382.5
			Implied market cap* ($m)	149.6	395.8	496.5	596.7

Source: Bloomberg, Edison Investment Research. Note: *Entire debt attributed to DP&G division, none attributed to Motive and Consumer Electronics divisions. Shading indicates exclusion from mean. Prices at 15 May 2015.

Our April initiation note gave a valuation range of £461m to £1,055m ($700m to $1,604m). The reduction is attributable to a small fall in the average Year 2 EV/Sales multiple for our sample of listed fuel cell companies from 2.6x to 2.4x.

Exhibit 3: Financial summary

	US$ m	2013	2014	2015e	2016e	2017e
Year end 31 December		IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue		32.5	21.2	162.0	369.0	695.1
Cost of Sales		(21.1)	(15.4)	(100.6)	(225.5)	(367.9)
Gross Profit		11.5	5.8	61.4	143.5	327.2
EBITDA		(36.5)	(81.7)	(61.4)	(6.2)	149.2
Operating Profit (before amort and except)		(41.6)	(66.5)	(103.8)	(88.9)	43.0
Amortization of acquired intangibles		0.0	0.0	0.0	0.0	0.0
Exceptionals		0.0	(11.0)	0.0	0.0	0.0
Share based payments		(0.0)	(9.3)	(4.0)	(4.0)	(4.0)
Operating Profit		(41.6)	(86.8)	(107.8)	(92.9)	39.0
Net Interest		(0.9)	(6.2)	(11.4)	(25.0)	(37.6)
Share of losses from JVs and exceptionals		(3.9)	0.0	0.0	0.0	0.0
Pre Tax Profit (norm)		(46.4)	(90.5)	(115.2)	(114.0)	5.4
Pre Tax Profit (FRS 3)		(46.4)	(93.0)	(119.2)	(118.0)	1.5
Tax		13.7	17.8	5.9	5.9	5.9
Profit After Tax (norm)		(32.7)	(72.7)	(109.3)	(108.0)	11.4
Profit After tax (FRS 3)		(32.7)	(75.2)	(113.3)	(112.0)	7.4
Average Number of Shares Outstanding (m)		134.4	153.4	188.1	188.1	188.1
EPADR - normalized (US$)		(1.2)	(2.4)	(2.9)	(2.9)	0.3
EPADR - normalized fully diluted (US$)		(1.2)	(2.4)	(2.9)	(2.9)	0.3
EPADR - (IFRS) (US$)		(1.2)	(2.5)	(3.0)	(3.0)	0.2
Dividend per ADR (US$)		0.00	0.00	0.00	0.00	0.00
Gross Margin (%)		35.3	27.4	37.9	38.9	47.1
EBITDA Margin (%)		N/A	N/A	N/A	N/A	21.5
Operating Margin (before GW and except) (%)		N/A	N/A	N/A	N/A	6.2
BALANCE SHEET						
Fixed Assets		43.2	59.1	128.9	192.0	231.8
Intangible Assets		20.7	22.9	38.1	36.0	34.3
Tangible Assets		8.2	10.7	65.3	130.5	172.0
Deferred tax assets		14.3	25.5	25.5	25.5	25.5
Current Assets		72.5	167.7	57.9	106.1	189.5
Stocks		2.4	6.4	13.5	23.8	30.5
Debtors		15.3	17.3	32.6	59.7	81.0
Cash and short-term deposits		49.3	138.6	6.4	17.2	72.7
Current tax assets		5.4	5.3	5.3	5.3	5.3
Current Liabilities		(13.4)	(27.4)	(36.0)	(158.9)	(178.5)
Creditors		(13.4)	(27.4)	(36.0)	(49.7)	(69.3)
Short term borrowings		0.0	0.0	0.0	(109.2)*	(109.2)
Long Term Liabilities		(33.0)	0.0	(60.7)	(157.2)	(249.3)
Long term borrowings		(28.9)	0.0	(60.7)	(157.2)	(249.3)
Other long term liabilities		(4.1)	0.0	0.0	0.0	0.0
Net Assets		69.3	199.4	90.1	(17.9)	(6.6)
CASH FLOW						
Operating Cash Flow		(36.4)	(79.0)	(71.2)	(26.0)	144.8
Net Interest		(0.1)	0.5	(11.4)	(25.0)	(37.6)
Tax		5.1	5.9	5.9	5.9	5.9
Capex		(7.8)	(10.7)	(101.8)	(149.8)	(149.9)
Acquisitions/disposals		0.0	1.8	(14.3)	0.0	0.0
Equity financing		2.3	169.1	0.0	0.0	0.0
Dividends		0.0	0.0	0.0	0.0	0.0
Forex		0.1	(0.0)	0.0	0.0	0.0
Net Cash Flow		(36.8)	87.5	(192.9)	(194.9)	(36.8)
Opening net debt/(cash)		46.6	(20.4)	(138.6)	54.2	249.1
HP finance leases initiated		0.0	0.0	0.0	0.0	0.0
Other		103.8	30.7	0.0	0.0	0.0
Closing net debt/(cash)		(20.4)	(138.6)	54.2	249.1	285.9

Source: Edison Investment Research. Note: *$109.2m additional finance assumed as short-term debt for the purpose of the model.

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