

CAPSTONE TURBINE (NASDAQ: CPST)

Powering Ahead with Energy as a Service (EaaS) Strategy

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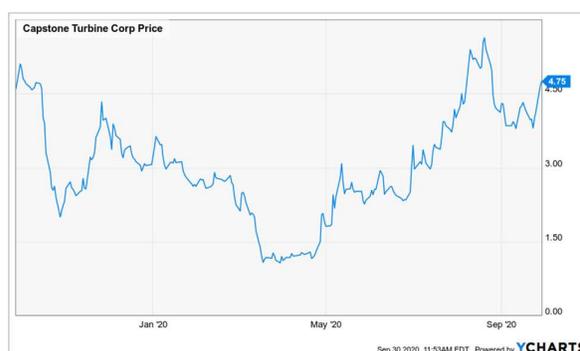
KEY POINTS

- Capstone is positioned in the distributed energy generation (DEG) - or microgrid industry - with a proprietary microturbine technology platform.
- According to Capstone, its platform can reduce energy costs, ensure power availability, and meet CO2 reduction goals with a near-zero emissions profile, which also positions the product within the customer's Environmental, Social & Governance (ESG) framework.
- We believe broader industry trends will continue to favour technologies and services that will help companies reduce their carbon footprint driven by regulation as well as corporate responsibility.
- The global microgrid industry is expected to grow over 10% CAGR between 2020 and 2025 and we expect the industry will continue to benefit from long-term trends.
- Capstone's business has pivoted over the last 12 months to increasingly focus on developing an energy as a services business (EaaS) around its core energy technology platform.
- If the company can continue to execute on an EaaS strategy, it should lead to more predictable and stable cash flows, despite product orders and backlog experiencing variability quarter to quarter.
- The company recently reached adjusted EBITDA breakeven following a multi-year cost cutting effort, but also acutely demonstrated the importance and positive impact EaaS can have on profitability.
- In addition to the existing distributor sales model, Capstone has initiated a National Account effort, which management believes will better target more substantial, corporate accounts with the potential to land larger orders for multiple locations.

KEY STATISTICS

Price:	\$4.75
52 Week Range:	\$1.0 - \$6.0
Avg. Daily Vol. (30 day)	185,133
Shares Out (MM):	11.0
Market Cap (MM):	\$52.4
Institutional Ownership:	8.47%
Short Int. (MM) / % of float:	0.17/1.6%
Debt to Equity:	279%
Revenue TTM (MM):	\$63.9

Source: Bloomberg, *As of Sept 29, 2020



COMPANY OVERVIEW

Capstone Turbine Corporation® states it is the world's leading producer of highly efficient, low-emission, resilient microturbine energy systems. Capstone microturbines serve multiple vertical markets worldwide, including natural resources, energy efficiency, renewable energy, critical power supply, transportation and microgrids. Capstone offers a comprehensive product line-up, providing scalable systems focusing on 30 kW to 10 MWs that operate on a variety of gaseous or liquid fuels, including natural gas, renewable natural gas, and hydrogen to provide solutions for distributed power generation needs. The company is pivoting its focus to further emphasise energy as a service (EaaS), which is comprised of growing its rental fleet and aftermarket service and components business described as a Factory Protection Plan (FPP).

WTR CATALYST MONITOR

- ✓ Continue to pivot towards the EaaS model demonstrated by growing the rental fleet to the targeted 10MW and beyond in addition to communicating the next leg of the strategy.
- ✓ Refinancing the Goldman Sachs' note of \$30 million Senior Secured Notes and sourcing additional capital to drive the EaaS strategy and in particular the rental business. The note carries a relatively high cost of capital at 13%, so anything Capstone can do to reduce the cost of borrowing should subsequently improve the IRR on rental business.
- ✓ Management has stated FY21 goals of \$10M+ of Y/Y adj. EBITDA improvement, 10MW of rentals, 22% gross margin, 15% of revenue from direct sales and 6 inventory turns. Delivering on these goals should help to further establish the credibility and ability of the company to deliver on the stated strategy and improve investor confidence.
- ✓ Reaching cash flow positive could help relieve concerns about the need for or the use of proceeds from any future capital requirements as the transition would move from survival capital to growth capital. This would also help to solidify the financial health of the company from a customer perspective and management believes this would meaningfully reduce the perceived risk of working with Capstone on large scale deployments.

OUR INSIGHT

The Opportunities

Capstone has experienced a variety of cycles and shifts in the industry over the past decade, but management believes it has never been better positioned to leverage what is now a sea change in how energy is viewed, created and delivered. The proliferation of renewables, a focus on energy security and reliability, outdated power grids and energy as a service (EaaS) are all driving change. It is important to note that Capstone's products are not experimental but rather have been deployed in wide scale commercial applications for decades. The platform has proven itself to be as advertised and is demonstrated by the fact that the company has to date shipped over 10,000 systems into 73 countries logging millions of operating hours. So, the question stands what is different today? Some of the highlighted opportunities include the following:

- Management took aggressive steps to reduce the operating costs of the business designed to make the company profitable on a much lower revenue base.
- The mega trend towards microgrids is firmly in place in our opinion, which should therefore increase the total available market to Capstone and aid in expanding revenue opportunities.
- There is a greater focus by numerous industries to lower their carbon footprint driven by corporate responsibility and/or regulations and Capstone's energy systems can help achieve those goals.
- A continuing pivot by the company to drive EaaS should, if successful, help stabilize the cash flows, improve predictability, and increase overall margins based on management commentary.

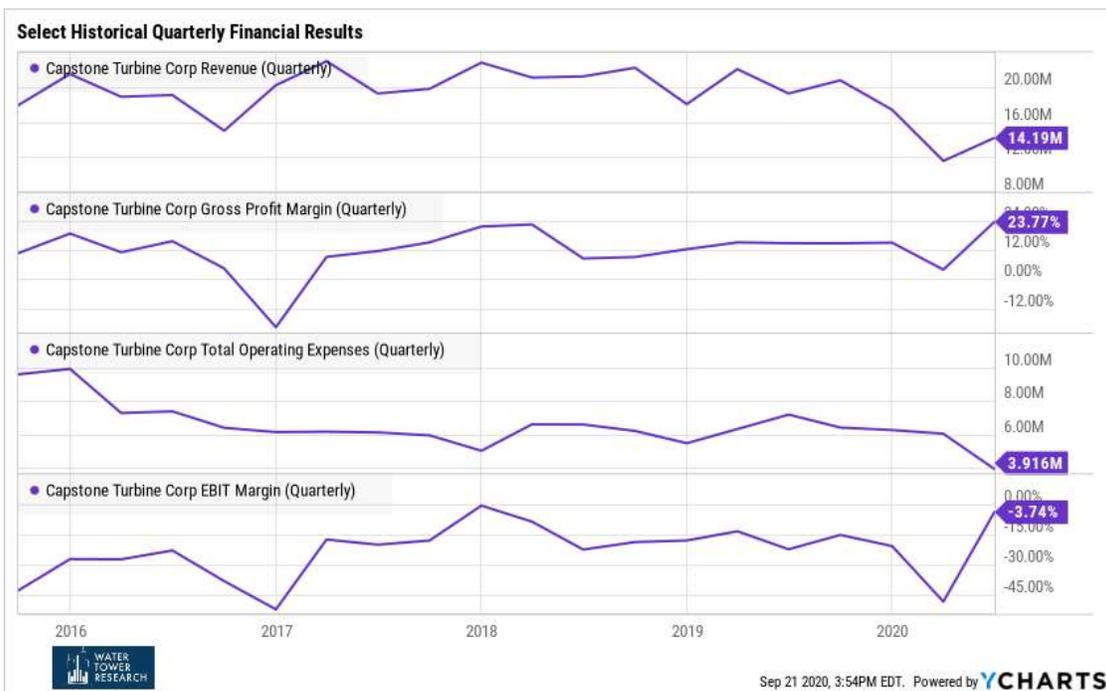
The Obstacles

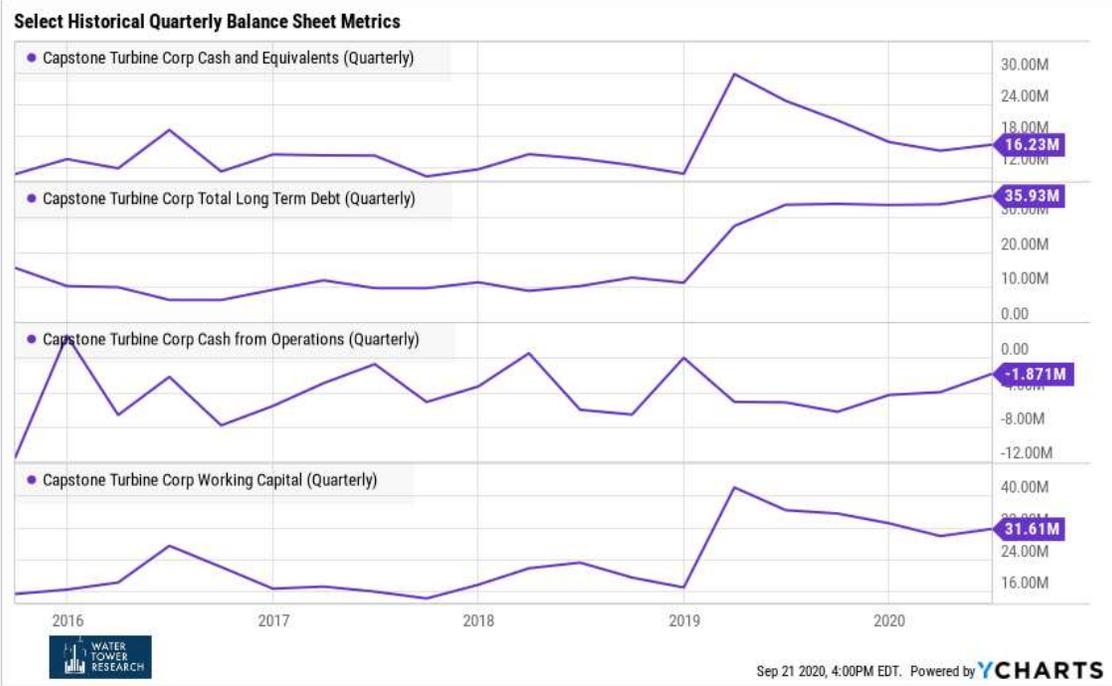
Although there are numerous favourable tailwinds, there are also challenges that must be navigated and overcome. The company has a long operating history throughout which it has not been profitable. There are a variety of externalities and issues that have been problematic, but nonetheless that is the reality. Some of the highlighted obstacles include the following:

- It is obvious, but external economic factors, elections, geopolitical issues, pandemics, etc. can all negatively impact demand for any product or service and Capstone is no different. Despite the variety of factors helping to sell microturbines, customers are still sensitive to the global economic conditions, which makes the product sales of the company somewhat cyclical. This is being offset to some degree for EaaS, but we believe the company needs both product sales and EaaS to grow to be successful.
- If the company can not refinance the Goldman note, the balance sheet could be strained and capital costs would remain high. The company needs to lower its cost of capital for long-term success and build an EaaS business.
- The direct sales force focused on national accounts needs to succeed as they are pivotal in increasing the average size of orders and driving more scale. This could prove to be a challenge given Capstone's size and balance sheet, but management has stated this is an important part of the strategy to return to revenue growth.

WATER TOWER RESEARCH CHART TOPPERS







ABOUT THE ANALYST
Shawn Severson – Co Founder & President
Head of ClimateTech & Sustainable Investing Research

Shawn Severson is President & Co-Founder of Water Tower Research and is a member of the Board of Managers. Prior to co-founding Water Tower Research and previously founding predecessor firm alphaDIRECT Advisors, Shawn spent over 20 years as a senior equity research analyst covering the Technology and ClimateTech sectors, including senior positions at JMP Securities, ThinkEquity, Robert W. Baird (London) and Raymond James, and he started his career as an equity research associate at Kemper Securities. Shawn was frequently ranked as a top research analyst including one of the Wall Street Journal’s “Best on the Street” stock pickers and a StarMine Analyst Awards Top 3 stock picker. Prior to co-founding Water Tower Research as well as alphaDIRECT Advisors, Shawn spent over 20 years as a senior research analyst covering the Technology and ClimateTech sectors that included senior positions at The Blueshirt Group, JMP Securities, ThinkEquity, Robert W. Baird (London) and Raymond James and he started his career as an Equity Research Associate at Kemper Securities. Shawn was frequently ranked as a top equity research analyst including one of the Wall Street Journal’s “Best on the Street” stock pickers and multiple awards as Starmine’s top three stock pickers. Shawn holds a BA in Finance and Economics from Augustana College.

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