WATER TOWER RESEARCH

CAPSTONE TURBINE (NASDAQ: CPST)

Preliminary 2Q21 Results and Adjustment of Debt Agreement

10 / 5/ 2020
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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.
- Broader industry trends should continue to favor 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 the industry should 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 shows the 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:	$5.38
52 Week Range:	$1.0 - $6.0
Avg. Daily Vol. (90 day)	198,665
Shares Out (MM):	11.0
Market Cap (MM):	$53.47
Institutional Ownership:	8.47%
Short Int. (MM) / % of float:	0.17/1.6%
Debt to Equity:	279%
Revenue TTM (MM):	$63.9

Source: YCharts, *As of October 5, 2020

WHAT HAPPENED?

On Friday, 10/2/20, the company reported preliminary financial results for 2Q21 showing positive cash generated from operations and total cash on hand increasing to $16.7 million, up from $16.2 million. The cash increase was generated without proceeds from any type of financing, loans, or government grants during the period. Additionally, on 10/30/20 the company announced gross product orders increased 73% in 2Q21 from 1Q21.

On October 5th, the company announced it entered into an amended Note Purchase Agreement (NPA) in which Capstone issued $20M in additional notes, to total $50M up from $30M. All $50M now bears an interest at LIBOR Rate plus 8.75% per annum and is due on October 1, 2023. At today's rates that translates into approximately 9.75%. This compares to the 13% rate previously paid on the $30M note. Capstone agreed to use the $20M to expand its high-margin, long-term rental fleet from today's 8.6 MW to 21 MW and for general corporate purposes. The covenants include requiring Capstone to expand its long-term rental fleet by at least 6.25 MW by the 9-month anniversary of the closing date and 12.5 MW by the 18-month anniversary of the closing date.

OUR INSIGHT ON WHAT HAPPENED

The Opportunities

Preliminary 2Q21 results were announced on 10/2/20 and on 9/30/20, but with limited information. On November 30th Capstone announced new microturbine gross product orders were approximately $9.5 million for the 2Q21 ending September 30, 2020, compared to $5.5 million in 1Q21, representing a 73% improvement in bookings. On October 2nd, the company announced that for the second quarter ended September 30, 2020, it posted positive cash generated from operations and total cash on hand increased to $16.7 million, up from $16.2 million in the prior quarter ended June 30, 2020. The takeaways are that business is recovering off the pandemic bottom as shown by bookings and importantly the company's cash balance managed to increase without any dilution. Management attributed the positive cash flow to lower operating expenses and better management of working capital in combination with improving aftermarket service margins and a further rebound in product shipments. It is worth noting that this is the first time the company has produced positive cash from operations since the quarter ended March 31, 2018.

As we pointed out in our Initiation of Coverage Report on September 30, maintaining cash levels and reaching positive operational cash flow are key milestones. Although results could fluctuate quarter to quarter, holding around breakeven on operational cash flow should reduce the need for any dilutive capital unless required for additional growth opportunities.

The second notable event occurred today when the company announced it has refinanced and expanded its Note Purchase Agreement (NPA) with Goldman Sachs in which Capstone issued $20 million in additional notes from the $30 million in place already to a total of $50 million. The overall rate on the $50 million note is now LIBOR Rate plus 8.75% per annum (approximately 9.75% based on current rates) and is due on October 1, 2023 compared to 13% before. More importantly however, is that Capstone now has access to additional capital, which is critical to the company's ability to grow its Energy as a Service (EaaS) platform. Specifically, the expanded $20 million note will be used to grow the long-term rental fleet from today's 8.6 MW to 21 MW as well as some corporate expenses. The covenants include requiring Capstone to expand its long-term rental fleet by at least 6.25 MW by the 9-month anniversary of the closing date and 12.5 MW by the 18-month anniversary of the closing date.

The EaaS strategy, if successful, could have numerous benefits including more predictable and stable cash flows and margin expansion, despite product orders and backlog experiencing variability quarter to quarter. A critical factor in making this an attractive business to Capstone is having access to capital at a reasonable rate, which this amended agreement facilitates.

The Obstacles

Execution and the economy remain important variables. Specifically, to meet the covenants of the note, Capstone must secure additional wins as cited above. The company will also have to absorb approximately $1 million in additional interest expense on an annual basis. However, to add perspective, the cash returns on the rental business are attractive and successful execution on the additional 12.5 MW of rental business should boost cashflow meaningfully above the additional cash interest payment.

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 kWs 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 emphasize 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).

WATER TOWER RESEARCH CHART TOPPERS


Price-To-Sales
Capstone Turbine Corp PS Ratio (Forward 1y)
Capstone Turbine Corp PS Ratio (7y Median)
Capstone Turbine Corp PS Ratio (3y Median)
Capstone Turbine Corp PS Ratio (5y Median)
1.20
0.90
0.60
0.30
0.574
0.559
0.531
0.382
Jan '19
May '19
Sep '19
Jan '20
May '20
Sep '20
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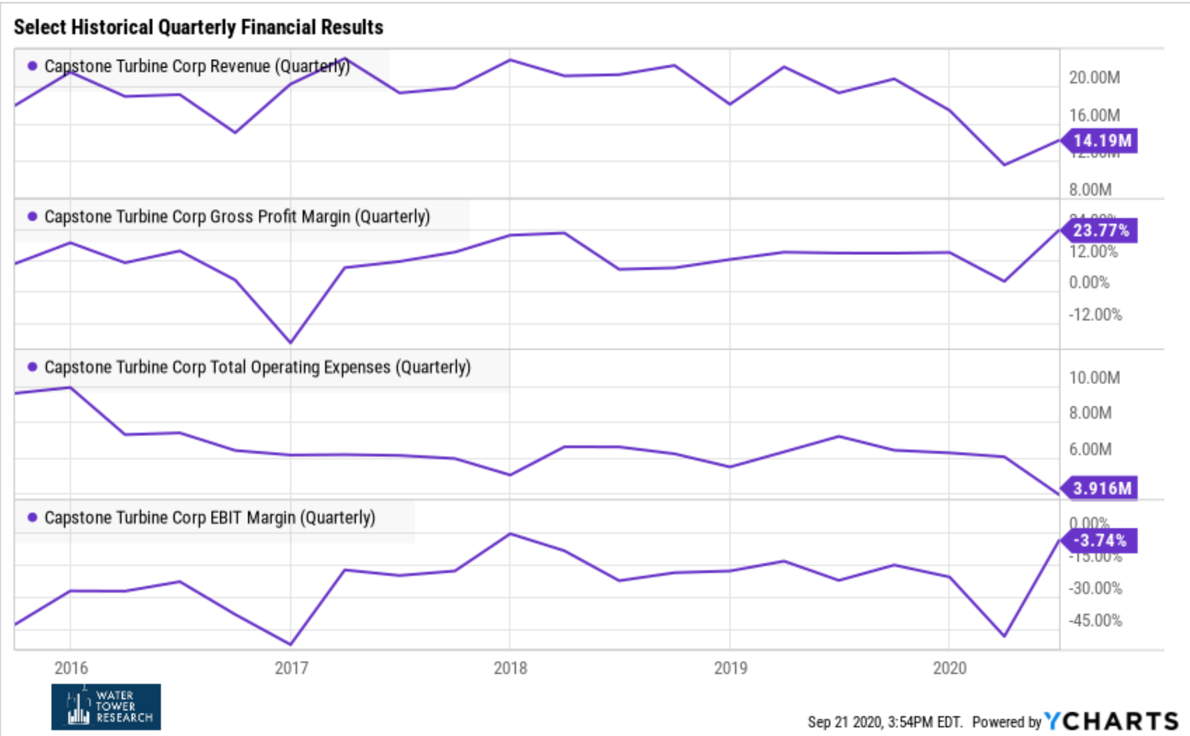
Select Historical Quarterly Financial Results
Capstone Turbine Corp Revenue (Quarterly)
20.00M
16.00M
14.19M
8.00M
Capstone Turbine Corp Gross Profit Margin (Quarterly)
23.77%
12.00%
0.00%
-12.00%
Capstone Turbine Corp Total Operating Expenses (Quarterly)
10.00M
8.00M
6.00M
3.916M
Capstone Turbine Corp EBIT Margin (Quarterly)
-3.74%
-30.00%
-45.00%
2016
2017
2018
2019
2020
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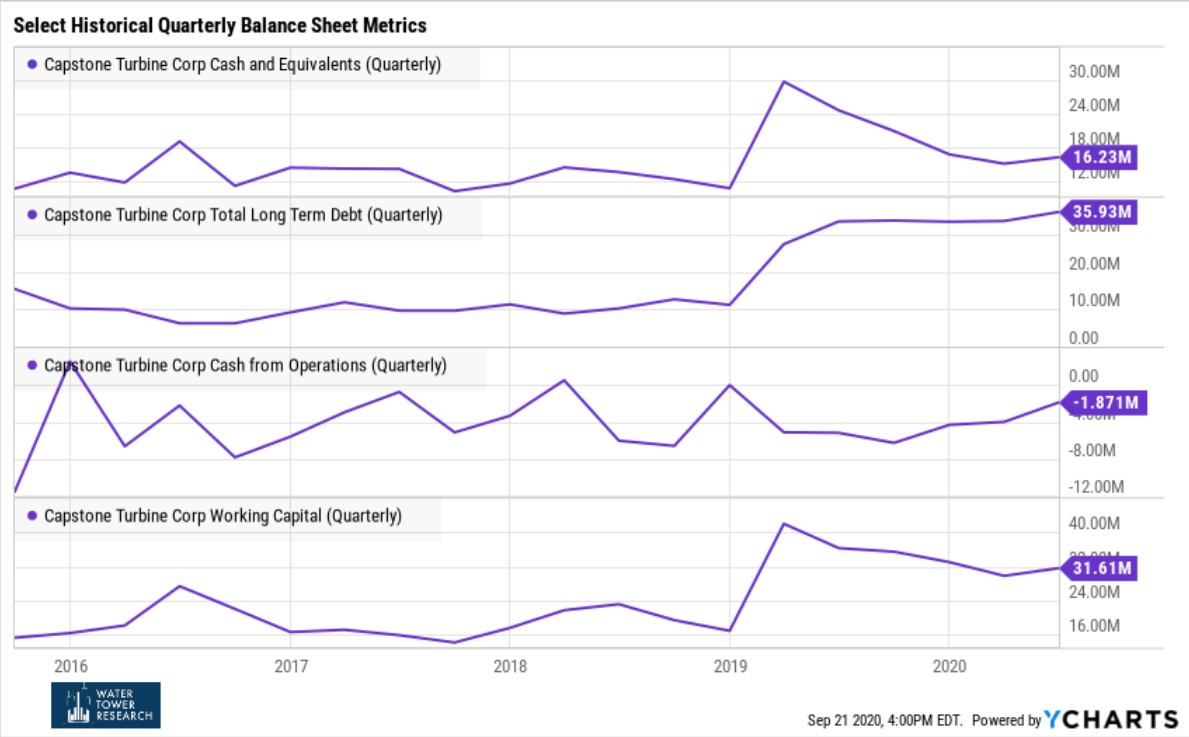

ABOUT THE ANALYST
Shawn Severson – Co Founder & President
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Shawn Severson is President & Co-Founder of Water Tower Research and is a member of the Board of Managers. Prior to co-founding Water Tower Research and previously founding predecessor firm 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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