EQUITY RESEARCH

RBC Capital Markets

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December 5, 2024

Water Intelligence PLC

Sound Q3 trading - looking good for 2025

Our view: 9m results were in line, with sales +10% (vs +7% at H1) and adjusted EBITDA +12%, with margin progress of c. 20bp. We aren't making forecast changes today, but continue to see earnings risks to the upside as we go into 2025 and see the valuation as attractive, given the size of the growth opportunity. We remain at Outperform, with significant upside potential to our 800p price target.

Key points:

9m results as expected - Sales growth was 10% (vs H1 +7%) and adjusted EBITDA was $11.9m vs $11.8m forecast, up +11% (vs H1 +12%) with the margin up +20bp (vs H1 +110bp). The balance sheet remains strong with gearing at 0.84x, providing ammunition for further M&A/franchise buy-ins and buybacks.

Outlook positive on growth acceleration - The overall outlook from management remains positive post the 50th year ALD convention, the launch of its Next 50 growth plan, and the appointment of Will Knell as CEO of ALD. Management believes it is well-placed to fund an accelerated plan for organic growth, accretive M&A, along with options for share buybacks. It also talks about aiming for better communication around the equity story going forward.

No material forecast changes but risks to upside - We recently increased our 25/26 EPS forecasts by 6%/7% post the announcement of the Dallas franchise reacquisition. We are leaving forecasts unchanged today, however, see upside potential given the growth potential from new product offerings (e.g. Pulse in the US), the roll-out of new technicians from the Bridgeport training facility, leveraging Salesforce, and from a general re-invigoration post the launch of the Next 50 strategy and the Will Knell appointment. We believe there is also further potential upside to come from M&A, and we would note management's more aggressive growth commentary in this regard over the last 6m (as evidenced by the Dallas buy-in), especially given the recently increased balance sheet capacity.

Well positioned in structural growth markets - WATR is the US market leader in the large, defensive, high-single-digit growth leak detection arena, where we believe there are significant competitive advantages from its national network, technology capability and matrix of solutions across the water and wastewater value chain. We believe structural drivers remain strong and there are multiple value levers to pull from expanding the national account channels, expanding into new geographies and executing further franchise buy-ins. In terms of valuation, the FY25E P/E is now c. 12x, with the FCF yield over 9%, a material discount to the defensive growth names in the sector. Our DCF-derived price target remains at 800p, comprising 630p for the core business and 170p for further franchise buy-ins/M&A, representing significant upside potential.

Outperform

LSE: WATR; GBp 397.50

Price Target GBp 800

WHAT'S INSIDE	
☐ Rating/Risk Change	☐ Price Target Change
☐ In-Depth Report	☐ Est. Change
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Scenario Analysis*

Downside Scenario	Current Price	Price Target	Upside Scenario
285.00	397.50	800.00	1,075.00
↓ 28%		↑ 101%	↑ 170%

*Implied Total Returns

Key Statistics

Shares O/S (MM):	17.4	Market Cap (MM):	69
Dividend:	0.00	Yield:	0.0%
		Avg. Daily Volume:	14,043

Market Cap in GBP

RBC Estimates

FY Dec	2023A	2024E	2025E	2026E
Revenue	75.9	85.5	99.2	105.4
EPS, Adj Diluted	33.50	36.20	41.40	44.90
P/AEPS	15.1x	13.9x	12.2x	11.2x
DPS	0.00	0.00	0.00	0.00
Div Yield	0.0%	0.0%	0.0%	0.0%

All market data in GBp; all financial data in USD; dividends paid in GBp.
Priced as of prior trading day's market close, EST (unless otherwise noted).

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9m update in line

Results for the 9m were in line with expectations with adjusted EBITDA coming in at $11.9m (vs $11.8m forecast). Overall revenue growth was 10% (vs 7% in H1), with good EBITDA margin progress of 20bp, leading to adjusted EBITDA increasing 11% (vs +12% in H1). This is despite continued inflationary pressures on wages and materials, and the cost of the ALD convention.

Exhibit 1 - Key numbers from 9m update

Year ended 31 Dec ($m)	9m24A	9m23A	Change YoY
Royalty income	5.2	5.3	-3%
Franchise-related activities	8.3	8.8	-5%
US corporate operated locations	42.7	37.9	13%
International corporate activites	7.3	5.8	26%
Total revenue	**63.5**	**57.8**	**10%**
Adjusted EBITDA	11.9	10.7	11%
Adjusted EBITDA margin	18.7%	18.5%	
Reported EBITDA	10.9	9.8	11%
Reported EBITDA margin	17.2%	17.0%	
Adjusted PBTA	7.7	7.3	6%

Source: Company reports

Sales – 9m sales growth was 10% (vs 7% in H1), with the increase helped by franchise reacquisitions and the Feakle acquisition in Ireland.

Margin – The Adjusted EBITDA margin was up 20bp (vs.+110bp in H1), which reflects a good operational performance given continued inflationary pressures, the impact of lower margin M&A and the cost of the big 50 year ALD convention.

Balance sheet –The balance sheet position is in line with expectations with gearing at 0.84x. (an increase from the 0.54x at H1 due to M&A).

Corporate developments YTD:

- Pittsburgh, Fresno, Lafayette and Dallas re-acquisitions announced YTD
- Launch of Next 50 growth strategy at recent ALD convention
- Will Knell appointed CEO of ALD and corporate HQ moved to Dallas
- Refinancing of credit facilities in August

Outlook positive – The overall outlook from management remains positive and it believes it is well placed to fund an accelerated plan for organic growth, accretive M&A along with options for share buybacks. It remains excited about the future having formally launch its Next 50 growth plan in October, coinciding with its American Leak Detection Convention celebrating the fiftieth anniversary of its core business. Management also talks about improving communication of the value in the shares over the next period.

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No forecast changes at this point

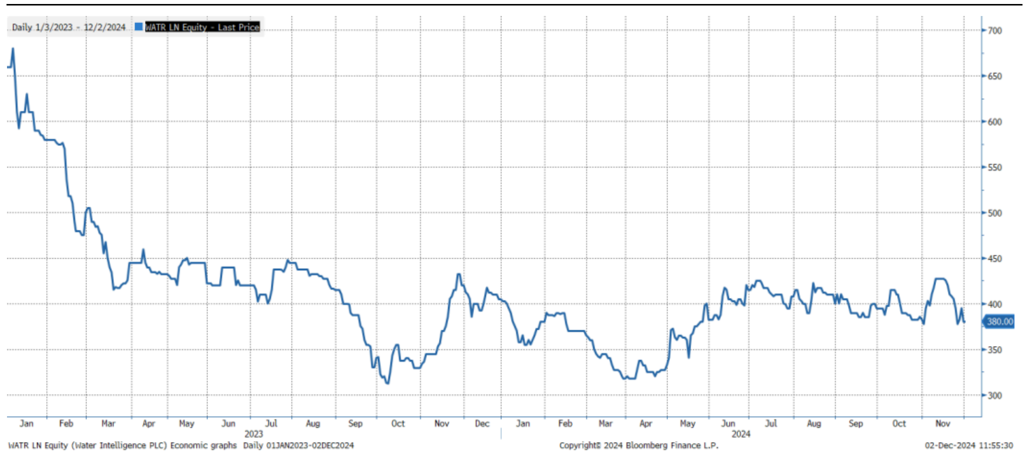
We increased 25/26 EPS forecasts by 6%/7% post the announcement of the Dallas franchise buy-in at the start of November. We have not changed forecasts today. However, we continue to see upside into 2025 given the potential for growth from new product offerings (e.g. Pulse in the US), the roll-out of new technicians from the Bridgeport training facility, leveraging Salesforce, and from a general re-invigoration post the ALD convention, launch of the Next 50 strategy and the appointment of Will Knell as ALD CEO. WE believe there is also further potential upside to come from M&A and we would note more aggressive management commentary of late in that regard.

Share price performance

The shares have performed poorly over the last 2 years. This partly reflects the impact of bond yields going up on growth stocks as interest rates have risen, along with the general malaise of UK mid-cap names, AIM listed especially given fund outflows, where the lack of liquidity in WATR also hasn't helped.

In addition, organic growth and EPS momentum has slowed at WATR due to the macro, although we expect this to improve over the next few quarters as investments made start to kick-in and M&A impacts (as per the Dallas buy-in announced in November).

Exhibit 2 - Share price performance since 2023



Source: Bloomberg

Valuation

The shares have de-rated materially over the past 2 years and now trade on a 25E P/E of c.12x and a FCF yield of over 9% – these valuations look very attractive in the context of the sector given the organic revenue growth potential and the likelihood of further franchise buy-ins (at very attractive valuations). To this end, our core valuation analysis comprises a two-stage DCF of the business on an 'as is' basis, plus our estimate of the future value creation from self-funded franchise buy-ins.

Our price target values the core 'as is' business, including M&A announced to date, at 630p per share (based on a WACC of 9.5% and terminal growth of 2.0%), plus a discrete valuation of future franchise re-acquisitions (we think highly value accretive) at a further 170p per share, (assuming WATR buys back c.3% of franchise revenue p.a.) combining to create our 800p price target.

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Business Services

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Share price (£)	**Priced at 4/12/24**	**Market cap (£m)**
3.95	**(1515 UK time)**	**69**

Year to 31 December

P&L ($m)	**2023A**	**2024E**	**2025E**	**2026E**
Revenues	**76.0**	**85.5**	**99.2**	**105.4**
% change YoY	6.5%	12.6%	16.0%	6.3%
Adjusted EBITDA (co. APM)	**13.4**	**15.2**	**17.5**	**18.8**
% change YoY	8.6%	13.1%	15.7%	7.0%
Adjusted EBITA (co. APM)	**9.7**	**11.1**	**12.7**	**13.6**
% change YoY	6.0%	15.1%	14.3%	7.2%
EBITA margin	12.7%	13.0%	12.8%	12.9%
Net finance expense	(0.9)	(0.9)	(1.1)	(1.1)
Tax	(1.6)	(2.6)	(3.0)	(3.3)
Other charges (net)	(2.7)	(1.7)	(1.7)	(1.7)
Net income	**4.4**	**5.9**	**6.8**	**7.4**
Shares outstanding y/e (m)	17.4	17.4	17.4	17.4
Reported EPS (basic) - ¢	25.3	34.2	39.4	42.9
Underlying EPS (basic) - ¢	**33.5**	**36.2**	**41.4**	**44.9**
% change YoY	31.2%	8.1%	14.4%	8.3%
DPS - ¢	**0.0**	**0.0**	**0.0**	**0.0**

MARGIN and RATIO ANALYSIS	**2023A**	**2024E**	**2025E**	**2026E**
EBITDA margin (%)	17.7	17.7	17.7	17.8
EBITA margin (%)	12.7	13.0	12.8	12.9
Net profit margin (%)	5.8	6.9	6.9	7.1
FCF margin (on revenue) (%)	8.3	6.9	7.9	8.8
Revenue/Total assets (x)	0.8	0.9	0.9	0.9

P/E (adj)	**15.2x**	**14.1x**	**12.3x**	**11.4x**
Dividend yield	0.0%	0.0%	0.0%	0.0%
EV/EBITDA	6.6	4.2	3.8	4.0
EV/EBITA	9.2x	5.7x	5.3x	5.5x
PEG Ratio	0.5x	1.7x	0.9x	1.4x
FCF Yield (%)	7.1	6.7	8.8	10.5
Net debt/EBITDA	0.0x	0.3x	0.1x	-0.3x
ROE (post-tax)	11.4	11.9	13.1	12.9
ROIC (post-tax)	10.2	10.2	11.5	12.3

CASH FLOW ($m)	**2023A**	**2024E**	**2025E**	**2026E**
EBITA	9.7	11.1	12.7	13.6
Depreciation/amortisation	3.7	4.0	4.8	5.2
Working capital	(0.0)	(1.5)	(1.2)	(0.6)
Taxes, Interest & other	(2.6)	(3.0)	(3.5)	(3.8)
CF from operations	**10.7**	**10.7**	**12.8**	**14.4**
Capex (inc. new leases)	(4.4)	(4.8)	(5.0)	(5.1)
Equity FCF	**6.3**	**5.9**	**7.8**	**9.3**
M&A/Other investments	(4.2)	(6.0)	(2.5)	(1.5)
Net equity movements	-	-	-	-
Dividend to shareholders	(0.2)	-	-	-
Others /FX	(7.4)	(4.9)	(1.4)	(0.4)
Change in net debt	**(5.5)**	**(4.9)**	**3.9**	**7.4**
Y/e net (debt)/cash (ex leases)	**(0.0)**	**(4.9)**	**(1.0)**	**6.4**

KEY OPERATING STATISTICS	**2023A**	**2024E**	**2025E**	**2026E**
Constant currency growth rate (%)	3.0%	6.0%	6.0%	6.3%
Capex/Depreciation	1.2x	1.2x	1.0x	1.0x
Tax Rate (%)	30.0%	30.0%	30.0%	30.0%

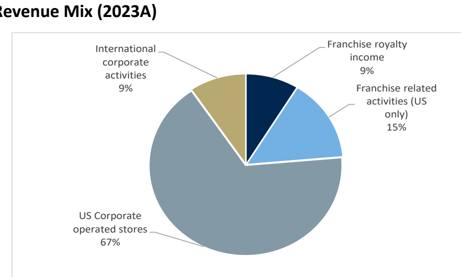
SHARE OWNERSHIP	**%**
Patrick Desouza	25.0
Plain Sight Systems Inc	12.5
Cannacord Genuity	11.0
Berenberg AM	6.5
George D Yancopoulous	4.5
Amati	4.2
Herald	3.3

BALANCE SHEET ($m)	**2023A**	**2024E**	**2025E**	**2026E**
Tangible fixed assets (inc. RoUAs)	10.5	8.1	5.1	1.9
Intangible fixed assets	57.6	60.2	62.7	65.2
Receivables	14.3	17.2	19.6	20.8
Cash	15.8	15.8	19.5	26.7
Other	(1.6)	(1.4)	(1.4)	(1.5)
Total assets	**96.6**	**99.8**	**105.4**	**113.0**
Borrowings (inc. leases)	19.3	24.4	24.4	24.4
Payables	6.0	7.4	8.6	9.2
Provisions/Def. consideration	8.4	6.1	4.7	4.3
Deferred tax	2.6	3.1	3.8	4.4
Other liabilities	0.0	(0.0)	0.0	0.0
Total liabilities	**36.3**	**41.1**	**41.5**	**42.3**
Share capital, reserves, others	60.3	58.7	63.9	70.8
Total equity	**60.3**	**58.7**	**63.9**	**70.8**
Book value per share ($/sh)	3.48	3.38	3.68	4.08

VALUATION

We value the core business on a DCF basis and then assume a buy-in of c.3% of its franchise revenue every year.

Business Revenue Mix (2023A)



For RBC Capital Markets valuation comparatives, recent research, and other data please see RBC Insight or Bloomberg <RBCR> GO

Source: RBC Capital Markets estimates, Company Reports, Refinitiv

Key fundamental questions

	Our view
What are the market growth drivers?	There are a number of growth drivers – population growth, climate change, poor water infrastructure, the poor state of US housing and the propensity for leaks, the rising costs to insurers and potentially increased regulation given an increased focus on water scarcity. Whilst it is tough to scale the overall market size, market estimates suggest the market is growing at c.6-10% pa.
Why is ALD well positioned?	ALD is the market leader in minimally invasive leak detection in the US. It has a national footprint with network sales of over $100m, with over 200k customers. The market remains extremely fragmented, ranging from one-man-band plumbers to specialist leak detection players and so the national network is a key competitive advantage. It has strong technology capability, has now started to leverage the business into national accounts (with insurers) and has the opportunity to expand further internationally.
How important is technology?	We believe WATR's technology offering is a key differentiation, especially versus some of the smaller players. It also reflects a realisation that using the best technology can produce the best, least invasive service for customers which is key for recurring future revenues. Having both strong technology and the national network provides a strong competitive advantage.
What is the potential uplift from buying back franchises?	WATR has been selectively re-acquiring franchises where it makes sense from an operational and/or financial perspective. This has no impact on the overall network sales but is positive from a financial perspective, as these deals tend to be very accretive. We estimate that using the current financial headroom of $18m to buy back franchises would be 30% accretive to profits.
Isn't the headline valuation too high?	We believe the headline valuation is now attractive given: (1) other network businesses in high structural growth defensive end markets trade on high valuations in the US (e.g. Ecolab, Rollins, Cintas, etc.); and (2) the significant accretion on buying back franchises needs to be taken into account.
Can the business fund its own growth?	WATR is a relatively high margin business and currently has a strong Balance Sheet with gearing sub 1.0x. The company currently has sufficient resources to deliver its growth plan, although we would not rule out further equity raises should there be an acceleration of franchise buy-ins or should other attractive M&A opportunities present themselves.

Key ESG questions

This section is intended to highlight key ESG discussion points relevant to this company, as well as our views on the outlook. Both the questions we highlight and our responses will evolve over time as the dialogue between management, analysts and investors continues to advance. We welcome any feedback on the topics.

	Our view
What are the most material ESG issues facing this company?	Given the people-intensive nature of the business, the importance of advanced human capital to a technology and services-led business is high. Maintaining a safe and motivated and well-trained workforce are the key issues for the group. On the Environmental side, the overall ethos of the Group is about reducing water leakage for customers – the key issue for WATR is to control its own environmental footprint, with the key variants being carbon and emissions from truck and its technology, and the carbon footprint from office usage. From a Governance perspective, the key issues are that the Chairman is the main shareholder and that there is no CEO, hence there is key man risk.
Does the company integrate ESG considerations into its strategy?	The Group's brand stands for the conservation of water and the importance of providing solutions to potable and non-potable water leaks, so sustainability credentials are high. ESG is important for the Group, and it recognises that as a fast-growing business it needs to improve disclosure. As such, there is minimal disclosure around the environmental footprint at present. However, WATR did receive the Green Economy Mark from the London Stock Exchange during 3Q20, and was also added to indices by a well-known ESG vendor during 4Q. On the Social side, the Group is committed to achieving equal opportunities and to complying with relevant anti-discrimination legislation. It established its Group policy to offer employees and job applicants the opportunity to benefit from fair employment, without regard to their sex, sexual orientation, marital status, race, religion or belief, age or disability. Employees are encouraged to train and develop their careers. We note the recent appointment of a Chief People Officer as a step in further formalising and disclosing processes. On the Governance side, we would note the recent strengthening of the Board and the appointment of incremental key management positions - e.g., Chief Innovation Officer. We believe there is more to do here over time, and would note there is currently no CEO position, with the Chairman and major shareholder running the business on a day-to-day basis.
What is diversity like at board / management level?	One out of five directors is female. We expect added disclosure on diversity as the Group improves its ESG disclosures over time.

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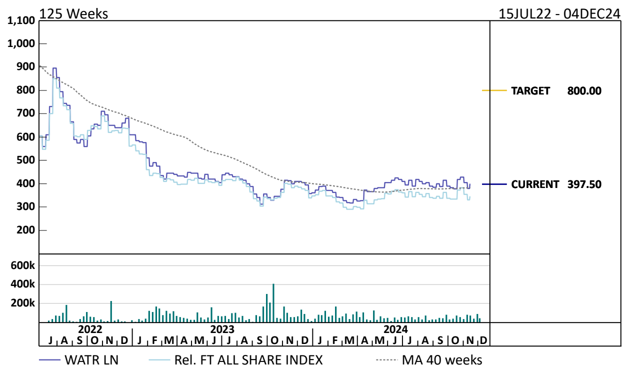
Target/Upside/Downside Scenarios

Water Intelligence PLC



Source: Bloomberg and RBC Capital Markets estimates for Target

Valuation

Our price target is based on a two-stage DCF, valuing the core ‘as is’ business, including M&A announced to date, at 630p per share (based on a WACC of 9.5% and terminal growth of 2.0%) plus a discrete valuation of future franchise re-acquisitions (we think highly value accretive) at a further c.170p per share, combining to create our 800p price target. We believe this material upside potential supports our Outperform rating.

Upside scenario

Franchise reacquisition activity steps up to 8% of PY franchise sales p.a.; all other core assumptions maintained. This generates an implied valuation of 1,075p.

Downside scenario

285p - Assumes 10% miss vs FY25E EPS and stock de-rates to 10x FY25E P/E.

Investment summary

- **Strong US market position in growth market** - WATR is the US market leader in minimally invasive leak detection. It has an established national footprint in a large, highly fragmented market with a number of structural growth drivers. Whilst it is tough to address the overall market size, market estimates suggest the market is growing at c.6-10% pa.
- **Potential to roll out more widely** - As well as the potential to grow the existing US business, there is scope to further grow the national account channel with insurers as well as to grow geographically in both municipal and residential markets. ALD already has businesses in Canada, UK and Australia.
- **Technology is a differentiator** - We believe WATR's investment in technology, along with its licences, IP, patents and preferred partner agreements is a competitive advantage, especially versus the smaller players. Its investment in Salesforce's field automation software and associated SOC II environment is an attractive attribute for national account customers.
- **Value from buying back franchises** - WATR has been selectively reacquiring franchises where it makes sense from an operational and/or financial perspective. These re-acquisitions have been typically done at 3.5-6.5x profits and are highly accretive.

Risks to rating and price target

- **Growth costs** - The business is in a high-growth phase and investment in people and systems will be needed over time. This may cause some lumpiness in the cost base.
- **M&A** - The timing, price and funding of further franchise buybacks and any incremental M&A could potentially impact valuation.
- **Management bandwidth and ESG** - As the business continues to grow, it will need to add further management and capability. From an ESG perspective, we expect better disclosure over time, whilst from a Governance point of view, we would note there is currently no CEO position, which presents some key man risk.
- **Is technology a real advantage?** There is some risk that new technology will be developed that will usurp current products.
- **High headline valuation -** Headline valuations are high, although other network businesses in high growth markets also trade on high valuations. In addition, the significant accretion on buying back franchises needs to be taken into account. The ability to continue to do franchise buy-ins thus remains a risk.
- **Forex** - With the majority of revenues in USD and a GBP share price, there is a translation risk.

Company description

Water Intelligence PLC is a holding company for two wholly owned subsidiaries:

American Leak Detection (ALD) - Established in 1974, ALD is largely a US-based franchise business with strategic corporate-operated locations. ALD is a leader in using both proprietary and third party technology to pinpoint and repair water leaks without destruction. Solutions target both residential and business-to-business customers, such as insurance companies, which value its “minimally invasive” value proposition. The critical mass of sales is derived from direct sales via corporate-operated locations and indirect sales measured by royalty income from franchisees, which, in turn, is based on franchisee gross sales to end-users. With its installed and growing base of residential customers, ALD can also up-sell technology-based home services products to meet growing consumer demand for solutions to water loss and water quality.

Water Intelligence International - WII, its UK-based operation, focuses on municipal solutions given the world-wide problem of failing water infrastructure. WII’s solutions are also technology-based. It is exclusively a corporate-run unit that leads the group’s international expansion. WII does have the capability to execute ALD service offerings and is currently doing so at its corporate-operated locations in Australia. WII also cross-sells complementary municipal offerings and residential wastewater solutions to ALD for municipal customers in the US.

Required disclosures

Non-U.S. analyst disclosure

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RBC Europe Limited makes a market in the securities of Water Intelligence PLC.

RBC Europe Limited currently acts as Broker to Water Intelligence PLC

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Ratings
Outperform (O): Expected to materially outperform sector average over 12 months.
Sector Perform (SP): Returns expected to be in line with sector average over 12 months.
Underperform (U): Returns expected to be materially below sector average over 12 months.
Restricted (R): RBC policy precludes certain types of communications, including an investment recommendation, when RBC is acting as an advisor in certain merger or other strategic transactions and in certain other circumstances.
Not Rated (NR): The rating, price targets and estimates have been removed due to applicable legal, regulatory or policy constraints which may include when RBC Capital Markets is acting in an advisory capacity involving the company.
Risk Rating
The **Speculative** risk rating reflects a security's lower level of financial or operating predictability, illiquid share trading volumes, high balance sheet leverage, or limited operating history that result in a higher expectation of financial and/or stock price volatility.

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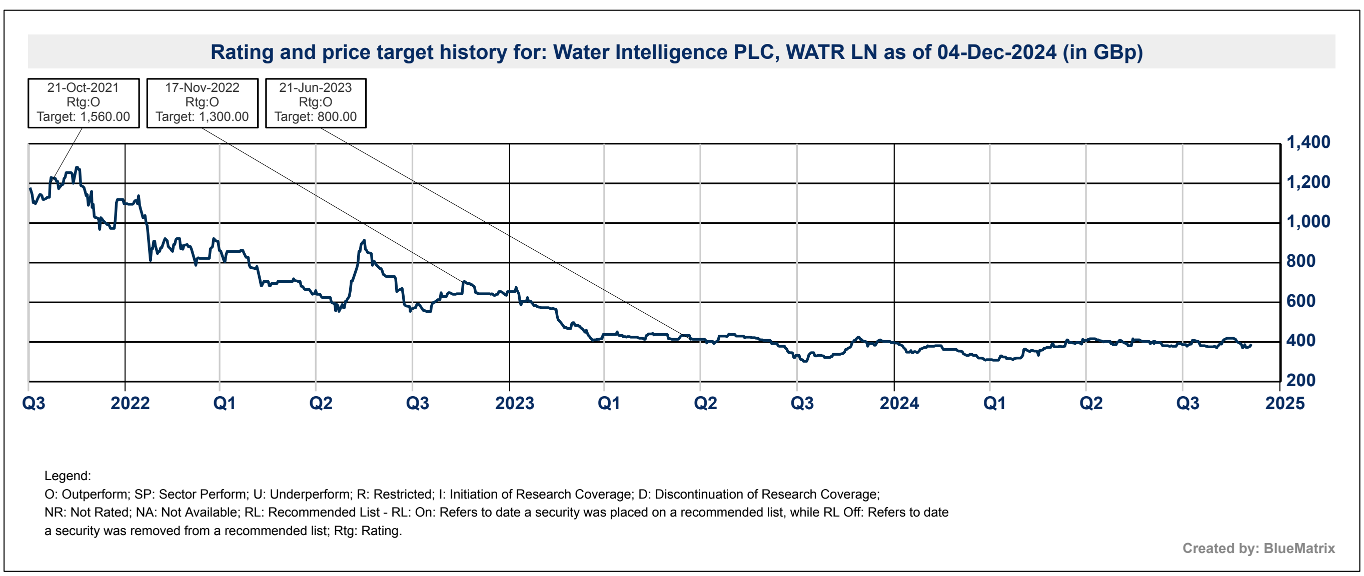
Distribution of ratings
RBC Capital Markets, Equity Research
As of 30-Sep-2024

			Investment Banking Serv./Past 12 Mos.	
Rating	Count	Percent	Count	Percent
BUY [Outperform]	858	57.39	290	33.80
HOLD [Sector Perform]	599	40.07	153	25.54
SELL [Underperform]	38	2.54	3	7.89



References to a Recommended List in the recommendation history chart may include one or more recommended lists or model portfolios maintained by RBC Wealth Management or one of its affiliates. RBC Wealth Management recommended lists include the Guided Portfolio: Prime Income (RL 6), the Guided Portfolio: Dividend Growth (RL 8), the Guided Portfolio: ADR (RL 10), and the Guided Portfolio: All Cap Growth (RL 12). The abbreviation 'RL On' means the date a security was placed on a Recommended List. The abbreviation 'RL Off' means the date a security was removed from a Recommended List. As of April 3, 2023, U.S. RBC

Wealth Management's quarterly reports will serve as the primary communication for its models and will highlight any changes to the model made during the quarter.

Equity valuation and risks

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Water Intelligence PLC

Valuation

Our price target is based on a two-stage DCF, valuing the core 'as is' business, including M&A announced to date, at 630p per share (based on a WACC of 9.5% and terminal growth of 2.0%) plus a discrete valuation of future franchise re-acquisitions (we think highly value accretive) at a further c.170p per share, combining to create our 800p price target. We believe this material upside potential supports our Outperform rating.

Risks to rating and price target

- **Growth costs** - The business is in a high-growth phase and investment in people and systems will be needed over time. This may cause some lumpiness in the cost base.
- **M&A** - The timing, price and funding of further franchise buybacks and any incremental M&A could potentially impact valuation.
- **Management bandwidth and ESG** - As the business continues to grow, it will need to add further management and capability. From an ESG perspective, we expect better disclosure over time, whilst from a Governance point of view, we would note there is currently no CEO position, which presents some key man risk.
- **Is technology a real advantage?** There is some risk that new technology will be developed that will usurp current products.
- **High headline valuation -** Headline valuations are high, although other network businesses in high growth markets also trade on high valuations. In addition, the significant accretion on buying back franchises needs to be taken into account. The ability to continue to do franchise buy-ins thus remains a risk.
- **Forex** - With the majority of revenues in USD and a GBP share price, there is a translation risk.

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