# Ubika Sustainability 20

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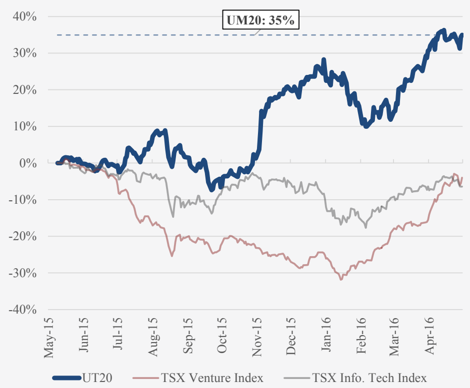
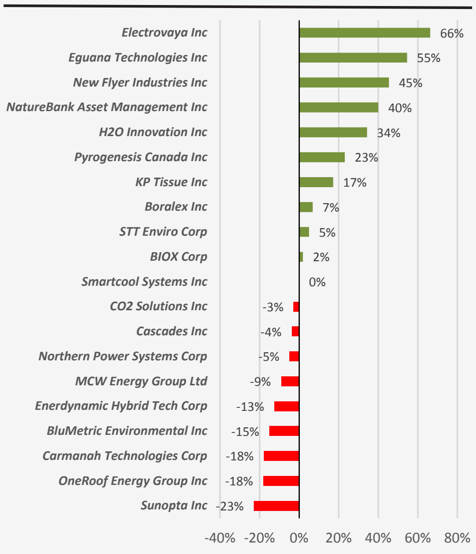
**Ubika Sustainability 20**
Feb. 22, 2016 - May 9, 2016

| | |
|---|---|
| US20: | +22.7% (36% Y/Y) |
| TSX Venture: | +24.9% (-4% Y/Y) |
| DJSI - NA40: | +6.5% (-6% Y/Y) |

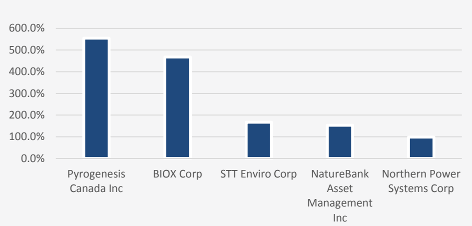
*Dollar amounts in CAD unless otherwise stated.*




## US20: Performance Distribution




## Top Volume Gainers (m/m)




# Is the Growing Demand for Renewable Energy Sustainable?

The 2-year crash in oil prices, natural gas, and coal have been detrimental to the fossil fuel industry at large. With the fall in prices, some wonder if oil is a better “bang for your buck” form of power generator. However, during the same timeframe, renewable energy has grown immensely. Specifically, wind and solar investments have risen and are forecasted to continue at an accelerating pace. Investors should note the fundamental drivers to this increased demand for renewables. It comes in two-folds: 1) government subsidies and programs geared towards higher investments and 2) economies of scale driving prices to fractions of what they were only a few years back.

## Industry Highlights

- Global oil glut and depressed Chinese demand has caused mayhem in the oil sector. Some producers are finding their marginal costs of extraction reach higher than the selling price of a barrel of oil. Along with that comes a record amount of bankruptcies in the sector and a shift in investment from oil to renewables. It must be noted that there is virtually no oil or natural gas company which has not substantially cut their capital expenditure plans.
- Global Warming is becoming more and more apparent: March 2016 was recorded as the third warmest month ever and April 2016 was the fourth. April 22nd marked the day of the Paris Agreement on Climate Change which has 196 countries striving to keep the increase of global temperature below 1.5 degrees Celsius by 2100.
- Coal consumption is falling YoY in the majority of the Organization of Economic Co-operation and Development (OECD) countries. Even China, the world’s largest consumer of coal witnessed negative YoY % change.
- In March of this year, 16 successful Large Renewable Procurement (LRP) contracts were awarded by the Ontario government, 75% supported by local municipalities. The province has set targets to increase wind, solar, hydroelectric, and bioenergy power generation.
- Tesla’s ‘Gigafactory’ set for 2020 release of innovative batteries is to be used extensively in solar-power generation. The Lithium Ions are expected to sell for $100/kWh, compared to the current industry average of ~$350/kWh. This speaks to the heightened Lithium demand over the past years, and shows early signs of a bubble market getting ready to burst. In effect, this will hurt the producers of such batteries, however will benefit the users via the cost reduction.

## Outlook for Upcoming Months:

The renewable energy and sustainability sector is, without a doubt, growing. As investors, we need to stay caught up with current events. Coming up events include the Sustainable Brands San Diego (June 6-9, 2016), American Water Works Association (June 20-22, 2016) and Sustainability in Public Works Conference (August 24-26, 2016).

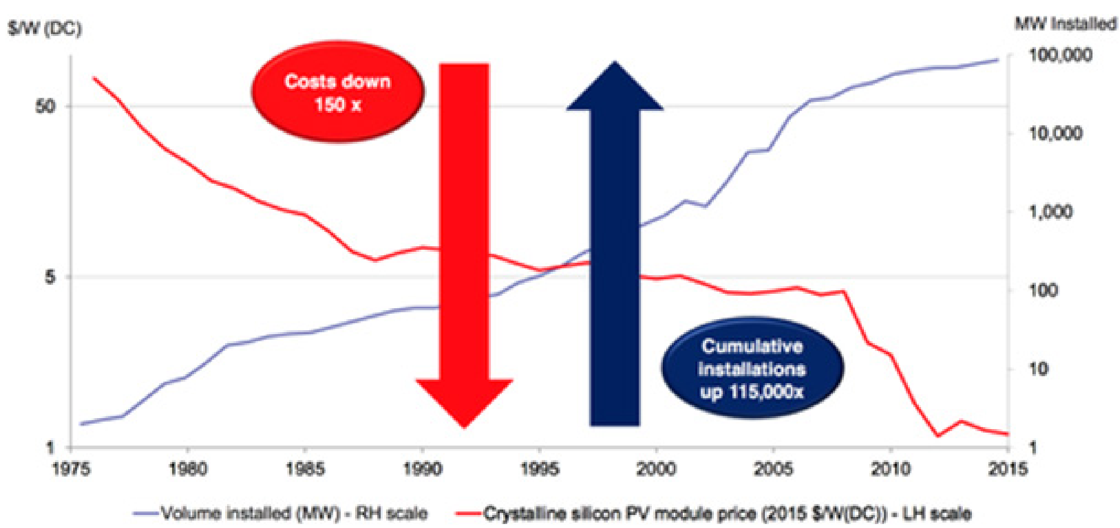
## Ontario Government: Large Renewable Procurement (LRP)

One example of government promotions in the space comes in the form of feed-in tariffs (FIT) as part of the LRP initiative. They refer to the prices paid to the suppliers for the electricity to be generated and consumed. This program allows anyone to generate renewable energy and sell it at a guaranteed price for a fixed long term contract plan. As a result, demand for renewable energy electronics has been rising steadily. In addition, in order to help maintain Canadian competitiveness, the provincial government qualifies only applicants with more than 50% of the power generation manufactured locally.

## Economies of Scale Lead to Falling Costs

Being a form of technology, solar-power generation is subject to constant innovations and efficiency improvements. As a result, the costs needed to implement such technologies fall. Further, battery prices continue to drop, making solar power more viable during times of no sunshine.

Figure 1: Volume Installed Compared to Prices over Time




Source: Bloomberg

## Analyzing the Environment at Large

As competition and deregulation grows over time, investors must be increasingly aware of key metrics and figures used to assess the strength of an individual stock in the sector. Listed below are three external qualitative factors investors should use to help determine a strong investment in sustainability stocks:

- **Location**: Companies situated in high population growth areas naturally incur higher demand for their products. However, a growing population doesn't necessarily translate into more housing starts. As a result, investors should favor a growing rate of housing starts along with a growing population at large. It should also be noted that regions with higher sunshine will naturally receive more solar investment. This is evident in the United States as California and Florida lead the nation's rollout of renewable energy. California is also the nation's most populated state, making it obvious why start-ups in the sustainability sector target the state.

- **Revenue Segment**: If the company is generating revenue, how are the segments split? More specifically, the customer base requires detailed examination. For example, a company providing its product to a large residential customer base is less prone to earnings volatility, compared to industrial and commercial customers. In addition, there is more risk if a single customer accounts for a substantial amount of revenue. This is specifically true for small-cap sustainability stocks in the US20 where one customer can comprise a very large portion of sales and profits.

- **Regulatory Environment**: Studying the regulation of a growth industry is also very important. Going even further, investors should assess the regulatory bodies that have jurisdiction over a sub-sector in a certain province/state. With that, investors should form predictions and forecasts of future regulations in the upcoming years that could be of material importance to the industry. For example, the Clinton administration has announced two national goals, if she is elected President:

    - The US will have half a billion solar panels by the end of her first term
    - Within 10 years of her presidency, the US will have enough renewable energy generation to power every single home in America

  One initiative she plans to relay these goals is called the "Clean Energy Challenge" which incentivizes cities and states to increase the amount of green energy used. This will in turn demand more products and innovations from sustainability stocks.

# Index Analysis

Since the release of the 8th issue, the US20 index continues to outperform the TSX Venture Index, as well as the Dow Jones Sustainability Index. This time, the index appreciated in value by **36% over the last 52-weeks**, crushing the -4% and -6% reported by the two respective benchmarks. Let's take a closer look at some of the big winners in the space, and then examine some of the laggards.

### Eguana Technologies: Potential 2016 Recovery Play

Eguana Tech (CVE:EGT) gained 55% in value since February 22nd, 2016. The company, which develops electronics used for renewable energy storage, had several feats during March. Increased US exposure is apparent as Hawaiian Electric opts to deploy Eguana's AC Battery to increase effectiveness of the island's rooftop solar power generation.

What had the stock surge almost 30% was the announcement of a winning bid in renewable procurement from Ontario's Independent Electricity System Operator (IESO) on March 10th. The company was also featured on CanadianGreenTech, which outlined its expanded customer orders for its premier product: the AC Battery. We believe this is likely the case due to the increased demand for solar. As the cost of solar electricity continues to fall, infrastructure demand will rise. As a consequence, Eguana's distributed energy storage batteries provide a pivotal improvement in efficiency and effectiveness of renewable energy. In addition, on April 15th, the company announced the completion of its final tranche in its brokered private placement, generating total proceeds of approximately $1.2 million.

Although demand for the product seems to be rising, the company's financials have room for improvement. While sales rose 163%, its cost of goods sold (COGS) increased by a larger margin. However, upon further examination, the $2.1 million gross margin deficit was in part due to an impairment of inventory to the company's primary supplier in Europe: Sonnenbatterrie, which has cut ties with Eguana. Approximately $1.9 million of the deficit is due to the impairment of inventories and rework costs. The dispute with the prior customer has led to Eguana commencing litigation to recover $3.7 million in charges. Accounting for the great majority of its sales, the loss of this customer materially affected its sales in Q1: $1.5 million in 1Q15, to $228 thousand in 1Q16. Lastly, perhaps the most worrisome figure to us is its liquidity. The company holds a working capital deficiency of ~$2.5 million, meaning additional capital is required to continue operations.

Despite losing Sonnenbatterrie as a customer, as well as exhibiting signs of poor liquidity, we believe that if Eguana can establish balance-sheet relief, it may have a bright future ahead for three reasons:

- Entrance of its product into Hawaii represents exposure into the lucrative US market, with potential ties to renewable energy powerhouse: California.
- Japanese market entry through a marketing contract with Itochu Corp. The company has expectations to have a distributable product in Japan by 3Q16.
- Global demand for solar continues to experience accelerating growth.

## Electrovaya Inc: Litarion Acquisition Gives the Company a Massive Boost

Electrovaya Inc. (TSE:EFL) was the US20's best performer with a 66% increase in price since February 22nd, 2016. In mid-2015, the company acquired Europe's largest Lithium Ion operation – Litarion. The $1.5 million acquisition has been a success story, as the subsidiary recently received purchase orders totalling $5.4 million for its Li-ion cells. The German subsidiary allows Electrovaya to expand sales to multiple customers in a variety of sectors and regions.

In terms of financials, the company seems to be doing well. It reported its second-consecutive profitable quarter in Q1 2016 with a bottom line of $4.2 million, representing a 121% increase from Q4 2015. In addition, a 1.6x current ratio, along with a cash mountain of $9.5M, show a stable liquidity position and possible room for additional M&A activity.

We believe the company has potential to continue its success and have found three catalysts in the upcoming years:

- Healthy balance-sheet provides an opportunity for organic and inorganic growth. Look out for deals as the company remains profitable and attempts to make use of its large cash balance.
- Lithium-ion battery market is in full growth: 2015 global market sales of $30 billion USD are expected to double in size by just 2020. Tesla's $5 billion investment in its Nevada Li-ion battery 'Gigafactory' exemplifies the surging forecasted demand. Electric vehicle sales, as again exemplified through Tesla, are rising globally, introducing more market opportunities for Electrovaya's products.
- German acquisition will continue to provide monumental revenues (the subsidiary represented 87% of last year's sales) as well as a greater reach into more OECD renewable energy friendly markets.

Figure 2: Expanding Battery Product into Different Markets


Source: Company Filings

### H2O Innovations: Hyper Backlog Sets Positive Outlook

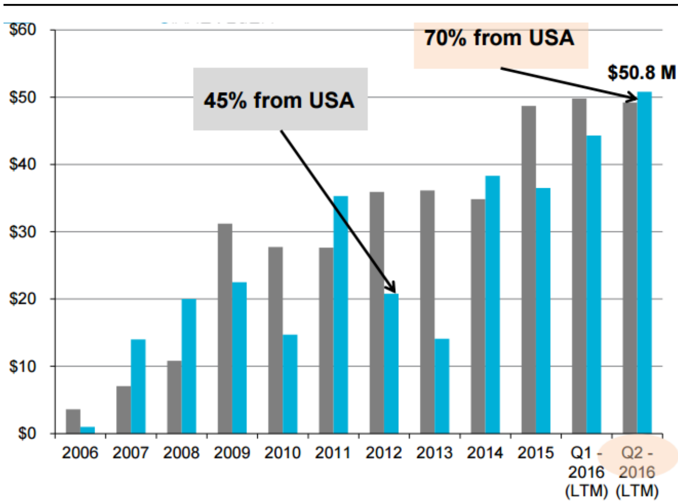
H2O Innovations' (CVE:HEO) stock price shot up 34% during the period. The rally began shortly after the company was listed as one of four nominees by Global Water Intelligence (GWI) to win the "Water company of the Year Award." H2O ended up winning the international award and gaining significant exposure. Particularly, the company beat GE Water and Processes, an arm of the $270B conglomerate: General Electric. The reference is highly regarded in the water-tech market, and sent the stock skyrocketing.

From a financial standpoint, the company is increasingly profitable, primarily from a cost-reduction front. While the latest fiscal quarter (Q3) reported a 4% decline in revenues compared to the prior Q3, COGS fell by 14%, representing a healthier gross margin, and an improvement in its core business line. Its balance-sheet is also modest with a 1.5x current ratio, and a relatively low net-debt-to-equity ratio of 0.26, indicating the company is not over-leveraged, even with the added $2.7M loan used to finance its most recent acquisition of Clearlogx, which provides patented technology enhancing all three pillars of revenue. In terms of cash flow, the company again exhibits core business strength as operating cash flows are consistently positive and substantial.

Lookout for a repeat success story from this company due to the following three reasons:

- Strong backlog of $50.8 million coupled with ~45% of revenues being recurring in nature, lead us to believe the company has a steady stream of sales in the foreseeable future.
- Market-leading innovations such as Fiberflex as well as the acquisition of Cleaglogx help differentiate the company's products.
- Water filtration is a growth sector with increasing demand for infrastructure, as water becomes more precious, especially in regions like California. The state suffers from water filtration issues, as well as severe and constant droughts. As a result, H2O has set its sight on this lucrative market.

Figure 3: Stable Revenue (grey) and Backlog (blue) Growth




Source: Company Filings

## Other Notable Winners

***New Flyer Industries Inc. (TSE:NFI)*** controls nearly 45% of the North American market for transit-bus manufacturing and parts supplying. It has been impressing investors lately with high return on invested capital (ROIC) figures. On April 19th, National Bank analysts quoted a price target of $44/share, causing the stock price to rally. Investors should keep an eye out for New Flyer's earnings report on May 12th.

***PyroGenesis Canada (CVE:PYR)*** recently released its 2015 fiscal earnings report on May 2nd, and also announced the finished installation of its DROSRITE Furnace System for a client. The machine proved to investors that it can successfully disrupt the $500 million USD market for aluminum by-product waste. It is the company's first sale of the product, giving hope to shareholders for further sales moving forward. In addition, the stock jumped nearly 10% on news of the company spinning off as much as 80% of the 3D Printing portion of its business.

## The Laggards

***Carmanah Technologies Corp. (TSE:CMH)*** lost 18% of its value since February 22nd. We believe this was primarily out of negative investor sentiment. The company reported a generally positive 2015 report, and an impressive forward guidance report on upcoming quarters as well as FY16.

***SunOpta Inc. (TSE:SOY)*** has dropped 23% during the period. The fall was witnessed shortly after a lackluster earnings report, which showed profit decline Y/Y. The company reported a loss from continuing operations of $3 million USD. SunOpta is undergoing initiatives to deleverage itself and lower its current 1.15 debt to equity ratio.

## About the Index

We believe that there is a lack of high quality, widely available research of promising small cap Canadian companies. To fill this gap, we have come up with various industry reports, such as the Ubika Sustainability 20, to provide coverage of quality Canadian mining juniors. We hope that our work, meets your investment standard.