Q4 2022 Earnings Call
Dec 13, 2022

Thank you Operator,

Good morning and welcome to Fluence Energy’s 's fourth-quarter 2022 earnings conference call. A copy of our earnings presentation, press release, and supplementary metric sheet covering financial results along with supporting statements and schedules, including reconciliations and disclosures regarding non-GAAP financial measures are posted on the investor relation sections of our website at fluenceenergy.com.

Joining me on this morning's call are Julian Nebreda, our President and Chief Executive Officer; Manu Sial our Chief Financial Officer; and Rebecca Boll our Chief Products Officer.

During the course of this call, Fluence management may make certain forward-looking statements regarding various matters related to our business and Company that are not historical facts.

Such statements are based upon the current expectations and certain assumptions and are, therefore, subject to certain risks and uncertainties. Many factors could cause actual results to differ materially. Please refer to our SEC filings for our forward-looking statements and for more information regarding certain risks and uncertainties that could impact our future results. You are cautioned to not place undue reliance on these forward-looking statements, which speak only as of today. Also, please note that the Company undertakes no duty to update or revise forward looking statements for new information.

This call will also reference non-GAAP measures that we view as important in assessing the performance of our business. A reconciliation of these non-GAAP measures to the most comparable GAAP measures is available in our earnings materials on the company's Investor Relations website. Following our prepared comments, we will conduct a question and answer session with our team. During this time; to give more participants an opportunity to speak on this call, please limit yourself to one initial question and one follow up. Thank you very much. I'll now turn the call over to Julian.

Thank you, Lex. I would like to extend a warm welcome to our investors, analysts and employees who are participating on today's call.

Additionally, I would like to welcome Manu Sial, our new CFO. Manu joined us in September and has already made a significant impact on the organization in a short period of time.

Today I will provide a brief update on our business and then review our strategic objectives, as well as some examples of the actions we've already taken towards these goals.

Following my remarks, Manu will discuss our financial performance as well as our outlook for fiscal year 2023.

Starting on Slide 4 with the key highlights of the fourth quarter. I am pleased to report that our team recognized $442 million dollars of revenue during the quarter, delivering our highest quarterly revenue in Fluence's history and deploying more than 1 gigawatt hour of energy storage solutions. More importantly, we achieved positive gross margins for the quarter, both on an adjusted and GAAP basis. Our demand was strong across all three of our business lines, and new orders were approximately $560 million dollars. Furthermore, our signed contract backlog as of September 30 was $2.2 billion dollars, a year to year increase of around 30%..

Lastly, our recurring revenue businesses, which consists of our services and digital businesses, experienced strong growth during the quarter. Notably, our services attachment rate of 119% for the fourth quarter was in line with our expectations, illustrating the catch up in service contracting we anticipated during our previous earnings call. Our digital business added nearly 1 gigawatt of assets under management since the third quarter, providing us visibility to future revenue.

Turning to slide 5. Over the past 90 days, the senior management team and I have conducted a deep dive of our business

During this deep dive we reaffirmed those aspects of the business that are working well and identified several areas that have significant upside potential but need some work. We confirmed that Fluence's energy storage solutions business has tremendous tailwinds across the globe, including from the Inflation Reduction Act in the United States (also known as IRA) and Europe's growing desire for increased energy security and independence. Although our digital business has strong potential, we have determined that the platform and business model would benefit from simplification and tighter integration with our storage solutions business. For example, our current Mosaic product is not able to expand into new markets quickly due to its current tech architecture. This is something that will be addressed.

Going forward, we will concentrate on accelerating the integration of our offerings, including digital and services, with our storage systems in order to serve customers with an end-to-end bundled solution.

Concentrating on executing and strengthening our risk management capabilities to ensure we monetize our contracting margins.

Additionally, we are simplifying our digital platform and retooling our go-to-market strategy in order to increase the scale of both Mosaic and Nispera, and to roll out these products more quickly and at a lower cost.

Furthermore, we will convert our supply chain into a competitive advantage by leveraging our size and scale to drive margin and support easier implementation of solutions. I'll provide more color on each of these initiatives in a few minutes.

After meeting with hundreds of our Fluence people in the past 90 days I am confident in our ability to maintain our leadership position in the market, deliver multi-year profitable revenue growth rates of more than 30% and be adjusted EBITDA breakeven in fiscal 2024. I believe our team's tenure, passion and resilience will set Fluence up for long-term success, unlocking significant value for our customers and shareholders.

Turning to slide 6. Coming out of this process, I am even more convinced that our strategy of using our ecosystem to provide energy storage solutions to our customers is the right one. Our ecosystem gives us access to the largest energy infrastructure providers in the world and, importantly, it provides opportunities to further integrate with our customers at any point of the value chain. Our revised go-to-market approach is simple, we will utilize one sales channel for our entire ecosystem. This is different from our past where we would use multiple sales channels across our organization. This turned out to be an ineffective strategy when it comes to attaching our services and digital solutions to an energy storage sale. An integrated sales channel will give us a better ability to integrate our customers into our ecosystem. As we have seen, our digital software is valuable beyond its own P&L contribution; as it supports hardware and services creating a flywheel effect of value.

Additionally, we will work to integrate our technology more closely, so our digital offerings interface with our storage solutions seamlessly thus increasing the attractiveness to our customers of choosing bundle solutions.

Our ability to offer an integrated energy storage solution is one of the key reasons our customers select us. We are increasingly recognized as one of the premier energy solutions providers in the world by large multinational developers or IPPs, many of which are planning on deploying significant amounts of gigawatts.

The integration of these offerings is a key tool in retaining customers beyond day 1 sales so we can access them anywhere along the value chain. We have visibility to multi-year high revenue growth rates. We operate with an asset lite business model with high returns on invested capital. We have significant technical depth which helps us to monetize data and help our customers drive returns. We also have a rapidly improving cost structure with high revenue per employee. And ultimately, we believe we have a business model and strategy set up for success.

Turning to slide 7, I'd like to discuss the five strategic objectives that will provide the framework for the actions we will be taking over the next few years:

First, we will deliver profitable growth. Both profitability and growth are essential to maximizing shareholder value. We will focus on those market segments that provide continuous growth and where our complex solutions allow us to maximize profitability.

Second, we will develop the products and solutions that our customers need. Understanding our customers' challenges is the driving force behind our continuous technological advancement. We expect to provide customers with the most sought-after solutions rooted in our industry-leading experience.

Third, we will convert our supply chain into a competitive advantage. We are establishing a best-in-class supply chain that is centered around diversifying our suppliers, capturing incentives from the IRA, and improving the delivery times for our solutions, all of which will ultimately increase margins and drive value for our customers.

Fourth, we will use Fluence Digital as a competitive differentiator and a margin driver. Harnessing the power of artificial intelligence and machine learning in our integrated solutions, we can uniquely provide our customers with the ability to both maximize their revenues and lower their overall cost of ownership. This will increase visibility into our growing and profitable recurring revenue stream.

And finally, our fifth objective is to work better. This starts with being disciplined with our capital spending and contract underwriting, optimizing and using our resources efficiently, and strong corporate risk management capabilities, controlling our costs and maximizing our financial performance for our shareholders.

We have already taken actions towards these objectives, some of which I'd like to highlight today.

Turning to slide 8, I am pleased to announce we are launching a new energy storage solution, geared towards the transmission segment. We are calling it the Fluence Ultrastack. The transmission segment is a growing market that currently sits at 450 megawatts, which we expect will grow to 17 gigawatts by 2030. We expect demand for this product will be driven by our customers' need to reduce transmission congestion resulting from growth in distributed energy resources. Furthermore, the transmission segment is highly complex and requires the best performance, and highest safety features, thus creating a barrier to entry in the market, some of which are proprietary. More importantly, higher complexity commands a higher premium for our products and services, and often results in higher margins. We will continue to lean into the transmission segment as we deliver profitable growth and develop new products and solutions that our customers need.

Turning to slide 9, I am pleased to report we recently signed a contract for more than $500 million dollars with Orsted, under which we will deliver a 1.2 gigawatt hour energy storage facility in the United States complete with our Gen 6 Gridstack solution. By further increasing our scale we will be able to better capture value from our supply chain. We also note that Orsted selected us as they were looking for a trusted partner with strong experience delivering complex solutions. As a comprehensive solutions provider, we continue to outpace our competition due to our scale, industry-leading experience, and our ability to solve highly complex problems. We are quickly establishing ourselves as a leader among the mega project segment.

Turning to slide 10. Including the Orsted contract, which was signed subsequent to our fiscal year-end, our backlog now sits at more than two and a halfbillion dollars. This highlights the strong demand we are seeing at the top of our funnel that is now providing us greater certainty with respect to our multi-year revenue outlook. Looking at the chart, you can see that even before any impacts from the IRA, we have a pipeline that is nearly three times our current backlog. It is also important to note that we are expanding our sales to non-related parties and as a result the majority of our backlog today is with this customer segment.

Turning now to slide 11, as we mentioned earlier, we are experiencing tremendous tailwinds from the Inflation Reduction Act. BNEF has estimated that the TAM for energy storage increased by more than 100 gigawatt hours or around $35 billion dollars as a result of the IRA. That is a significant figure. The expected ITC improves overall project returns for customer this benefit is expected to accrue to us through improved pricing power or increased volumes. Furthermore, the production tax credit provides margin uplift for Fluence from capturing benefits associated with manufacturing our own battery modules. It’s also important to note that the IRA benefits are not necessary for achieving our adjusted EBITDA breakeven target in fiscal 2024, and thus represent upside potential.

We currently see the IRA impacting Fluence in three areas. The first is the ITC for standalone storage. This benefit accrues to our customers, and we expect it will incentivize more projects to move forward and to green light other projects that were previously not economic for our customers. As a result, we anticipate the US market growth to increase from 30% per year to around 40-50% per year. Based on our conversations with customers, we expect to enter into the first of these contracts attributable to the IRA about mid-calendar year 2023. We would expect to see the impact on our financial results in the second half of 2024.

Second, the production tax credit under section 45X of the IRA provides significant opportunities for Fluence, as we are launching our own battery module manufacturing, which I'll discuss further shortly. As a result, we expect to qualify for the $10 per kilowatt hour incentive from the IRA. It's important to note that this is an uncapped incentive and carries a direct pay option. As a reminder, we opened our Utah production facility in September, which will have an expected cube output of nearly 6 gigawatt hours per year by 2024. We expect we will be able to begin battery module production starting in the summer of 2024, thus capturing the $10 per kilowatt hour incentive. The PTC further supports our mid-teens gross margin target.

And third, section 48C provides for the one-time reimbursement for onshoring or establishing qualifying manufacturing facilities in the U.S. As a result, we are currently looking at the possibility of expanding our operations in the U.S. with an additional facility.

Turning to slide 12, I am pleased to announce that we are launching our own battery module and battery pack manufacturing at our new Utah facility. This gives us greater control over the global supply chain and allows us to capitalize on incentives under the IRA. One of the key benefits to the Fluence Battery Pack is that it is easier to incorporate new cells and diversify our cell supplier base, creating competition at a cell level. Our Battery Pack makes it easier to swap packs in and out of new product variants. It also allows us to incorporate our own battery management system technology with more granular data access and system control. And it expands Fluence's battery intelligence capabilities. We expect to see initial battery module production coming out of our Utah facility during the summer of 2024.

Looking at slide 13, we further illustrate our supply chain and how our battery module and battery pack fit together. Starting on the left-hand side, we will continue to purchase battery cells from multiple battery manufacturers. Battery cells by themselves are useless and to a great extent a commodity. We take those battery cells and integrate them into our own battery modules complete with our own battery management system or BMS. Thus, we are taking those commoditized battery cells and turning them into smart batteries capable of performing the tasks our solutions demand. These battery modules will qualify for the $10 per kwh incentive under the IRA. We then put several battery modules together to make a battery pack that is combined with our DCPM, which is the brain of the pack system. This DCPM collects battery data for communication with the Fluence operating system and is the point of contact of our cloud-based digital solutions providing value added integration for our customers.

Turning now to slide 14. As I briefly mentioned earlier, we have assessed our digital business and have refocused the model and go-to-market strategy. Now, I'd like to discuss what this means for Fluence Digital and where we are going.

First, we ensure we are offering an integrated, holistic end-to-end bundled solution to our customers through one sales channel. As I mentioned this is a major change for our prior sales efforts.

Second, we will simplify our suite of digital offerings by focusing on our existing two applications, Fluence Mosaic and Nispera. We plan to roll out Mosaic to four additional U.S. markets over the next three years and improve the ability of Nispera to integrate with battery-based energy storage systems. By taking a more focused approach, we expect to reduce the cost, complexity and time to market for these applications. We do not plan to build out any additional applications at this time.

Third, we are accelerating the Nispera platform's ability to be deployed onto battery energy storage systems by the end of this year. Thus enabling our new bundled solutions to be more integrated with our batteries.

What do we expect to achieve as a result of these actions?

Improved attachment rates for services and digital through a bundled approach;

Increased annual recurring revenue, or ARR, from our digital and services business;

A low rate of customer churn, though I would note that our churn rate is already very low.

Going forward, starting later in fiscal 2023, we will report our progress on these initiatives by disclosing the relevant KPIs. We expect that this retooling will have a relatively small investment of $5 to $10 million dollars.

As it relates to the financial outlook for our digital business, we do not expect meaningful contributions from our digital business in 2023 or 2024. We expect to have positive gross margins in fiscal year 2023 and onwards and expect adjusted EBITDA to be at or near breakeven in fiscal year 2025.

Moving to slide 15 we are enhancing our India technology center increasing utilization through a workforce optimization that will augment roles in India in 2023 to the benefit of our onshore overhead. This contributes to our operating leverage, with our operating expenses expected to grow at less than half the rate of revenue growth which Manu will explain further.

Turning to slide 16 for a summary of recent actions. As a management team, we are committed to delivering increased shareholder value, and to executing the five strategic objectives that I have discussed as the foundation of our plan. We will provide you with quarterly updates on our progress toward our strategic objectives as we transform the way we operate and drive sustainable returns.

Overall, we continue to see strong demand that is expected to be amplified by the current IRA tailwinds that will start adding to our backlog in mid-2023. We are committed to breaking even on an adjusted EBITDA basis in fiscal year 2024 as we enter into higher margin contracts, and we are committed to improving our project execution and our overall risk management. I'm pleased with the early results of our efforts, but there is still work to be done. As we move forward, we will continue to focus on executing a high growth, capital-light solutions business model and expect to make of Fluence the optimal investment vehicle in our sector.

That being said, I will now turn the call over to Manu.

Thank you, Julian.

Before I begin, I would like to express my gratitude to Julian and the Fluence board for their confidence and trust in me. The last couple of months have been a period of rapid learning for me. I continue to believe that Fluence is positioned well to take advantage of a vast, untapped TAM that was enhanced by the Inflation Reduction Act by more than $35 billion. My focus is to strengthen the organizational foundation to enable profitable growth, and this includes enhancing our deal underwriting, risk management and execution capabilities.

Let me now review the financial performance for the fourth quarter 2022.

Please turn to slide 18.

In the fourth quarter we delivered our highest ever quarter with $442 million in revenue, representing an increase of 85% from Q3. This record revenue generation was primarily driven by strong project execution as several projects achieved significant milestones.

We also achieved positive gross margins in the fourth quarter -- 3% on an adjusted basis and 2% on a GAAP basis driven by strong revenue performance and improvement in our ability to pass through to the customer, increases in certain input and supply chain costs. This is a significant turning point for us and while 2022 was a challenging year, we ended the fourth quarter with positive gross profit and believe that the issues we confronted are well understood and now largely behind us. Compared to 2022, we expect new contract margins in 2023 will be positively impacted by improvements in our deal underwriting process such as implementation of index-based pricing. We have also improved execution on product roll-out, including leveraging our lab to test and 'de-bug' solutions before we launch them in the field.

Moving from gross profit to operating expense. We improved our operating leverage in the fourth quarter 2022 by lowering our operating expense as a percentage of revenue compared to prior quarter and prior year.

Our operating expense can be divided into two categories. The first is SG&A spend, which is the required amount of overhead spend to operate our business, both at corporate and at the regional level. We do not expect that corporate opex will scale with the growth of the business. The second area of spend is what we refer to as platform investment. This represents primarily R&D spend, which we view as a type of growth capex.

Full Year 2022 operating expense spend was 15.5% of revenue, which we expect will be a high annual watermark. Looking at 2023 and beyond, although we expect to continue to grow our operating expense in absolute dollar terms, but we expect it to grow at a rate less than half of the rate of our revenue growth.

We expect this operating leverage to be one of the drivers of the improvement in Adjusted EBITDA we see over the next few years.

In the interest of greater transparency, this quarter we have begun providing a supplemental quarterly metric sheet on our investor relations website that is designed to provide analysts and investors with a deeper understanding of our financial and operating performance.

Please turn to [slide 19].

I am pleased to report that we ended 2022 with total cash of $540 million, which includes our short-term investments and restricted cash, and is in line with what we had guided to. As shown on this cash bridge, majority of our cash usage in 2022 was driven by negative Adjusted EBITDA. That trend is expected to continue in Fiscal Year 2023.

Let me also provide some color on the other drivers of our 2023 cash outlook. We expect to incur modest capex spend, including for our digital business retooling. In addition, as we did in 2022, we will use some operating cash in 2023 at a rate roughly 10% of our year-on-year revenue growth. We believe that we have ample liquidity to meet our 2023 cash needs.

Please turn to slide 20.

We are initiating guidance for fiscal year 2023 for total revenue of between $1.4 billion and $1.7 billion. Additionally, we expect our adjusted gross profit to be between $60 million and $100 million.

We are coming into 2023 with approximately 90% of expected revenue at the mid-point of our FY 2023 guidance already in our backlog. We have also secured additional supply chain commitments for 2023. This gives us confidence in our revenue guidance. On the next slide, I will provide additional color on why we are confident of achieving our 2023 Adjusted Gross Profit guidance.

Please note that our 2023 guidance does not assume any financial benefit from the Inflation Reduction Act, as we expect to see order growth in 2023 with the benefit to sales occurring mostly in 2024 and beyond.

In terms of revenue seasonality, we expect to see a split of approximately 40% in the first half and 60% in the second half.

Furthermore, we expect operating expense to grow at less than 50% of our revenue growth, providing us significant operating leverage. As Julian mentioned, we will be utilizing our India Technology Center more, enabling us to scale at a much lower cost.

Please turn to slide 21, where I will walk you through key drivers of our 2023 Adj. Gross profit guidance when compared to 2022 actuals.

We are confident in our 2023 Adjusted Gross profit guidance of $60 million to $100 million driven by improved contract underwriting and execution.

This reflects a combination of signing new contracts at margins that are at or close to double digit, an improvement compared to the past, our ability to re-coup some of the increase in our supply chain costs, and improved execution. I would note that we expect our exit 2023 gross margin run rates to be higher than the full year 2022 margin rates as our legacy contracts near completion and new deals start to have a larger impact on revenue.

Before we open the call for questions, I want to reiterate that we have visibility to achieve 2024 break even Adjusted EBITDA as well as multi-year 30%+ revenue growth and are positioned well to take advantage of the upside from the Inflation Reduction Act.