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Fundamental Research Corp.
*Investment Analysis for Intelligent Investors*

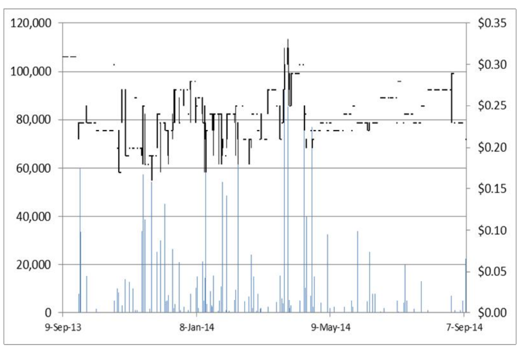
# West Mountain Environmental Corp. (TSXV: WMT) – Q2 Revenues up 21% QOQ

**Sector/Industry: Environmental Services** **www.westmountaincapital.com**

**Market Data (as of September 9, 2014)**

| | |
|---|---|
| Current Price | C$0.21 |
| **Fair Value** | **C$0.56** |
| **Rating*** | **BUY** |
| **Risk*** | **4 (Speculative)** |
| 52 Week Range | C$0.16– C$0.33 |
| Shares O/S | 53.44 mm |
| Market Cap | C$11.22 mm |
| Current Yield | N/A |
| P/E (forward) | N/A |
| P/B | 2.7x |
| YoY Return | -32.3% |
| YoY TSX-V | 3.9% |

*see back of report for rating and risk definitions




## Highlights

- Q2-2014 revenues increased 21% QOQ, from $0.19 million to $0.23 million.
- EBITDA was negative $0.86 million in Q2-2014 versus negative $0.21 million in Q2-2013. The net loss in Q2-2014 was $1.29 million (EPS: -$0.04) versus $0.43 million (EPS: -$0.02) in Q2-2013. Q2 revenues and EPS were lower than our estimates primarily due to lower than expected processing rates, and higher than expected general and administrative ("G&A") expenses.
- In Q2-2014, the company processed 5,023 tonnes of contaminated soil, up from 3,930 tonnes in Q1-2014, but down from 5,672 tonnes in Q2-2013. The company experienced 11 days of unscheduled downtime in Q2-2014.
- Subsequent to the quarter end in July 214, WMT processed a record volume of 2,722 tonnes of soil.
- There have been slight delays in the projects in Nahai and Changquing. The projects are now expected to be operational by Q4.
- At the end of Q2, WMT had $4.13 million in cash. Working capital and the current ratio were $3.76 million and 5.9x, respectively.
- We are lowering our fair value estimate from $0.60 to $0.56 per share, while maintaining WMT on our list of top picks.

| Key Financial Data (FYE - December 31) (C $) | 2012 | 2013 | 2014E | 2015E |
|---|---|---|---|---|
| Cash | 162,499 | 497,144 | 2,755,653 | 278,829 |
| Working Capital | (547,920) | (2,197,017) | 2,605,823 | 241,792 |
| Total Assets | 4,728,586 | 5,399,451 | 7,318,681 | 8,887,679 |
| Revenues | 257,528 | 1,962,926 | 1,728,675 | 3,280,000 |
| Net Income | (1,839,813) | (2,338,338) | (3,407,237) | (2,404,360) |
| EPS | -0.05 | -0.06 | -0.06 | -0.04 |

*West Mountain Capital is in the business of thermal treatment of soil, sludge and other waste streams. Currently, the company's focus is on penetrating China's contaminated soil, oily sludge and industrial sludge treatment markets.*

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***21% QOQ revenue growth***

Q2-2014 revenues increased by 21% QOQ, from $0.19 million to $0.23 million. Q2-2014 revenues are not comparable to Q2-2013, as the company recently negotiated with Dadi to remove utility costs from its pricing. Previously, Dadi was paying WMT utility costs, and WMT was subsequently reimbursing Dadi. WMT negotiated to pass on the utility costs directly to Dadi.

The following table shows segmented revenues and gross margins.

| | Q1-2013 | Q1-2014 | Q2-2013 | Q2-2014 | 2013 (6M) | 2014 (6M) |
|---|---|---|---|---|---|---|
| **China** | | | | | | |
| Revenues | $445,782 | $191,150 | $494,043 | $220,647 | $939,825 | $411,797 |
| COGS (excl amortization) | $335,719 | $62,240 | $214,954 | $68,136 | $550,673 | $130,376 |
| Gross Margin | 25% | 67% | 56% | 69% | 41% | 68% |
| **Canada** | | | | | | |
| Revenues | $0 | $0 | $81,724 | $11,581 | $81,724 | $11,581 |
| COGS (excl amortization) | $202,991 | $165,275 | $129,971 | $158,514 | $332,962 | $323,789 |
| Gross Margin | n/a | n/a | -59% | -1269% | -307% | -2696% |
| **Total Revenues** | **$445,782** | **$191,150** | **$575,767** | **$232,228** | **$1,021,549** | **$423,378** |
| COGS (excl amortization) | $538,710 | $227,515 | $344,925 | $226,650 | 883,636 | $454,165 |
| Gross Margin | -21% | -19% | 40% | 2% | 14% | -7% |

**In Q2-2014, the company processed 5,023 tonnes of soil, up from 3,930 tonnes in Q1-2014, but down from 5,672 tonnes in Q2-2013.** WMT experienced a total of 11 days of unscheduled downtime in the quarter. The downtime was a result of upgrades required for the Thermal Phase Separation ("TPS") systems, and the construction of site infrastructure by Dadi. Based on the average production in the quarter, we estimate that 11 days of lost processing implies a loss of approximately 700 tonnes. If not for the unscheduled downtime, the company would have processed the same or higher amount of soil in Q2-2014, compared to Q2-2013. **Subsequent to the end of the quarter, WMT processed 2,722 tonnes in July, the highest monthly volume for the Dadi project.**

Revenues per tonne in Q2-2014 were $44 versus $49 in Q1-2014. As of July 2014, WMT had processed a total 34,935 tonnes of soil for the Dadi contract (see table below). Notice the steep drop in revenues per tonne as utility costs were removed from pricing.

| | Tonnes | $ / t |
|---|---|---|
| Q4-2012 | 1,259 | $84.35 |
| Q1-2013 | 5,207 | $85.61 |
| Q2-2013 | 5,672 | $101.51 |
| Q3-2013 | 5,253 | $97.43 |
| Q4-2013 | 5,869 | $73.20 |
| Q1-2014 | 3,930 | $48.64 |
| Q2-2014 | 5,023 | $44.08 |
| Q3-2014 (July) | 2,722 | |
| **Total** | **34,935** | |

The company commenced Phase II (which is for a minimum of 70,000 tonnes of contaminated soil) in July 2014. **For Phase II operations, WMT's partner, Jereh Energy**

*Slight delay in other projects / Potential to expand to South America*

**Services, is financing and manufacturing a TPS unit, with an annual treatment capacity of approximately 50,000 tonnes**. WMT has still not disclosed any details regarding Jereh's equity interest in the project. Manufacturing of the unit has commenced. Management expects to have the unit commissioned in October 2014.

**Updates on other agreements**:

*Oily Sludge Treatment in Zhoushan with Nahai:* - At the time of our previous update report, management expected this project to be operational by July. However, this has been delayed, and **management now expects the facility to be commissioned in Q3, and operational by Q4.** As mentioned in our previous updates, the facility is designed to process 50,000 tonnes per year of oily sludge. WMT has a 30% interest in the joint venture. Management indicated that the joint venture expects to process approximately 3,500 tonnes in 2014 (previous estimate – 9,000 tonnes).

*Industrial Sludge Treatment, a sub-contract agreement with Huafu Environmental Engineering Company, in Changqing –* According to the Q2 MD&A, Huafu has started a process to obtain permits from the Shanxi Environmental Protection Bureau to bring the facility to operational status. At the time of our previous report, management had predicted that operations will commence in July. Fabrication of the TPS unit was completed in October 2013. Management now expects this project to be operational by Q4. Our discussions with management indicated that they expect to process 1,500 tonnes of industrial sludge in 2014 (previous estimate – 2,500 tonnes).

In the MD&A, management also indicated that they are currently actively targeting opportunities in Jiangsu, Zhejiang and Guandong in China, and in South America. No other details were disclosed.

**Revenue forecasts –** We have lowered our processing rate estimate for 2014 due to the lower than expected rate in Q2, and as we were expecting the new TPS unit to be operational by August/September 2014. Our revised estimate for 2014 is 32,500 tonnes versus our previous estimate of 48,500 tonnes. **Our revised revenue forecast is $1.73 million versus our previous forecast of $2.17 million for 2014**. Our revised 2015 estimate is $3.28 million versus our previous estimate of $3.51 million. Note that these estimates are very preliminary as details on the company's partnership with Jereh are yet to be disclosed.

The following table shows the company's margins.

| Margins | Q2-2013 | Q2-2014 | 2013 (6m) | 2014 (6m) | Environmental and Facilities Services Industry |
|---|---|---|---|---|---|
| Gross | 40.09% | 2.40% | 13.50% | -7.27% | 21.70% |
| EBITDA | -36.75% | -369.91% | -64.62% | -318.22% | 13.70% |
| EBIT | -68.46% | -443.89% | -100.47% | -399.07% | 10.10% |
| EBT | -71.75% | -523.50% | -103.36% | -463.66% | |
| Net | -75.29% | -554.33% | -105.47% | -482.40% | 2.20% |

G&A expenses increased by 82% YOY, from $0.44 million to $0.80 million, due to a

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significant increase in legal and consulting fees related to the transaction with Jereh, and salaries. G&A expenses were significantly higher than our estimates. We have raised our estimates for 2014 accordingly.

***Lowering EPS estimates***

EBITDA was negative $0.86 million in Q2-2014, versus negative $0.21 million in Q2-2013. Net losses in Q2-2014 were $1.29 million (EPS: -$0.04) versus $0.43 million (EPS: -$0.02) in Q2-2013. Our revised forecast for 2014 is a net loss of $3.41 million (EPS: -$0.06) versus our previous estimate of net losses of $2.48 million (EPS: -$0.05). Our 2015 estimate is a net loss of $2.40 million (EPS: -$0.04) versus our previous estimate of a new loss of $2.02 million (EPS: -$0.05).

Free cash flows (FCF) in the first six months of 2014 were negative $1.40 million versus negative $1.64 million in the comparable period in the previous year.

| Summary of Cash Flows | 2013 (6M) | 2014 (6M) |
|---|---|---|
| Cash Flows from Operations | (854,081) | (1,256,420) |
| Cash Flows from Investing | (790,437) | (140,874) |
| Cash Flows from Financing | 1,506,576 | 4,962,795 |
| Net Change | (137,942) | 3,565,501 |
| Free Cash Flows | (1,642,987) | (1,395,761) |
| CAPEX | (788,906) | (139,341) |

***Strong Working Capital***

At the end of Q2, WMT had $4.13 million in cash. Working capital and the current ratio were $3.76 million and 5.9x, respectively (see table below).

| Liquidity Analysis | 2012 | 2013 | Q2-2014 | Industry |
|---|---|---|---|---|
| Cash | $162,499 | $497,144 | $4,127,585 | |
| Working Capital | (547,920) | -$2,197,017 | 3,764,017 | |
| Current Ratio | 0.37 | 0.23 | 5.85 | 1.50 |
| Debt / Capital | 10.6% | 62.8% | 49.7% | 13.2% |
| EBIT Interest Coverage Ratio | (36.3) | (10.8) | (20.8) | 2.4 |

Debt to capital decreased from 63% at the end of 2013, to 50% at the end of Q2 due to the equity financing (by Jereh) in the year.

***Stock Options***

The company has 3.71 million stock options, with a weighted average exercise price of $0.23 per share, and 2.47 million warrants with an exercise price of $0.32 per share outstanding. Approximately 0.58 million options are currently in the money.

***Valuation & Rating***

Our Discounted Cash Flow (DCF) valuation dropped from $0.60 to $0.56 per share as we lowered our EPS estimates. **We are maintaining WMT in our list of top picks as we expect the upcoming catalysts in Q4 to have a positive impact on the company.** We maintain our BUY rating, and adjust our fair value estimate to $0.56 per share.

## *Risks*

The following risks, though not exhaustive, will cause our estimates to differ from actual results:

- Due to the end of the regulatory deadline for the removal of PCB soil stockpiles, Canada's PCB soil treatment market is slow, and we do not expect any significant revenues from this market in the near future.
- Regulations requiring environmental protection/cleanup are key for the company's long-term growth.
- Old incineration techniques have been the most popular methods for treatment of contaminated soil in China, and are more cost effective compared to TPS.
- Although WMT has three strategic agreements in China, the company is still new to the market.
- Huafu has yet to sign the head contract with its client.
- WMT's license to use TPS technology expires in 2019.
- Access to capital and share dilution.

# Appendix

| STATEMENTS OF OPERATIONS (in C$) | 2012 | 2013 | 2014E | 2015E |
|---|---|---|---|---|
| Sales | 257,528 | 1,962,926 | 1,728,675 | 3,280,000 |
| COGS | 384,143 | 1,630,628 | 1,427,645 | 2,260,725 |
| **Gross Profit** | **(126,615)** | **332,298** | **301,030** | **1,019,275** |
| **Expenses** | | | | |
| G&A | 1,065,439 | 1,713,363 | 2,400,677 | 2,268,639 |
| Stock-based compensation | 36,187 | | 86,434 | 164,000 |
| Bad Debt | | | | |
| **EBITDA** | **(1,228,241)** | **(1,381,065)** | **(2,186,080)** | **(1,413,364)** |
| Amortization | 535,126 | 716,427 | 807,436 | 749,996 |
| **EBIT** | **(1,763,367)** | **(2,097,492)** | **(2,993,516)** | **(2,163,360)** |
| Interest & Bank Charges | 48,634 | 193,481 | 413,721 | 241,000 |
| **EBT** | **(1,812,001)** | **(2,290,973)** | **(3,407,237)** | **(2,404,360)** |
| Exchange rate and others | (27,812) | (77,865) | | |
| Gain from sales of the assets | | | | |
| **EBT** | **(1,839,813)** | **(2,368,838)** | **(3,407,237)** | **(2,404,360)** |
| Discontinued operations, net of income taxes | | | | |
| Income Taxes | - | (30,500) | - | - |
| **Net Earnings for the period** | **(1,839,813)** | **(2,338,338)** | **(3,407,237)** | **(2,404,360)** |
| EPS | (0.05) | (0.06) | (0.06) | (0.04) |

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| BALANCE SHEETS (in C$) | 2012 | 2013 | 2014E | 2015E |
|---|---|---|---|---|
| **Assets** | | | | |
| Cash and cash equivalents | 162,499 | 497,144 | 2,755,653 | 278,829 |
| Accounts receivable | 115,178 | 161,248 | 128,675 | 244,149 |
| Prepaid Expenses and deposits | 41,199 | 14,512 | 15,241 | 28,919 |
| **Current Assets** | **318,876** | **672,904** | **2,899,570** | **551,898** |
| Decommissioning Funds | 376,163 | 379,406 | 379,406 | 379,406 |
| Property Plan and Equipment + Others | 4,007,003 | 4,222,717 | 3,920,401 | 7,842,191 |
| Intangible Asset | 26,544 | 124,424 | 119,304 | 114,184 |
| **Total Assets** | **4,728,586** | **5,399,451** | **7,318,681** | **8,887,679** |
| **Liabilities & Shareholders' Equity** | | | | |
| Bank loan | 405,647 | 2,428,678 | - | - |
| Accounts Payables & Accrued Liabilities | 436,807 | 430,230 | 293,747 | 310,106 |
| Current Portion of Obligations Under Capital Lease | 24,342 | 11,013 | - | |
| **Current Liabilities** | **866,796** | **2,869,921** | **293,747** | **310,106** |
| Obligations under capital lease | 11,013 | - | | |
| Convertible debentures | | 587,189 | 4,210,000 | 3,402,250 |
| Asset retirement obligation | 150,471 | 150,471 | 150,471 | 150,471 |
| **Shareholder's Equity** | | | | |
| Share Capital | 7,452,298 | 7,452,298 | 11,645,694 | 16,246,444 |
| Contributed surplus | 714,518 | 1,144,420 | 1,230,854 | 1,394,854 |
| Deficit | (4,466,510) | (6,804,848) | (10,212,085) | (12,616,446) |
| **Total Liabilities & Shareholders' Equity** | **4,728,586** | **5,399,451** | **7,318,681** | **8,887,679** |

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| STATEMENTS OF CASH FLOWS (in C$) | 2012 | 2013 | 2014E | 2015E |
|---|---|---|---|---|
| **Operating Activities** | | | | |
| Net earnings for the period | (1,839,813) | (2,338,338) | (3,407,237) | (2,404,360) |
| **Items not involving cash** | | | | |
| Amortization | 532,947 | 845,143 | 807,436 | 749,996 |
| Gain on settlements of debentures | | | | |
| Stock-based compensation | 36,187 | - | 86,434 | 164,000 |
| Gain or Loss on embedded derivative | | 47,725 | | |
| Deferred income tax | | (49,500) | | |
| Accretion expense – Debentures | | | 413,721 | 241,000 |
| | **(1,270,679)** | **(1,494,970)** | **(2,099,646)** | **(1,249,364)** |
| Changes in non-cash operating working capital | 238,060 | 26,590 | (104,639) | (112,793) |
| Cash prvided by (used in) operating activities | **(1,032,619)** | **(1,468,380)** | **(2,204,286)** | **(1,362,157)** |
| **Cash from (used in) operations** | **(1,032,619)** | **(1,468,380)** | **(2,204,286)** | **(1,362,157)** |
| **Financing activities** | | | | |
| Proceeds from bank loan | 375,647 | 2,023,031 | (2,428,678) | |
| Payment of capital lease obligations | (41,148) | (24,342) | (11,013) | |
| Proceeds (repayment ) of debentures - net | | 790,000 | 3,216,984 | (948,000) |
| Common share and excersice of stock options | - | | 4,185,502 | 4,500,000 |
| **Cash provided by (used in) financing activities** | **334,499** | **2,788,689** | **4,962,795** | **3,552,000** |
| **Investing activities** | | | | |
| Increase in restricted cash | (15,450) | (3,244) | | |
| Cash Advanced to Join Venture | | (683,289) | | |
| Purchase of capital assets | (912,576) | (194,086) | (500,000) | (4,666,667) |
| Others | | (120,000) | | |
| **Cash used in investing activities** | **(928,026)** | **(1,000,619)** | **(500,000)** | **(4,666,667)** |
| Cash provided by investing activities- disc operations | | | | |
| **Cash provided by (used in) investing activities** | **(928,026)** | **(1,000,619)** | **(500,000)** | **(4,666,667)** |
| Increase (decrease) in cash | (1,626,146) | 319,690 | 2,258,509 | (2,476,824) |
| Cash beginning of period | 1,788,645 | 162,499 | 497,144 | 2,755,653 |
| FOREX | | 14,955 | | |
| **Cash end of period** | **162,499** | **497,144** | **2,755,653** | **278,829** |

**Buy** – Annual expected rate of return exceeds 12% or the expected return is commensurate with risk
**Hold** – Annual expected rate of return is between 5% and 12%
**Sell** – Annual expected rate of return is below 5% or the expected return is not commensurate with risk
**Suspended or Rating N/A—** Coverage and ratings suspended until more information can be obtained from the company regarding recent events.

**Fundamental Research Corp. Risk Rating Scale:**
**1 (Low Risk) -** The company operates in an industry where it has a strong position (for example a monopoly, high market share etc.) or operates in a regulated industry. The future outlook is stable or positive for the industry. The company generates positive free cash flow and has a history of profitability. The capital structure is conservative with little or no debt.

**2 (Below Average Risk) -** The company operates in an industry where the fundamentals and outlook are positive. The industry and company are relatively less sensitive to systematic risk than companies with a Risk Rating of 3. The company has a history of profitability and has demonstrated its ability to generate positive free cash flows (though current free cash flow may be negative due to capital investment). The company's capital structure is conservative with little to modest use of debt.

**3 (Average Risk) -** The company operates in an industry that has average sensitivity to systematic risk. The industry may be cyclical. Profits and cash flow are sensitive to economic factors although the company has demonstrated its ability to generate positive earnings and cash flow. Debt use is in line with industry averages, and coverage ratios are sufficient.

**4 (Speculative) -** The company has little or no history of generating earnings or cash flow. Debt use is higher. These companies may be in start-up mode or in a turnaround situation. These companies should be considered speculative.

**5 (Highly Speculative) -** The company has no history of generating earnings or cash flow. They may operate in a new industry with new, and unproven products. Products may be at the development stage, testing, or seeking regulatory approval. These companies may run into liquidity issues, and may rely on external funding. These stocks are considered highly speculative.

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