TIDY ISLAND INVESTORS

2023.02.19 EOS Energy Investment Update

Update Summary

On February 2nd, EOS released a *Business Update*, which included revised guidance on FY 2023 revenue (-), the path to profitability (-), and additional details on the DoE Loan (+). Further details below.

Both 2023 revenue and forward cash flow estimates were negatively impacted by a delay in the ramp-up of Z3 production. As stated in the original memo, our assumptions on Z3 unit economics (40%+ gross margins in steady state) are core to the underwrite. EOS's only path to becoming cash flow positive is through the commercialization of the next gen Z3 battery and its production at scale. While the Company has pushed back the timing for the Z3 launch, our assumptions on unit economics remain unchanged which is the more important takeaway. We recognize that the revised profitability timing (EOS is expected to be cash flow positive in 2H '24 versus Q4 '23 in our initial underwrite) puts additional pressure on the Company's weak balance sheet. Should EOS not secure the DoE Loan, EOS will need to raise ~$250 - $300MM (estimated based on historical cash burn) to bridge the gap over the next six quarters before becoming cash flow positive. In this situation, existing equity holders would be meaningfully diluted and the Company would likely face a liquidity crisis. That said, EOS provided positive and leading guidance regarding the DoE loan, providing an estimated loan quantum ("at least $250MM") for the first time publically. Should the Company receive this loan (at or above $250MM), EOS would be meaningfully de-risked and we believe this event could be a significant catalyst for the stock to sharply increase in price. We do not believe this event is fully priced in based on where the stock trades today (under $2.00 / share).

Pundits on Twitter and elsewhere are quick to call out existing risks (i.e., unit economics assumptions, weak balance sheet, reliance on the DoE loan) that cannot be fully mitigated as reasons to avoid EOS as an investment. To clarify, we are not investing in EOS because of our belief that it is a value-based play on the margin. We believe this investment opportunity is attractive on a risk-adjusted basis because (1) there will likely be an initial binary outcome driven by the result of the DoE loan approval process (which we believe is high probability) and that this binary outcome has asymmetric upside, and (2) there remains multiple medium-term catalysts over the next 18 months (i.e., validation of Z3 unit economics, Z3 launch timing, continued pipeline generation and conversion to backlog) that could unlock further upside after a DoE loan is approved. We continue to hold our price target by year-end of $3.00 / share and believe there is an achievable long-term upside scenario north of 10x+ MoM (implied share price of $15.00 / share) should the Company execute on its outlined initiatives. Please see our update tracker below for additional detail.

Area of Focus		Commentary	Change Since Last Update
Funding Sources / Dilution Risk		▪ In our original underwrite, liquidity and dilution concerns were categorized as the number one risk for this investment. There was and remains no way to fully mitigate this risk. That said, we believe the commentary from the Business Update and the small incremental bridge financings (via equity) over the last few weeks suggest that the DoE loan is higher likelihood than initially assumed. Further, the quantum of funding EOS could receive ($250MM+) is larger than initially expected and should be large enough to fully bridge the Company's path to profitability. We would expect a formal announcement for the approval of this loan to take place in Q1 – Q2 '23. Please see below for additional detail. ▪ "We are very excited about our continued growth and the Agreement," said Joe Mastrangelo, CEO of Eos. "With implementation of the 2022 Inflation Reduction Act taking place this year, we foresee continued market expansion. We continue to progress through the Department of Energy Loan Programs Office's due diligence process, and we expect that our loan amount could be at least $250 million, if successfully approved."	+
Financial Projections	**2023**	▪ In the Business Update, EOS provided guidance for FY23. The Company currently expects 2023 revenue to be in the range of $30 to $50MM. This is meaningfully lower than our base case estimates for 2023, which predicted FY23 revenue of $200MM+. This change is driven by a delay in the ramp-up of Z3 production. While this delay is a disappointment, we view EOS's approach to push-out existing backlog until they can meet demand with its next gen Z3 solutions as prudent given existing liquidity issues. For context, EOS has been operating at a loss due to a negative gross margin product (Gen 2.3) and one-time expenses related to the commercialization of the Z3 battery. ▪ Also in the Business Update, EOS provided guidance on the path to profitability, predicting that operating cashflow would be positive in 2H '24. This is a negative development compared to our initial underwrite, in which we assumed cash flow profitability as soon as Q3 '23. This change is also related to the ramp-up of Z3 production being delayed.	–
	2024	*See above*	–
	2025	*No change*	~
Z3 Production Timing		▪ Per the Business Update, the Z3 battery production line is expected to be launched in Q3 '23. We assumed the Z3 production capabilities would be initially launched in Q2 '23 and fully ramped-up by Q3 '23 in our initial underwrite.	–
Z3 Unit Economics		▪ As stated in the original memo, the assumptions regarding the unit economics of the Z3 battery are a key value driver within the model. These assumptions have been guided by management and EOS's external presentations. This will be key to monitor going forward. *No change*	~
Pipeline Growth / Conversion		▪ Eos announced an order for a 47 MWh initial renewables plus storage project with one of the largest operators of energy storage in the US, along with a separate long term agreement providing a framework for up to 4 GWh of energy storage volume over the next 6 years (the "Agreement"). The Agreement contributes 4GWh to the Company's Pipeline	+
Other		▪ CFO Transition: On January 23rd, EOS announced that Randall (Randy) B. Gonzales will be stepping away from his Chief Financial Officer responsibilities into a corporate advisory role and will be succeeded by Nathan Kroeker. We do not view this change as a concern.	~