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SPEC BUY

Current Price \$0.175
Valuation \$0.30

Ticker: K2F.ASX
Sector: Software

Shares on Issue (m): 174.2
Market Cap (\$m): 30.5
Net Debt / (Cash) (\$m): -6.2
Enterprise Value (\$m): 24.3

52 wk High/Low: 0.305 0.145
12m Av Daily Vol (m): 0.1

Key Metrics

	22A	23F	24F
EV/End ARR (x)	3.7	2.6	1.6
EV/EBITDA (x)	neg	neg	neg
P/E (x)	neg	neg	neg

Ratios

	22A	23F	24F
ND / Equity	-58.9%	-44.2%	-26.3%
EBITDA Mgn	-40.3%	-27.0%	-5.9%
RoA	-32.1%	-27.4%	-14.1%
RoE	-35.5%	-27.9%	-17.6%

Financials*:

	22A	23F	24F
ARR Beg (\$m)	3.4	6.0	8.6
ARR End (\$m)	6.0	8.6	14.0
Revenue (\$m)	10.0	13.0	18.5
EBITDA (\$m)	-4.0	-3.5	-1.1
EBIT (\$m)	-5.4	-4.8	-2.4
NPAT (\$m)	-4.6	-3.4	-1.7

* Underlying

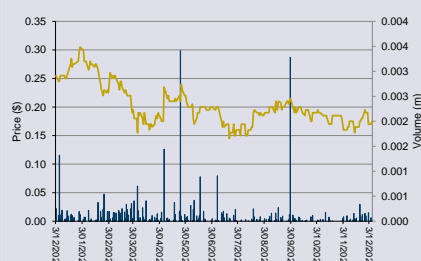
Net Assets (\$m) 14.0 10.6 8.9

Op CF (\$m) -0.8 -2.3 -1.2

Per Share Data:

	22A	23F	24F
Norm. EPS (cps)	-3.17	-1.98	-0.99
DPS (cps)	0.00	0.00	0.00
Div Yield	0.0%	0.0%	0.0%
NTAPS (cps)	-0.35	-1.66	-2.05
CFPS (cps)	-0.58	-1.33	-0.67

Share Price Graph



Please refer to important disclosures at the end of the report (from page 4)

Wednesday, 7 December 2022

K2fly (K2F)

Contract update and review

Analyst | Ian Christie

Quick Read

The flurry of recent contract wins was offset by the news last week that the RIO Ground Disturbance contract has been discontinued. We don't think it an indictment on K2F's software given validation by other Tier 1 miners, but it has set back ARR growth. We have lowered forecasts, but continue to see opportunities for K2F and share price upside.

Key points

September quarter: At the end of 1Q23 K2F had grown annual recurring revenue (ARR) to \$6.5M and total contract value (TCV) to \$18.8M. Following a strong 4Q22, cash receipts of \$2.2M in 1Q23 were down due to timing, although receipts for the last two quarters combined were up 71% on the prior two quarters combined. K2F ended the quarter with \$6.2M cash.

Contracts update: Since the end of 1Q23 new contracts include a 3-year contract with Rio Tinto (RIO) for K2F's Reconciliation module (TCV \$0.4M, ARR \$0.1M), a 3-year contract with Mineral Resources (MIN) for K2F's Resource Governance and Technical Assurance modules (TCV \$1.75M, ARR \$0.5M), and a 5-year contract with ArcelorMittal for K2F's Resource Disclosure and Model Manager modules (TCV \$1.9M, ARR \$0.3M). The trend was broken last week with the announcement that RIO and K2F mutually agreed to drop their Ground Disturbance contract. This was awarded in October 2021 and was one of K2F's largest with ARR of \$0.6M and a remaining TCV of \$2.6M.

Flattens Dec Q ARR growth: No explanation was given for the loss of the RIO contract, although recent news reports indicate RIO plans on hiring up to 600 developers to build software in-house to replace some external providers. RIO still uses 5 other K2F solutions, and BHP and FMG are both using K2F's Ground Disturbance solution, so it is likely the issue was more to do with RIO's bespoke requirements falling outside K2F's off-the-shelf offering. It does mean though that the reported ARR of \$7.1M at the end of November has subsequently pulled back to \$6.5M, which is where K2F started the quarter.

Forecasts: We have reviewed forecasts, paring back revenue growth in light of the above. We also pencil in slightly higher costs than prior; although FY22 EBITDA was in line with our expectations, the current high cost inflationary environment suggests caution in forecasting margin is warranted. We still assume breakeven is achieved during FY24 and that the Company has sufficient cash until this inflection point, but cash flow will need to remain a key focus for investors over the coming quarters.

Recommendation

We reset our valuation, based on discounted cash flows, to \$0.30 (prior blended valuation \$0.36). On a presumption there is nothing untoward with the loss of the RIO contract we maintain the current enterprise value of \$24.3M is undemanding given ESG tailwinds.

K2fly

Equity Research

Ian Christie, CFA

Recommendation	SPEC BUY
Current Price (\$)	0.175
Valuation (\$)	0.300

Sector	Software
Market Cap (\$m)	30.5
Enterprise Value (\$m)	24.3
Date	7 December 2022

Trading Metrics	FY22A	FY23F	FY24F	FY25F
EV / EBITDA (x)	(5.5)	(6.4)	(20.5)	6.4
EV / EBIT (x)	(4.1)	(4.6)	(9.4)	10.0
P/E (x)	(5.5)	(8.8)	(17.6)	20.4
Dividend Yield (%)	0.0%	0.0%	0.0%	0.0%

Per Share Data	FY22A	FY23F	FY24F	FY25F
Reported EPS (cps)	-3.17	-1.98	-0.99	0.86
Adjusted EPS (cps)	-3.17	-1.98	-0.99	0.86
Div. per share (cps)	0.00	0.00	0.00	0.00
NTA per share (cps)	-0.35	-1.66	-2.05	-0.60
CF per share (cps)	-0.58	-1.33	-0.67	1.28

P&L (\$m)*	FY22A	FY23F	FY24F	FY25F
Revenue	10.0	13.0	18.5	26.8
GP	4.7	7.4	11.7	17.8
GP Margin	47%	57%	63%	67%
Other Income/Expenses	(8.7)	(10.9)	(12.8)	(14.4)
EBITDA	(4.0)	(3.5)	(1.1)	3.5
D&A	(1.4)	(1.3)	(1.3)	(1.2)
EBIT	(5.4)	(4.8)	(2.4)	2.2
PBT	(5.5)	(4.9)	(2.5)	2.1
NPAT	(4.6)	(3.4)	(1.7)	1.5

* Underlying

Cash Flow (\$m)	FY22A	FY23F	FY24F	FY25F
Receipts	12.6	12.7	17.6	25.9
Payments	(13.6)	(16.7)	(19.6)	(23.0)
Other	0.2	1.7	0.9	(0.7)
Cash from Operations	(0.8)	(2.3)	(1.2)	2.2
Property, Plant & Equip	(0.1)	(0.1)	(0.1)	(0.1)
Payment for Subsidiary	(0.5)	(1.2)	(1.1)	-
Other	(2.7)	-	-	-
Cash From Investing	(3.3)	(1.3)	(1.2)	(0.1)
Issue of Shares	5.8	-	-	-
Net Borrowing	(0.2)	-	-	-
Dividends / Other	-	-	-	-
Cash From Financing	5.7	-	-	-
Net Cash Flow	1.5	(3.6)	(2.4)	2.2
Ending Cash	8.3	4.7	2.3	4.5

Balance Sheet (\$m)	FY22A	FY23F	FY24F	FY25F
Cash	8.3	4.7	2.3	4.5
Receivables	1.9	1.8	2.5	3.7
Inventory / Other	-	-	-	-
Current Assets	10.2	6.5	4.9	8.2
Property, Plant & Equip	0.1	0.1	0.1	0.1
Other NC Assets	16.1	15.0	14.0	13.0
Non-Current Assets	16.2	15.1	14.1	13.1
Total Assets	26.4	21.6	19.0	21.2
Payables	2.2	2.7	3.1	3.5
Borrowings	-	-	-	-
Provisions / Other	10.1	8.3	7.0	7.3
Total Liabilities	12.4	11.0	10.1	10.8
Net Assets	14.0	10.6	8.9	10.4
Ordinary Equity	36.9	36.9	36.9	36.9
Reserves	2.7	2.7	2.7	2.7
Retained Earnings	(25.5)	(28.9)	(30.6)	(29.1)
Total Equity	14.0	10.6	8.9	10.4

Valuation	Calcs.	\$m	\$ps
DCF Valuation:			
Discount Rate / WACC (%)	12.0%		
PV Free Cash Flow (\$m)		44.7	
Less Net Debt / Plus Cash (\$m)		8.3	
Plus Unpaid Cap (\$m)		-	
Equity Value (\$m)		53.0	0.30

The Implied ARR Multiple based on our DCF Valuation:

Implied multiple based on current ARR of \$6.5M	6.9
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Valuation (\$/share)	0.30
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P&L (\$m)*	1H21A	2H21A	1H22A	2H22A
Revenue	3.4	3.5	4.6	5.4
GP	1.8	1.9	2.1	2.6
GP Margin	53%	53%	46%	47%
Other Income/Expenses	(2.7)	(3.4)	(4.3)	(4.4)
EBITDA	(0.9)	(1.5)	(2.2)	(1.9)
D&A	(0.1)	(0.4)	(0.6)	(0.7)
EBIT	(1.1)	(1.9)	(2.8)	(2.6)
PBT	(1.1)	(1.9)	(2.8)	(2.7)
NPAT	(1.1)	(1.9)	(1.7)	(2.9)

* Underlying

Cash Flow (\$m)	1H21A	2H21A	1H22A	2H22A
Receipts	3.7	3.5	5.4	7.2
Payments	(4.2)	(4.5)	(6.7)	(6.8)
Other	0.2	(0.1)	0.1	0.1
Cash from Operations	(0.4)	(1.2)	(1.3)	0.4
Property, Plant & Equip	(0.0)	(0.0)	(0.1)	(0.0)
Payment for Subsidiary	(0.5)	(1.2)	(0.5)	(0.0)
Other	-	-	(1.3)	(1.4)
Cash From Investing	(0.5)	(1.2)	(1.9)	(1.5)
Issue of Shares	0.6	6.8	-	5.8
Net Borrowing	(0.0)	(0.0)	(0.1)	(0.1)
Dividends / Other	-	-	-	-
Cash From Financing	0.6	6.7	(0.1)	5.7
Net Cash Flow	(0.3)	4.3	(3.2)	4.7
Ending Cash	2.6	6.9	3.6	8.3

Financial Ratios	FY22A	FY23F	FY24F	FY25F
Growth				
Revenue growth (%)	44.0%	29.4%	43.0%	44.4%
EBITDA growth (%)	N/A	N/A	N/A	N/A
NPAT growth (%)	N/A	N/A	N/A	N/A
Profitability Ratios				
EBITDA Margin (%)	-40.3%	-27.0%	-5.9%	13.0%
Return on Assets (%)	-32.1%	-27.4%	-14.1%	13.3%
Return on Equity (%)	-35.5%	-27.9%	-17.6%	15.4%
ROIC (%)	-19.9%	-16.9%	-6.5%	16.5%
Balance Sheet Ratios				
Net Debt (ND) / Equity (%)	-58.9%	-44.2%	-26.3%	-43.3%
ND / ND + Equity (%)	-143.3%	-79.2%	-35.6%	-76.3%
Current Ratio (x)	1.1	0.7	0.5	0.8
Net Interest Cover (x)	-54.0	-48.1	-23.6	22.2
Cash Flow Ratios				
Free Cash Flow Yield (%)	-5.8%	-11.8%	-7.8%	7.1%
Cash Conversion (x)	0.2	0.7	1.1	0.6



K2F SaaS Contracts (since May 2019)

Date	Client	TCV	ARR (Incl. Arg. Est.)*	Value Year 1*	Contract Length	SaaS Solution	Locations
3-Jun-19	Imerys SA	N/A	N/A	\$0.15M	N/A	Resource Governance	80 sites, 25 countries
15-Aug-19	Glencore Canada	N/A	N/A	\$0.25M	Renewable annually	Resource Governance	56 sites, 7 countries
2-Sep-19	Newcrest Mining	\$0.33M	\$0.08M	\$0.15M	3.0 years	Resource Governance	7 sites, 3 countries
25-Oct-19	Nexa Resources	N/A	N/A	\$0.17M	Renewable annually	Resource Governance	12 sites globally
19-Nov-19	Rio Tinto	\$1.45M	\$0.24M	\$0.49M	5.0 years	Resource Governance	20 sites globally
13-Dec-19	Teck Resources	\$0.38M	\$0.10M	\$0.18M	3.0 years	Resource Governance	13+ sites globally
18-Dec-19	Westgold	\$0.58M	\$0.10M	\$0.18M	5.0 years	Land Management	3 production hubs in WA
24-Jan-20	Gold Fields Australia	\$0.58M	\$0.10M	\$0.18M	5.0 years	Resource Governance	Global operations & major projects
12-Mar-20	Newmont	\$0.90M	\$0.23M	\$0.44M	3.0 years	Resource Governance	12 operating mines
16-Mar-20	AngloGold Ashanti	\$0.24M	\$0.06M	\$0.12M	3.0 years	Resource Governance	Global operations
20-Apr-20	Sibelco	N/A	N/A	N/A	3.0 years	Resource Governance	60 sites globally
21-Apr-20	Kinross Gold	\$1.10M	\$0.18M	\$0.38M	5.0 years	Resource Governance	8 operating mines & 1 project
15-Jun-20	South32	\$0.88M	\$0.15M	\$0.28M	5.0 years	Resource Governance	19 sites globally
6-Jul-20	Orano SA (was Areva)	\$0.30M	\$0.05M	\$0.10M	5.0 years	Resource Governance	
25-Jan-21	Alcoa	\$0.57M	\$0.10M	\$0.17M	5.0 years	Resource Governance	6 sites globally
4-Feb-21	Rio Tinto	\$0.72M	\$0.18M	\$0.36M	3.0 years	Heritage Management	Iron ore operations
8-Mar-21	Coeur Mining	\$0.72M	\$0.12M	\$0.24M	5.0 years	Resource Governance	5 operating sites
18-May-21	Fortescue Metals	\$1.46M	\$0.49M	\$0.49M	3.0 years	Land Management	Pilbara and international
24-May-21	Roy Hill	\$2.44M	\$0.41M	\$0.80M	5.0 years	Technical Assurance	Pilbara
6-Aug-21	Alcoa	\$1.50M	\$0.22M	\$0.44M	5.0 years	Dams & Tailings	7 sites globally
17-Sep-21	Newmont	\$1.30M	\$0.26M	\$0.26M	5.0 years	Resource Governance	Contract extension
20-Sep-21	Sibanye Stillwater	\$2.85M	\$0.48M	\$0.95M	5.0 years	Tailings	38 tailing facilities globally
5-Oct-21	Rio Tinto	\$3.44M	\$0.62M	\$0.34M	5.0 years	Ground-Disturbance	Pilbara Iron Ore operations
10-Nov-21	Glencore Canada	\$0.44M	\$0.13M	\$0.18M	3.0 years	Resource Governance	56 sites, 7 countries
10-Mar-22	South32	\$0.78M	\$0.18M	\$0.42M	3.0 years	Dams & Tailings	6 mine sites
14-Mar-22	Freeport-McMoRan	\$0.77M	\$0.20M	\$0.37M	3.0 years	Resource Governance	12 global operations
9-May-22	BHP	\$2.12M	\$0.62M	\$2.12M	1.0 years	Ground Disturbance	Pilbara Iron Ore operations
28-Sep-22	Fortescue Metals	\$1.20M		\$1.20M	0.5 years	Software development	n/a
30-Sep-22	Imerys	\$0.86M	\$0.12M	\$0.61M	3.0 years	Land Access	15 sites
21-Nov-22	Rio Tinto	\$0.36M	\$0.08M	\$0.21M	3.0 years	Reconciliation	Global operations using RCubed
22-Nov-22	Mineral Resources	\$1.75M	\$0.48M	\$0.80M	3.0 years	Model Manager & Ore Blocker	Iron ore and lithium operations
28-Nov-22	ArcelorMittal	\$1.90M	\$0.33M	\$0.57M	5.0 years	Resource Discl. & Model Mgr	10 mining regions

* In certain cases, Argonaut estimates for ARR and Value Year 1 (which includes implementation fees)

Source: Argonaut from K2F

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