

X2M Connect Limited

Q1 FY23 Trading Update

On track despite some China delays

X2M Connect Limited (ASX:X2M) has provided a trading update in conjunction with its September quarter 4C release. In a nutshell, the September quarter results place X2M on track to achieve both our H1 FY23 and FY23 revenue forecasts and connected device assumptions despite some delays in China due to COVID lockdowns. Q1 FY23 revenue rose 137% (to \$3.8m) and represents 40% of our H1 FY23 estimates. There is \$12.5m in contracts to be delivered over the remainder of FY23 which covers 85% of our FY23 estimates before any additional contract announcements. Connected device growth was 19% against June 2022 and 92% relative to September 2021, in-line with forecasts and a key driver to future SaaS revenue. Annual Recurring Revenue (ARR) grew 50% over September 2021 to \$0.9m and will continue to grow in-line with connected devices. Cash at bank ended the quarter at \$2.7m, with cash used for both prepayments and additional inventory. An R&D tax rebate of \$0.5m is expected to bolster cash in November.

Business model

The X2M business model starts with the sale of a hardware device which enables legacy utility meters or sensors to communicate with an Internet-of-Things (IoT) platform. This sale historically has been at gross margins between 10% and 25%. A monthly SaaS software fee is then charged for each device in the field for the ongoing reading and monitoring of data from the meter, together with a monthly maintenance fee. The average yearly SaaS fee across all regions is currently ~A\$3.40 with gross margins between 60% and 90%. Additional functionality is being developed and deployed to increase this yearly fee over time. The benefits for utility companies include the detection of leaks, a reduction in manual reading and increased customer insights, while for end customers improved public safety and overall customer service are key benefits. In some regions a licensing-only model is employed where the customer provides all hardware and marketing and X2M the SaaS services.

FY23 RaaS estimates on track

RaaS is forecasting 85% revenue growth and a narrowing in EBITDA losses over FY23 as both connected devices and resulting SaaS licence fees continue to grow. The FY23 September quarter trading update implies these estimates are on track with revenue delivered and contracted for delivery this financial year already 85% of our FY23 estimate. Connected devices are half way to our H1 FY23 forecast with growth of 19% since June 2022. ARR has been released for the first time, growing 50% from September 2021 to reach \$0.9m. Such revenue growth has been achieved despite some delays in China due to Covid-related lockdowns. Cash has been used for working capital and prepayments in anticipation of new contracts.

Valuation of \$0.27/share or \$50m market cap fully diluted

We use a DCF methodology to value X2M given the early stages of market penetration and current loss-making position. The resulting valuation is \$0.27/share, with the biggest assumptions being device numbers in the field (including China) reaching 1.6m by FY25 and the recent Australian Energy Management initiative reaching 7.5k housing blocks (or equivalents) per annum by FY25.

Historical earnings and RaaS' estimates (in A\$m unless otherwise stated)

Year end	ARR*	Revenue	EBITDA adj.	NPAT adj.	EPS (adj.) (c)	EV/Revenue (x)
06/21a	0.1	5.7	(5.3)	(6.7)	n.m	n.m
06/22a	0.6	10.4	(6.6)	(7.9)	(0.057)	1.1
06/23f	2.0	19.3	(4.0)	(5.3)	(0.027)	0.5
06/24f	4.0	30.7	(0.6)	(2.2)	(0.008)	0.5

Source: Proforma for FY21; Actual FY22, RaaS estimates FY23f and FY24f; *Annual Recurring Revenue EBITDA, NPAT and EPS adjusted for one-time, non-recurring and non-cash items

Hardware, Software & Services

26 October 2022

Share Details

ASX code	X2M
Share price (25-Oct)	\$0.08
Market capitalisation	\$15.0M
Shares on issue	186.7M
Net cash at 30-Sep-22	\$2.7M
Free float	~60%

Share Performance (12 months)



Upside Case

- Market consolidation, particularly in South Korea
- New module/functionality offering higher SaaS fees
- Favourable SaaS pricing deal in China

Downside Case

- Continued SaaS pricing pressures
- Limited uptake of new functionality
- Access to funding

Board of Directors

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Jodie Leonard	Non-Executive Director
Damien Johnston	Non-Executive Director
John Stewart	Non-Executive Director

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Q1 FY23 Cash Flow Summary

Our key take aways from the 2022 September quarter trading update and 4C release include:

- Revenue +137% to \$3.8m. This represents 82% of H1 FY22 revenue and 40% of RaaS H1 FY23 estimates;
- Cash receipts +176% to \$3.9m;
- Connected devices +19% on June 2022 at 293k. This is almost halfway to our December 2022 estimate of 344k;
- The number of enterprise clients now totals 52, up 41% on the PCP;
- ARR for September 2022 of \$0.9m. This has grown 50% from the \$0.6m in September 2021 and will continue to grow (with a lag) with connected device growth;
- New contracts in South Korea has resulted in an increased TAM, defined as the numbers of customers that a client services. Management estimate client customers now represent 47% of South Korea households, up from 37% a year ago, with penetration at September 2022 ~4.5%;
- Operating cash burn of \$1.3m, impacted somewhat by COGS purchases in advance of delivery;
- Continued spend on software development in the form of 'intellectual property'. IP spend has been elevated for three quarters now and is important for new product development;
- Cash at bank of \$2.7m post the recent equity raising, with some cash used for prepayments (\$0.2m) and additional inventory (\$0.3m);
- \$0.5m in R&D tax rebates are expected in November; and
- \$12.5m in contracts expected to be delivered over the remainder of the financial year, which when added to the \$3.8m delivered in Q1 represents 85% of current FY23 RaaS revenue estimates. In the month of October alone an additional \$1.4m in contracts across four customers were announced.

Additional contracts should be expected through the year.

Exhibit 1: X2M quarterly cashflow summary (in A\$m unless otherwise stated)

Line item (\$'000)	Q1 FY22a	Q2 FY22a	Q3 FY22a	Q4 FY22a	Q1 FY23a
Cash receipts	1,441	5,027	1,483	4,122	3,971
% growth on pcg					176%
Outgoings	3,614	6,481	3,470	5,166	5,394
Cost of services sold/commissions	2,002	2,712	1,667	3,233	3,216
Staff and admin	1,212	3,486	1,477	1,859	1,866
Marketing/R&D/other	416	607	326	156	377
R&D rebate/govt grants	16	324	0	82	65
Net cash from operating activities	(2,157)	(1,130)	(1,987)	(962)	(1,358)
Equity issues	8,500	0	0	0	3,675
Repayment of borrowings	566	783	82	(535)	(218)
Other	13	642	108	197	194
Intellectual property	413	(37)	647	636	650
Net cash from investing activities	7,508	(1,388)	(837)	(298)	3,049
Cash at the end of the period	7,789	5,121	2,241	1,020	2,728
Connected devices	152,203	181,500	196,037	245,265	292,806

Source: Company announcements

X2M Contract Update

The table below summarises recent contract announcements, which provide good transparency and more recently dominated by contracts from South Korean municipalities. Covid lockdowns have clearly slowed momentum in China but an acceleration is expected when lockdowns ease.

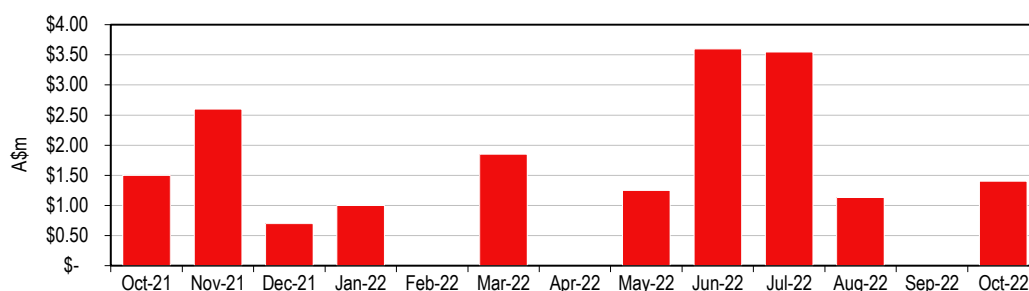
Exhibit 2: Key contract financials from recent announcements

Date	Value (A\$m)	Nature	Region	Units	Price/unit or bundle/year (A\$)
Oct-21	1.50	Hardware bundle*	South Korea	9,377	160
Nov-21	2.60	Hardware bundle*	South Korea	20,278	128
Dec-21	0.70	Hardware	China	n.a	n.a
Jan-22	1.00	Three-year SaaS/maintenance	South Korea	26,000	13
Mar-22	1.00	Hardware	China	n.a	n.a
Mar-22	0.85	Hardware bundle*	South Korea	5,360	159
May-22	1.25	Hardware bundle*	South Korea	10,387	120
Jun-22	1.00	Hardware	China	n.a	n.a
Jun-22	1.34	Hardware	China	22,000	61
Jun-22	0.66	Hardware bundle*	South Korea	7,777	85
Jun-22	0.60	Hardware bundle*	South Korea	4,000	150
Jul-22	1.60	Hardware bundle*	South Korea	11,000	145
Jul-22	1.25	Hardware bundle*	South Korea	9,754	128
Jul-22	0.70	Hardware bundle*	South Korea	3,252	215
Aug-22	1.13	Hardware bundle	South Korea	4,280	264
Oct-22	1.40	Hardware bundle*	South Korea	8,600	163

Source: Company announcements; *Bundles include 12months' SaaS fees

X2M has \$12.5m in contracts expected to be delivered over the next nine months, with the chart below highlighting the acceleration in size and timing of recent contract announcements.

Exhibit 3: Value of X2M contract announcements by month (\$m)



Source: Company announcements

Key revenue assumptions to FY25 are detailed in the table below:

Exhibit 4: X2M P&L summary (in A\$m unless otherwise stated)

Line item	2021a	2022a	2023f	2024f	2025f
Sales	5.70	10.39	19.33	30.70	49.98
Hardware	4.14	8.89	16.58	24.91	39.90
Subscription	1.44	1.15	2.75	5.79	10.08
Other	0.12	0.34	0.00	0.00	0.00
Gross profit	1.63	2.31	5.55	10.09	17.43
GP%	29	22	29	33	35
Operating costs	6.89	8.88	9.55	10.70	11.98
EBITDA	(5.26)	(6.57)	(4.00)	(0.61)	5.44
D&A	1.24	0.95	0.71	0.92	0.98
EBIT	(6.50)	(7.51)	(4.72)	(1.53)	4.47
Interest expense/(income)	0.16	0.07	0.04	0.02	0.02
Tax expense	0.00	0.00	0.00	0.00	0.00
NPATA	(6.32)	(7.24)	(4.26)	(0.85)	5.20
Reported NPAT	(8.44)	(10.23)	(5.03)	(2.03)	3.92

Source: Company announcements and RaaS estimates

A summary of RaaS regional assumptions in terms of device sales, Total Addressable Markets (TAM) and revenue for FY23 is presented in the table below. As a general comment South Korea and China dominate revenue assumptions, while forecast devices on the ground by June 2023 remain low in terms of estimated total market penetration.

Exhibit 5: X2M summary by region (FY23)

Variable	South Korea	Japan	Taiwan	China	Australia
Monitoring type	Water	Gas bottle	Gas	Water	Energy Mgt
Est. devices @ June 2023	167,500	252,000	17,920	187,705	500
Est. TAM	3,000,000	7,200,000	552,000	9,100,000	40,000
Est. TAM penetration %	5.6	3.5	3.2	n.m	1.3
Hardware sales	Yes	No	Yes	Yes	Yes
Software sales	Yes	Yes	Yes	No	Yes
Est. FY23 revenue (\$m)	10.02	0.50	0.76	7.09	0.66
(% X2M total)	53	3	4	37	3

Source: RaaS Advisory estimates

Investment Case Revisited

While the core X2M IoT platform technology is “mature”, having primarily been in development since ~2012, the commercial rollout is accelerating, promising a narrowing of losses near-term and ultimately “sticky” profitability long-term, driven by the following factors:

- The previous ownership structure had disputing shareholders, was sub-scale and ultimately under-resourced financially.

The new corporate structure has cleared all debts and provided funding for an acceleration in customer numbers and units in the field, with cumulative device numbers up from ~64k in H1 FY21 to 293k in September 2022. Contracts signed imply a number closer to 437k by June 2023 by RaaS estimates.

- Device sales ultimately drive recurring SaaS revenue and are therefore an important driver for long-term shareholder value as these sales are delivered at a much higher margin than the initial hardware sale and require less marketing support.
- The benefits of remote smart metering are maximised when a client is “all-in” in terms of the number of their customers being digitally measured and analysed. Based on X2M’s current penetration relative to a client’s TAM, there is significant upside across key regions. In South Korea, for example, we estimate X2M has penetrated only ~4.5% of its clients TAM in that country, while in Japan the number is estimated at 2.0%. Our FY26 estimates still imply modest penetration rates of 17% and 8% respectively relative to our estimated TAM in these regions.
- While existing SaaS fees are relatively low by SaaS standards, new product development promises additional functionality and, therefore, additional fees on the already installed device base.
- The group’s cost base is built for growth, and as a result we expect modest cost growth relative to both revenue and gross profit, resulting in significant operating leverage. Our FY23 forecasts as an example imply 86% revenue growth, 140% gross profit growth and only 12% operating cost growth.
- X2M products offer ESG benefits for both clients and their customers with respect to lower carbon footprints and direct energy cost savings, increasing their attractiveness in the current environment.
- Our DCF valuation of \$0.27/share fully diluted for the recent equity raise implies >200% upside to the current share price.

Exhibit 6: X2M Financial Summary

X2M Connect Limited (ASX:X2M)						Share price (24 October 2022)						A\$	0.080
Profit and Loss (A\$m)						Interim (A\$m)							
Y/E 30 Jun	FY21A	FY22A	FY23F	FY24F	FY25F	Revenue	H121A	H221A	H122A	H222A	H123F	H223F	
Revenue	5.7	10.4	19.3	30.7	50.0	Revenue	3.2	2.5	4.6	5.8	9.3	10.0	
Gross profit	1.6	2.3	5.5	10.1	17.4	EBITDA	(1.8)	(3.5)	(3.2)	(3.4)	(2.0)	(2.0)	
GP margin %	28.5%	22.3%	28.7%	32.9%	34.9%	EBIT	(2.4)	(4.1)	(3.8)	(3.5)	(2.2)	(2.3)	
EBITDA	(5.3)	(6.6)	(4.0)	(0.6)	5.4	NPATA (normalised)	(2.3)	(3.7)	(3.7)	(3.4)	(2.0)	(2.0)	
Depn	(0.9)	(0.6)	(0.2)	(0.2)	(0.2)	Adjustments	0.2	(2.3)	(2.6)	(0.2)	(0.2)	(0.3)	
Amort	(0.3)	(0.3)	(0.5)	(0.7)	(0.8)	NPAT (reported)	(2.2)	(5.9)	(6.4)	(3.5)	(2.2)	(2.3)	
EBIT	(6.5)	(7.5)	(4.7)	(1.5)	4.5	EPS (adjusted)	nm	nm	(0.028)	(0.025)	(0.011)	(0.011)	
Interest expense	(0.2)	(0.1)	(0.0)	(0.0)	(0.0)	Dividend (cps)	0.000	0.000	0.000	0.000	0.000	0.000	
Tax	0.3	(0.0)	0.0	0.0	0.0	Imputation	0.0	0.0	0.0	0.0	0.0	0.0	
Minorities	0.0	0.0	0.0	0.0	0.0	Operating cash flow	na	na	na	na	na	na	
Equity accounted assoc	0.0	0.0	0.0	0.0	0.0	Free Cash flow	na	na	na	na	na	na	
NPATA pre sign. items	(6.7)	(7.9)	(5.3)	(2.2)	3.7	Divisionals	H121A	H221A	H122A	H222A	H123F	H223F	
Adjustments	(2.1)	(2.8)	(0.5)	(0.7)	(0.8)	Revenue	3.2	2.5	4.6	5.8	9.3	10.0	
NPAT (reported)	(9.1)	(11.1)	(6.2)	(3.6)	2.2	Hardware	2.5	1.8	3.9	5.4	8.1	8.5	
Cash flow (A\$m)						Subscription/other	0.7	0.7	0.7	0.4	1.2	1.5	
Y/E 30 Jun	FY21A	FY22A	FY23F	FY24F	FY25F								
Adj EBITDA	(5.4)	(6.7)	(4.1)	(0.8)	5.3	Gross profit	1.0	0.6	0.9	1.4	2.6	2.9	
Interest	0.2	0.1	0.0	0.0	0.0	Gross Profit Margin %	31.6%	24.6%	20.4%	23.8%	28.1%	29.3%	
Tax	0.5	0.4	0.6	0.4	0.0	Employee	2.2	2.4	2.5	2.7	2.8	3.0	
Working capital/other	1.8	0.2	0.5	(0.4)	(1.0)	Professional fees	0.3	0.6	0.6	0.8	0.7	0.9	
Operating cash flow	(2.9)	(6.1)	(3.0)	(0.8)	4.3	Other	0.3	1.1	1.0	1.3	1.1	1.1	
Mtce capex	0.0	(0.0)	(0.0)	(0.1)	(0.1)	Total costs (ex SBP/1-time)	2.8	4.1	4.1	4.7	4.6	4.9	
Capitalised Software	(0.8)	(1.7)	(1.0)	(1.0)	(1.1)	EBITDA	(1.8)	(3.5)	(3.2)	(3.4)	(2.0)	(2.0)	
Free cash flow	(3.7)	(7.8)	(4.0)	(1.8)	3.1	EBITDA margin %	(240%)	(494%)	(443%)	(790%)	(168%)	(129%)	
Acquisitions/Disposals	0.0	0.0	0.0	0.0	0.0	Margins, Leverage, Returns		FY21A	FY22A	FY23F	FY24F	FY25F	
Other	(0.1)	0.1	0.0	0.0	0.0	EBITDA margin %		(92.3%)	-63.2%	-20.7%	-2.0%	10.9%	
Cash flow pre financing	(3.8)	(7.6)	(4.0)	(1.8)	3.1	EBIT margin %		(114.1%)	-72.3%	-24.4%	-5.0%	8.9%	
Equity	2.0	7.3	3.8	2.2	0.0	NPAT margin (pre significant items)		(116.9%)	-76.5%	-27.2%	-7.3%	7.4%	
Other	0.7	(1.4)	0.0	0.0	0.0	Net Debt (Cash)		0.46	-	0.46	-	0.54	-
Net Dividends paid	0.0	0.0	0.0	0.0	0.0	Net debt/EBITDA (x)	(x)	nm	nm	nm	nm	nm	
Net change in cash	(1.1)	(1.8)	(0.2)	0.4	3.1	ND/ND+Equity (%)	(%)	nm	nm	nm	nm	nm	
Balance sheet (A\$m)						EBIT interest cover (x)	(x)	nm	nm	nm	nm	nm	
Y/E 30 Jun	FY21A	FY22A	FY23F	FY24F	FY25F	ROA		nm	nm	nm	(16.0%)	33.4%	
Cash	2.0	1.0	0.7	1.1	4.2	ROE		nm	nm	nm	(512.7%)	47.3%	
Accounts receivable	0.2	0.2	0.5	1.0	1.8	NTA (per share)							
Inventory	0.1	0.1	0.3	0.4	0.6	Working capital		-1.8	-1.9	-1.9	-1.5	-0.5	
Other current assets	1.7	2.9	2.9	2.9	2.9	WC/Sales (%)		(30.9%)	(17.9%)	(9.7%)	(4.8%)	(0.9%)	
Total current assets	4.0	4.2	4.3	5.4	9.4	Revenue growth		nm	82.2%	86.1%	58.8%	62.8%	
PPE	0.6	0.6	0.6	0.6	0.6	EBIT growth pa		n/a	n/a	n/a	n/a	(392.0%)	
Capitalised Software	2.2	3.1	3.6	3.9	4.3	Pricing		FY21A	FY22A	FY23F	FY24F	FY25F	
Goodwill	0.0	0.0	0.0	0.0	0.0	No of shares (y/e)	(m)	-	133	179	201	201	
Deferred tax asset	0.0	0.0	0.0	0.0	0.0	Weighted Av Dil Shares	(m)	-	133	179	201	201	
Other non current assets	0.1	0.2	0.4	0.4	2.3	EPS Reported	A\$ cps	nm	(0.0807)	(0.0321)	(0.0146)	0.0146	
Total non current assets	3.0	3.9	4.6	4.9	7.1	EPS Normalised/Diluted	A\$ cps	nm	(0.0572)	(0.0266)	(0.0077)	0.0221	
Total Assets	6.9	8.2	8.9	10.2	16.5	EPS growth (norm/dil)		nm	-54%	-71%	-387%		
Accounts payable	2.0	2.2	2.7	2.9	2.8	DPS	cps	0.000	0.000	0.000	0.000	0.000	
Contract liabilities	1.1	2.2	3.6	4.4	6.8	DPS Growth		n/a	n/a	na	na	na	
Borrowings	2.4	0.6	0.6	0.6	0.6	Dividend yield		0.0%	0.0%	0.0%	0.0%	0.0%	
Other	0.9	1.0	1.0	1.0	1.0	Dividend imputation		0	0	0	0	0	
Total current liabilities	6.4	6.0	7.8	8.8	11.2	PE (x)		nm	-	1.4	-	3.0	-
Lease liabilities	0.1	0.3	0.3	0.3	0.3	PE market		15.0	15.0	15.0	15.0	15.0	
Employee benefits	0.2	0.3	0.3	0.4	0.4	Premium/(discount)		nm	(109.3%)	(120.1%)	(169.1%)	(75.9%)	
Total long term liabilities	0.4	0.6	0.7	0.7	0.7	EV/EBITDA (x)		nm	(1.7)	(2.5)	(23.1)	2.9	
Total Liabilities	6.8	6.6	8.4	9.5	11.9	FCF/Share	A cps	nm	(0.060)	(0.023)	(0.009)	0.015	
Net Assets	0.2	1.6	0.5	0.7	4.6	Price/FCF share		nm	(1.3)	(3.5)	(8.6)	5.2	
Share capital	9.4	19.3	23.3	25.5	25.5	Free Cash flow Yield		nm	(53.7%)	(27.3%)	(12.5%)	20.8%	
Reserves	0.4	2.1	2.1	2.1	2.1								
Accumulated losses	(9.6)	(19.9)	(24.9)	(26.9)	(23.0)								
Other	0.0	0.0	0.0	0.0	0.0								
Total Shareholder funds	0.2	1.6	0.5	0.7	4.6								

Source: Company data for actuals, RaaS estimates

FINANCIAL SERVICES GUIDE

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BR, RaaS, its directors and related parties have no associations or relationships with any product issuers other than when advising retail clients to invest in managed funds when the managers of these funds may also be clients of BR. RaaS's representatives may from time to time deal in or otherwise have a financial interest in financial products recommended to you but any material ownership will be disclosed to you when relevant advice is provided.

Complaints

If you have a complaint about our service you should contact your representative and tell them about your complaint. The representative will follow BR's internal dispute resolution policy, which includes sending you a copy of the policy when required to. If you aren't satisfied with an outcome, you may contact AFCA, see below. BR is a member of the Australian Financial Complaints Authority (AFCA). AFCA provide fair and independent financial services complaint resolution that is free to consumers.

Website: www.afca.org.au; Email: info@afca.org.au; Telephone: 1800931678 (free call)

In writing to: Australian Financial Complaints Authority, GPO Box 3, Melbourne, VIC, 3001.

Professional Indemnity Insurance

BR has in place Professional Indemnity Insurance which satisfies the requirements for compensation under s912B of the Corporations Act and that covers our authorized representatives.

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The science of climate change is common knowledge and its impacts may damage the global economy. Mitigating climate change may also disrupt the global economy. Investors need to make their own assessments and we disclaim any liability for the impact of either climate change or mitigating strategies on any investment we recommend.

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