

Positioned for operating leverage >FY23

K2fly Ltd (ASX:K2F) has reported its FY22 results which follows on from the 4C data released in July. Revenues growth was in-line with forecast at \$10.1m (+44%), with TCV and ARR already disclosed at \$17.8m (+80%) and \$6.0m (+76%) respectively. Gross profit was lower than forecast due to the mix between SaaS and consulting/implementation, with several large-scale implementations in FY22. We still see a step change in GP% over FY23 aided by the ARR starting base of \$6.0m. Underlying operating costs were slightly above forecast and ~60% above the pcip as a significant investment was made in capabilities to accelerate product growth. We see some stabilisation of the cost base in FY23 but it will be dependent on market opportunities. FY23 will see the launch of a new Resource Governance Platform, effectively upgrading the existing RCubed solution while making adoption of other solutions within the K2F portfolio easier. The platform will also integrate with Maptek's 3D geological modelling, mine design and production planning software Vulcan, which is also used by many existing and potential clients of K2F.

Business model

K2F licenses software together with associated consulting and implementation services to large/enterprise mining companies around the world. Key software products address the natural resource governance and ESG issues that mining companies are prioritising and centre around mineral resources and reserves governance (RCubed), community and heritage/land access (Infoscope), mining technical assurance (Sateva), and rehabilitation and tailings management (Decipher). In a number of these areas, K2F's offering is the world's only 'off-the-shelf' solution. New contracts typically involve an implementation fee and an annual recurring licence payment typically made in advance (SaaS fees). Contract durations range between three-to-five years (average 3.4 years) with a strong probability of renewal as they become embedded in the key work processes of clients. Utilising existing client relationships, K2F is looking to increase the number of software solutions a client purchases through product development and marketing.

Well positioned for further growth

A starting ARR of \$6.0m and the promise of more contracts provides a good base for gross margin improvement in FY23 (we have margins improving 1,100bps to 58%). The cost base was dramatically increased in FY22 (+60%) in readiness for revenues growth, which offers further operating leverage at the EBITDA line. The launch of an upgraded Resource Governance Platform and integration with Maptek's Vulcan platform supports further contract wins and an easier process for new solutions adoption.

Valuation of \$0.48/share or \$84m market cap

Near-term gross margin/EBITDA revisions have been offset by medium-term reductions to our working capital assumptions as key clients continue to pay in advance, resulting in an increase in our DCF valuation from \$0.46/share to \$0.48/share. Our DCF incorporates a WACC of 11.3%, CAGR revenues growth over the forecast period of 33%, medium-term growth of 12%, SaaS reaching 80% of total revenues (from 44% in FY22) and gross margins peaking at 70% (from 47% in FY22). Current EV/ARR metrics are undemanding at ~3.7x FY22, particularly considering half of the group's solutions have been in the market for less than three years.

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

Year end	ARR*	Revenues	Adj. EBITDA	Adj. NPAT	EPS (adj.) (c)	P/E (x)	EV/ARR (x)
06/21a	3.4	7.0	(2.0)	(2.1)	(0.016)	nm	4.5
06/22a	6.0	10.0	(5.0)	(4.2)	(0.021)	nm	3.7
06/23f	8.7	16.8	(0.6)	(0.9)	0.002	89.0	3.4
06/24f	11.3	22.4	2.8	1.4	0.017	12.5	2.5

Source: Company announcements for FY21 & FY22; RaaS estimates FY23f and FY24f; *Annualised Recurring Revenue

Software & Services

2nd September 2022

Share Details

ASX code	K2F
Share price (1-Sept)	\$0.21
Market capitalisation	\$37.0M
Shares on issue	175.5M
Net cash 30-Jun-22	\$8.3M
Free float	54.36%

Share Performance (12 months)



Upside Case

- New contracts with new mining customers
- New/existing products with existing clients
- Acceleration in new clients due to Maptek collaboration

Downside Case

- Large customers take software solutions in-house
- Failure to achieve contract renewals or renew at significantly lower prices
- Loss of key people

Board of Directors

Jenny Cutri	Non-Executive Chair
Neil Canby	Non-Executive Chair
James Deacon	Non-Executive Director
Peter Johnson	Non-Executive Director
Brian Miller	Non-Executive Director

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FY22 Results Summary

Key takeaways from the FY22 results relative to our estimates include:

- TCV and ARR (at \$17.8m and \$6.0m respectively) have already been reported and were both above our initial forecasts, growing at 80% and 76% respectively over the pcip;
- Gross profit margins were lower than forecast (47% vs 53%) despite an increased skew to higher-margin SaaS sales (44%/56% in FY22, up from 38%/62% in FY21) due to some margin pressures within consulting/implementation and a number of large projects on the go at the same time;
- Underlying operating costs were \$0.6m or 15% above forecast, and ~60% above the pcip on the back of additional staffing costs and related recruitment costs in advance of expected revenues growth. Significant product development has also been undertaken, culminating in an upgrade of the RCubed solution in the form of a new Resource Governance Platform;
- Net cash at June 2022 was \$8.3m (no debt), boosted by the \$6.2m capital raise in April; and
- Capitalised software spend for new product development (intellectual property) was \$2.7m for the year (\$1.3m/\$1.4m) and in-line with forecast as new products are developed and existing products upgraded.

Exhibit 1: K2F FY22 earnings summary

Variable (A\$000')	FY21	FY22	% CHG	Comments
Sales	6.95	10.02	44	
SaaS	2.61	4.44	96	SaaS mix continues to increase
Consulting/Other	4.34	5.58	13	(44%/56% vs 38%/62% in FY21)
(ARR)	3.38	6.00	78	Growth at the top-end of peers
Gross profit	3.68	4.67	27	
GP%	53	47	(12)	Some margin pressures in consulting
Operating costs	5.25	8.32	59	Additional heads for growth
EBITDA	(1.56)	(3.65)	133	
Amortisation	0.36	1.14	215	Capitalised software
EBIT	(1.93)	(4.79)	149	
NPAT (adj.)	(1.59)	(3.75)	136	
NPAT (reported)	(2.85)	(4.57)	60	Includes SBP, provision changes

Source: Company announcements

Outlook

We have fine-tuned our revenues and costs assumptions post the FY22 result with key changes and comments including:

- **Revenues are modestly higher** on the back of the new Resource Governance platform launch. We are forecasting ~45% ARR growth in FY23;
- **Gross profit margins** are forecast to see a step change from 47% in FY22 to 58% in FY23 as higher-margin SaaS revenues increase relative to consulting and implementation. A starting ARR base of \$6.0m helps the equation.
- **Operating cost** growth is forecast to stabilise relative to FY22 but still be ~6% higher, although cost growth will ultimately depend on revenues growth and opportunities.
- **EBITDA** is forecast to near break-even in FY23, driven by the step change in gross profit margins and a relatively stable cost base.

Exhibit 2: RaaS K2F earnings adjustments (in A\$m unless stated)

Variable	FY22	FY23	FY24	FY25	Comments
Revenues					
Initial	10.2	16.1	21.9	26.5	
Revised	10.0	16.8	22.4	27.4	
% CHG	(2.0)	4.4	2.1	3.6	New resource Gov.
Adj. EBIT					
Initial	-3.0	0.6	4.4	7.3	
Revised	-4.8	-0.5	3.0	6.6	
% CHG	58.8	nm	(31.6)	(9.8)	Lower consult. margins
Adj. NPATA					
Initial	-0.4	1.5	4.3	6.8	
Revised	-2.9	0.6	3.2	6.1	
% CHG	nm	nm	(26.7)	(9.2)	
EPS					
Initial	-0.003	0.008	0.024	0.038	
Revised	-0.020	0.003	0.018	0.034	
% CHG	nm	nm	(27.2)	(-9.7)	
Capitalised software					
Initial	2.2	2.5	2.0	1.5	
Revised	2.7	2.5	2.0	1.5	
% CHG	23	0	0	0	

Source: Company announcements and RaaS estimates

Exhibit 3: K2F forecast P&L summary (in A\$m unless otherwise stated)

Line item	2020a	2021a	2022a	2023f	2024f
Sales	5.60	6.95	10.02	16.84	22.39
Consulting/other	4.38	4.34	5.58	6.14	6.44
SaaS	1.22	2.61	4.44	10.70	15.95
Gross profit	2.30	3.68	4.67	9.79	14.05
GP%	41%	53%	47%	58%	63%
Operating costs	3.84	5.25	8.32	8.84	9.43
EBITDA	-1.53	-1.56	-3.65	0.95	4.62
D&A	0.09	0.36	1.14	1.35	1.56
EBIT	-1.62	-1.93	-4.79	-0.40	3.05
Interest expense/(income)	0.01	0.02	0.10	0.03	0.00
Tax expense	0.00	0.00	-0.88	0.27	1.38
NPAT	-1.63	-1.94	-4.01	-0.71	1.67
NPATA	-1.54	-1.58	-2.87	0.64	3.23

Source: Company announcement and RaaS estimates

Confidence in our medium-term sales assumptions is driven by the continued increase in average contract ARR and TCV as larger miners adopt more modules across more regions.

New Resource Governance Platform to launch Q2 FY23

K2F recently announced the launch of a new Resource Governance Platform in Q2 FY23 which will make it easier for customers to upgrade and leverage new modules while adding additional capability to existing systems:

- The core platform will initially be an upgrade/replacement of the Mineral Resource & Reserve Reporting Governance solution RCubed. It is a cloud first approach, with a new data model, reporting and analytics functions.
- RCubed houses a company's ore reserves and resources data which is required for reporting and disclosure if listed on a stock exchange and at the core of any companies' valuation.
- This data model can be leveraged for other K2F resource governance solutions, and the new platforms cloud first architecture will make adoption of other modules easier for both K2F and clients.

- The new platform will integrate with K2fly's Model Manager and Maptek's 3D geological, modelling, mine design and production planning software solution Vulcan. This provides additional layers of transparency and governance for mineral resource and reserve data. This solution is already being used by many of K2F's existing and potential new customers and is an example of the collaboration possible between the two groups.

Recent Small-Tech M&A Metrics

At the small end of tech there has been two M&A transactions that have relevance to the valuation of K2F, being:

- Paygroup (ASX:PYG). A scheme of arrangement with Deel Inc., a US-based payroll software group, implies an equity valuation of \$118m and an EV/ARR of 3.0x. Paygroup delivers mission-critical payroll solutions with a particular focus on multinational companies' contractors and franchises. The group could be considered relatively mature, with Deel Inc. looking to bolster its APAC presence.
- Kyckr (ASX:KYK). A scheme of arrangement with RealWise (a company associated with the major shareholder) implies an equity value of \$43m, EV of \$35.5m and EV/ARR 8.5x. KYK is a B2B data and software company that aggregates and organises data to reduce the business risks associated with fraud and money laundering.

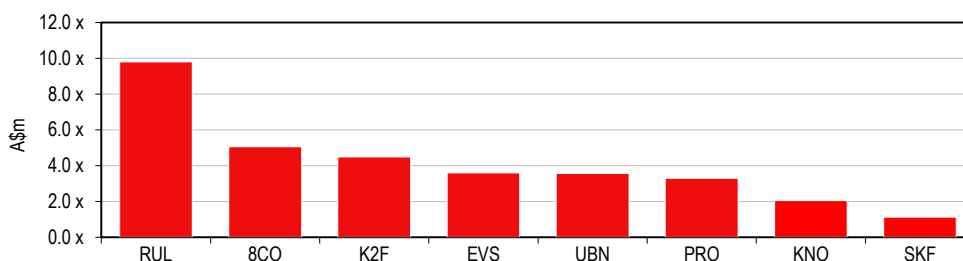
At the KYK multiples K2F would have a value of \$0.34/share on FY22 metrics.

Orica (ASX:ORI) recently announced the strategic acquisition of digital orebody intelligence business **Axis Mining Technology** for upfront consideration of \$260m and deferred earnout payments of up to \$90m. The purchase price based on the upfront consideration represents 11.8x FY22 EBITDA, implying \$22m EBITDA. Axis specialises in geospatial technology used at greater depth for more precise geophysics with a particular exposure to gold and copper.

In terms of peer ARR, K2F currently sits at the top-end of our assessed peer group in terms of EV/ARR at 4.5x against an average of 3.0x.

Recent relative growth rates and the fact that most of K2F's software solutions have been in market less than three years in our view justifies this relative rating.

Exhibit 4: EV/ARR at 30 June 2022



Source: Company announcements, RaaS estimates

DCF Valuation

Our DCF valuation has increased from \$0.46/share to \$0.48/share, with near-term gross margin reductions offset by the fact that most clients continue to pay their SaaS fees in advance, reducing working capital requirements. Key assumptions include:

- WACC 11.3%, including a RFR of 3.5%, beta of 1.2x and equity risk premium of 6.5%;
- Medium-term growth rate of 12.0%, perpetuity growth of 2.2%; and
- Sustainable gross margin of 70% and EBITDA margin of 27%.

Exhibit 5: K2F base-case DCF valuation

Parameters	Outcome
Discount rate / WACC	11.3%
Beta	1.2x
Terminal growth rate assumption	2.2%
Sum of PV (\$m)	30.4
PV of terminal value (\$m)	46.2
PV of enterprise (\$m)	76.6
Debt (cash) (\$m)	(7.9)
Net value – shareholder (\$m)	84.5
No. of shares on issue (m)	176
NPV (\$/share)	\$0.48

Source: RaaS estimates

Exhibit 6: K2F Financial Summary

K2fly Limited (ASX:K2F)						Share price (1 September 2022)						A\$	0.210
Profit and Loss (A\$m)						Interim (A\$m)							
Y/E 30 Jun	FY20A	FY21A	FY22A	FY23F	FY24F	H121A	H221A	H122A	H222A	H123F	H223F		
Revenue	5.6	7.0	10.0	16.8	22.4	3.4	3.5	4.6	5.4	8.0	8.8		
Gross profit	2.3	3.7	4.7	9.8	14.0	(0.6)	(1.0)	(1.9)	(1.7)	0.4	0.6		
GP margin %	41.1%	53.0%	46.7%	58.1%	62.7%	(0.6)	(1.3)	(2.4)	(2.3)	(0.3)	(0.1)		
EBITDA	(1.5)	(1.6)	(3.6)	0.9	4.6	(0.6)	(1.0)	(0.8)	(2.0)	0.3	0.4		
Depn	(0.1)	(0.1)	(0.2)	(0.2)	(0.2)	(0.4)	(0.5)	(0.4)	(0.2)	0.0	0.0		
Amort	(0.1)	(0.4)	(1.1)	(1.3)	(1.6)	(0.9)	(1.5)	(1.2)	(2.2)	0.3	0.4		
EBIT	(1.7)	(2.0)	(5.0)	(0.6)	2.8	(0.005)	(0.010)	(0.006)	(0.012)	0.001	#DIV/0!		
Interest expense	(0.0)	(0.0)	(0.1)	(0.0)	0.0	0.000	0.000	0.000	0.000	0.000	0.000		
Tax	0.0	0.0	0.9	(0.3)	(1.4)	0.0	0.0	0.0	0.0	0.0	0.0		
Minorities	0.0	0.0	0.0	0.0	0.0	na	na	na	na	na	na		
Equity accounted assoc	0.0	0.0	0.0	0.0	0.0	na	na	na	na	na	na		
NPAT pre significant item	(1.7)	(2.1)	(4.2)	(0.9)	1.4	Divisionals							
Adjustments	(1.7)	(0.9)	0.0	0.0	0.0	Revenue	3.4	3.5	4.6	5.4	8.0		
NPAT (reported)	(3.4)	(3.0)	(4.2)	(0.9)	1.4	SaaS	1.1	1.5	1.9	2.5	5.1		
Cash flow (A\$m)						Consulting/other	2.3	2.1	2.7	2.9	3.0		
Y/E 30 Jun	FY20A	FY21A	FY22A	FY23F	FY24F								
Adj EBITDA	(1.6)	(1.6)	(3.8)	0.8	4.4	Gross profit	1.8	1.9	2.1	2.6	4.6		
Interest	0.0	(0.0)	(0.0)	(0.0)	0.0	Gross Profit Margin %	53.0%	52.9%	45.8%	47.4%	57.9%		
Tax	0.2	0.1	0.2	0.8	(1.4)	Admin & corporate	1.5	1.9	2.7	2.8	3.0		
Working capital/other	0.8	(0.1)	2.8	1.3	1.8	Directors & employees	0.2	0.4	0.4	0.7	0.5		
Operating cash flow	(0.6)	(1.6)	(0.9)	2.8	4.9	Other	0.6	0.7	0.9	0.9	1.0		
Mtce capex	(0.0)	(0.0)	(0.1)	(0.1)	(0.1)	Total costs (ex SBP/one-c	2.4	2.9	4.0	4.3	4.3		
Free cash flow	(0.6)	(1.7)	(1.0)	2.7	4.7	EBITDA	(0.6)	(1.0)	(1.9)	(1.7)	0.4		
Capitalised Software	0.0	(1.1)	(2.7)	(2.5)	(2.0)	EBITDA margin %	(24.4%)	(48.9%)	(71.5%)	(59.7%)	12.9%		
Acquisitions/Disposals	(0.1)	(0.4)	(0.5)	(0.7)	(1.1)	Margins, Leverage, Returns		FY20A	FY21A	FY22A	FY23F		
Other	0.1	0.1	0.0	0.0	0.0	EBITDA margin %		(27.4%)	(22.5%)	-36.4%	5.6%		
Cash flow pre financing	(0.7)	(3.0)	(4.2)	(0.5)	1.6	EBIT margin %		(30.6%)	(29.4%)	-50.0%	-3.7%		
Equity	2.9	7.9	5.8	0.0	0.0	NPAT margin (pre significant items)		(30.8%)	(29.6%)	-42.2%	-5.5%		
Other	0.2	0.6	0.2	0.0	0.0	Net Debt (Cash)	-	2.85	-	6.86	-		
Net Dividends paid	0.0	0.0	0.0	0.0	0.0	Net debt/EBITDA (x)	(x)	nm	nm	nm	nm		
Net cash flow for year	2.4	5.4	1.9	(0.5)	1.6	ND/ND+Equity (%)	(%)	nm	nm	nm	nm		
Balance sheet (A\$m)						EBIT interest cover (x)	(x)	nm	nm	nm	nm		
Y/E 30 Jun	FY20A	FY21A	FY22A	FY23F	FY24F	ROA		(14.7%)	(20.5%)	(2.2%)	8.3%		
Cash	2.9	6.9	8.3	7.8	9.5	ROE		(224.9%)	(24.7%)	(30.1%)	(6.1%)		
Accounts receivable	1.2	2.2	1.9	3.7	4.9	NTA (per share)							
Inventory	0.0	0.0	0.0	0.0	0.0	Working capital		0.2	0.5	0.0	1.6		
Other current assets	0.1	0.0	0.0	0.0	0.0	WC/Sales (%)		3.5%	7.1%	0.2%	9.5%		
Total current assets	4.1	9.1	10.2	11.5	14.4	Revenue growth		47.9%	24.2%	44.0%	68.1%		
PPE	0.0	0.1	0.1	0.2	0.4	EBIT growth pa		nm	n/a	n/a	n/a		
Capitalised Software	0.3	5.7	7.2	8.4	8.8	Pricing		FY20A	FY21A	FY22A	FY23F		
Goodwill	0.7	7.3	7.3	7.3	7.3	No of shares (y/e)	(m)	82	105	146	176		
Deferred tax asset	0.0	0.0	0.0	0.0	0.0	Weighted Av Dil Shares	(m)	82	105	146	176		
Other non current assets	0.1	0.2	1.5	3.2	6.4	EPS Reported	A\$ cps	(0.0408)	(0.0247)	(0.0212)	0.0024		
Total non current assets	1.2	13.3	16.2	19.1	23.0	EPS Normalised/Diluted	A\$ cps	(0.0201)	(0.0161)	(0.0212)	0.0024		
Total Assets	5.4	22.3	26.4	30.6	37.4	EPS growth (norm/dil)		n/a	-20%	32%	-111%		
Accounts payable	1.0	1.7	1.9	2.1	2.8	DPS	cps	0.000	0.000	0.000	0.000		
Provisions	0.9	2.2	2.9	2.9	2.9	DPS Growth		n/a	n/a	n/a	na		
Borrowings	0.1	0.0	0.2	0.2	0.2	Dividend yield		0.0%	0.0%	0.0%	0.0%		
Deferred revenue	1.3	2.1	4.3	7.1	9.5	Dividend imputation		0	0	0	0		
Total current liabilities	3.3	6.0	9.3	12.3	15.4	PE (x)	-	10.5	-	13.0	-		
Provisions	0.5	3.1	2.1	1.4	0.3	PE market		18.0	18.0	18.0	18.0		
Deferred liabilities	0.0	1.3	1.1	1.8	2.3	Premium/(discount)		(158.1%)	(172.3%)	(154.9%)	394.5%		
Total long term liabilities	0.5	4.3	3.1	3.2	2.6	EV/EBITDA (x)		(9.9)	(14.4)	(8.1)	29.9		
Total Liabilities	3.8	10.3	12.4	15.4	18.0	FCF/Share	A cps	(0.010)	(0.031)	(0.029)	(0.002)		
Net Assets	1.6	12.0	14.0	15.2	19.4	Price/FCF share		(21.7)	(6.7)	(7.3)	(84.4)		
Share capital	18.2	30.9	36.9	38.8	41.4	Free Cash flow Yield		(2.1%)	(8.9%)	(11.3%)	(1.2%)		
Reserves	1.2	2.0	2.7	2.7	2.7								
Accumulated losses	(17.9)	(20.9)	(25.5)	(26.2)	(24.6)								
Other	0.0	0.0	0.0	0.0	0.0								
Total Shareholder funds	1.5	12.0	14.0	15.2	19.4								

Source: Company data for actuals, RaaS estimates

FINANCIAL SERVICES GUIDE

RaaS Advisory Pty Ltd

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Corporate Authorised Representative, number 1248415

of

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