![TMT ANALYTICS]

K2Fly Limited

Software and consultancy for asset-intense industries

K2Fly Limited (ASX:K2F) provides SaaS-based software and consultancy services aimed at helping asset-intensive enterprise clients, such as Mining and Utility companies, manage their assets and land tenements more efficiently.

The company generates revenues from three sources; recurring revenues from software licenses for its main product Infoscope, which is a data visualization platform that integrates companies' spatial and land data with day-to-day operational and financial data. Key customers include FMG, Westgold Resources and APIM.

The "The Keeping Place" solution is co-sponsored by BHP, Rio Tinto and FMG along with two Pilbara based aboriginal corporations and governed by The National Trust. K2F anticipates that Infoscope's recurring Software-as-a-Service (SaaS) revenues will account for the largest part of the company's revenues in the future.

Currently, K2F's largest revenue generator is Consultancy & Advisory Services. These are services, such as software development, consultancy, and IT systems deployment on a project basis. Customers include Western Power, Programmed, Public Transport Authority and FMG. There is strong synergy between Infoscope and Consultancy services and many opportunities for cross selling.

Lastly, K2F sells third-party software, such as Fieldreach from Capita, in a revenue sharing model. These channel partnerships also provide K2F with cross sell opportunities for Infoscope and Consultancy services.

SAP integration is a game-changer for K2F

K2F recently completed the integration of Infoscope with S/4 HANA, SAP's cloud-based Enterprise Resource Planning (ERP) solution. SAP is the world's largest provider of ERP software and has more than 700 mining companies on the books, including most of the top-20 largest mining companies globally.

In our view, porting Infoscope to S/4 HANA will prove to be a game-changer for K2F given that the company can now target SAP's Mining customers through SAP's commercial channels. This includes SAP's sales reps and the SAP App Centre from where SAP customers can now purchase Infoscope directly.

Many as-yet untapped opportunities in next few years

In addition to the acquisition of Infoscope, which was transformational for K2F, there are many similar acquisition opportunities on the market.

			FY17	FY18E	FY19E	FY20E
Number of shares (m)	60.4	Revenues	0.6	2.6	5.9	8.5
Number of shares FD (m)	79.3	EBITDA	-1.8	-2.2	0.1	0.9
Market capitalisation (A$	18.4	NPAT	-3.2	-3.6	0.1	0.3
Free Float (%)	67%	EPS FD	-0.17	-0.06	0.001	0.003
12 month high/low A$	0,345 / 0,068	EV/EBITDA	N/A	N/A	203.8	18.5
Average daily volume (k)	170	EV/Sales	13.5	6.9	3.1	2.1

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These are smaller companies with strong revenue potential that would benefit strongly if positioned and supported properly, e.g. through integration with platforms such as S/4 HANA. Given its track record with Infoscope, we believe K2F could acquire, integrate and grow such companies very successfully. K2F's senior leadership team has substantial experience in such acquisitions.

Additionally, with its technical skill set, K2F can develop additional products and consultancy services going forward. For instance, as SAP's S/4 HANA gathers steam among Enterprises, i.e. the move towards Cloud-based ERP systems, K2F would be in an excellent position to leverage its existing HANA expertise to service those companies.

Lastly, K2F has been predominantly focused on Western Australia (WA), given the State's mining dominance. However, there is substantial scope to expand the business Australia-wide, both through existing customers' operations outside of WA and through new customer wins. Furthermore, we also see ample opportunities for Infoscope outside of Australia, predominantly through the SAP integration.

K2F's revenue ramp up is just getting started: starting coverage with a BUY

Our financial model reflects the strong revenue ramp up we expect in the next several years, which will predominantly be driven by Infoscope. K2F's current valuation leaves very substantial upside, in our view, towards our price target of A$ 0.58 per share. Consequently, we start our coverage of K2F with a Buy recommendation.

K2Fly Limited

K2Fly Limited — FY-end June

Profit & Loss account

	2017A	2018E	2019E	2020E
Revenues	0.6	2.6	5.9	8.5
EBITDA	-1.8	-2.2	0.1	0.9
EBITDA %	*N/M*	*-86.5%*	*1.5%*	*11.1%*
Depreciation & Amortisation	-0.4	-0.7	-0.7	-0.7
EBIT	-2.3	-2.9	-0.6	0.2
EBIT %	*N/M*	*-113.9%*	*-10.4%*	*2.8%*
Interest income & expense net	0.0	0.0	0.0	0.0
Other items	0.0	0.0	0.0	0.0
Profit before Tax	**-2.2**	**-2.9**	**-0.6**	**0.3**
Taxes	0.0	0.0	0.0	0.0
Net earnings	**-3.2**	**-3.6**	**0.1**	**0.3**
Ordinary shares outstanding	33	47	61	62
Fully diluted # shares	19	56	80	81
Earnings per share	**-0.10**	**-0.08**	**0.002**	**0.004**
Earnings per share fully diluted	-0.17	-0.06	0.001	0.003

Cash Flow Statement

	2017A	2018E	2019E	2020E
Net income P&L	-3.2	-3.6	0.1	0.3
Depreciation & amortisation	0.4	0.7	0.7	0.7
Impairments	0.9	0.7	-0.7	0.0
Change in working capital	-0.1	0.0	-0.6	-0.3
Other items	0.0	0.0	0.0	0.0
Cash flow from operations	**-1.7**	**-2.2**	**-0.5**	**0.7**
Net cash flow from investments	**0.0**	**0.0**	**0.0**	**0.0**
Dividend paid	0.0	0.0	0.0	0.0
Change in equity	3.4	1.2	0.5	0.0
Change in debt	0.0	0.0	0.0	0.0
Other items	0.0	0.0	0.0	0.0
Cash flow from financing	**3.4**	**1.2**	**0.5**	**0.0**
Net cash flow	**1.7**	**-1.0**	**0.0**	**0.7**

Balance Sheet

	2017A	2018E	2019E	2020E
Current assets				
Cash and marketable securities	1.7	0.8	0.8	1.5
Accounts receivable	0.4	0.9	0.7	1.0
Inventories	0.0	0.0	0.0	0.0
Other current assets	0.0	0.1	0.1	0.2
Total current assets	**2.1**	**1.7**	**1.6**	**2.7**
Fixed assets				
Net property, plant & equipment	0.0	0.0	0.0	0.0
Goodwill	0.0	0.0	0.0	0.0
Other intangible assets	2.2	0.8	0.8	0.1
Other assets	0.0	0.0	0.0	0.0
Total fixed assets	**2.2**	**0.8**	**0.8**	**0.1**
Total assets	**4.3**	**2.5**	**2.4**	**2.7**
Current liabilities				
Short-term debt	0.0	0.0	0.0	0.0
Accounts payable	0.0	0.3	0.8	0.1
Dividends payable	0.0	0.0	0.0	0.0
Other current liabilities	0.0	0.0	0.1	0.1
Total current liabilities	**0.3**	**0.9**	**0.2**	**0.4**
Long-term liabilities	0.1	0.1	0.1	0.1
Total provisions	0.0	0.0	0.0	0.0
Total group equity	**3.9**	**1.5**	**2.1**	**2.3**
Total liabilities and equity	**4.3**	**2.5**	**2.4**	**2.7**

Valuation

	2017A	2018E	2019E	2020E
Relative valuation				
P/E (reported)	-3.2	-4.0	182.9	74.0
P/B	2.6	9.4	9.0	8.1
P/CF	N/A	N/A	N/A	27.1
Price to sales	16.2	5.6	3.1	2.2
EV / sales	13.5	6.9	3.1	2.1
EV / EBITDA	N/A	N/A	203.8	18.5
Dividend yield	0.0	0.0	0.0	0.0
EV / Common equity	2.2	11.6	8.7	7.5

Discounted Cash Flow

Assumptions

Long term interest rate	3.0%
Risk premium	5.75%
Marginal tax rate	27.5%
Long term growth	3%
Leveraged Beta	1.46
Implied WACC	*11.7%*

TMT Analytics applied WACC	11.7%
DCF fair value per share	A$ 0.58

Profitability ratios

	2017A	2018E	2019E	2020E
Return on Equity	-82%	-236%	5%	11%
Return on Assets	-74%	-145%	4%	9%
Return on Invested Capital	N/M	-60%	6%	11%
EBITDA margins	N/M	-86.5%	1.5%	11.1%
EBIT margins	N/M	-113.9%	-10.4%	2.8%
Net margins	N/M	-139.8%	1.7%	3.0%

Financial Strength

	2017A	2018E	2019E	2020E
Net debt	-1.7	-0.8	-0.8	-1.5
Net debt / Equity	-0.4	-0.5	-0.4	-0.6
Net debt / EBITDA	N/M	N/M	N/M	-1.6
Interest coverage	N/M	N/M	N/M	N/M

Capital Structure

Ordinary shares	60
Performance rights	3
Options and warrants (m)	16
Fully diluted	79
Market capitalisation (A$ m)	18.4
Market cap. fully diluted (A$ m)	24.2
Free float %	67%
12 month high/low A$	0,345 / 0,068
Average daily volume (k)	170.0
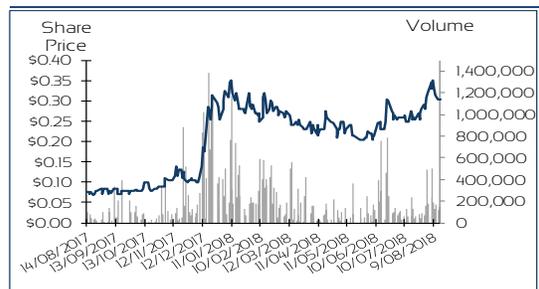
Source: Factset, TMT Analytics

Asset and land management solutions for enterprise clients

K2Fly Limited (ASX:K2F) provides various software products and consultancy services aimed at helping asset-intensive enterprise clients manage their assets and land tenements more efficiently. For instance, through the company's Infoscope software solution, clients, such as Mining companies, can more effectively manage the land on which they operate.

Targeting the Mining, Utilities and Infrastructure sectors

K2F predominantly targets companies in the Mining, Utilities and Infrastructure sectors, given their large asset bases and large-scale use of land. The current client base is fairly well-spread across these sectors with at least one large client in each of these sectors, including Western Power, Fortescue Metals Group and ARC Infrastructure.

Oil & Gas and Telecoms are other sectors that K2F is targeting with multiple commercial proposals to companies in these sectors outstanding.

Three revenue generators

K2F generates revenues from three main sources, IP licensing, consultancy services and reselling of 3rd party software products.

1. Licensing of Intellectual Property in a Software-as-a-Service model

K2F's main software product is Infoscope, which is sold in a SaaS model (Software-as-a-Service). Customers pay a recurring fee per user for unlimited access to the Infoscope platform.

In FY18 K2F's SaaS revenues accounted for approximately 20% of revenues, versus nearly 80% for one-off consultancy revenues (Figure 1). Given the recurring and predictable nature of SaaS revenues, and the associated higher stock market valuation for SaaS companies compared to pure consultancy companies, one of K2F's aspirations is to generate approximately 50% of its revenues from recurring SaaS business within three years' time.

FIGURE 1: REVENUE BREAKDOWN FY18
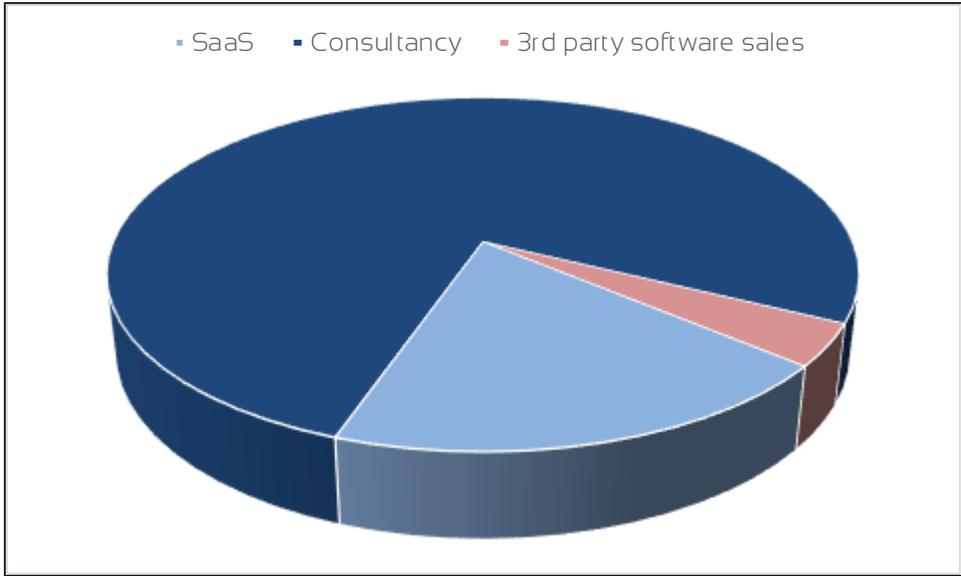
Source: TMT Analytics, K2Fly

Land management through Infoscope

Infoscope is a data visualization platform which integrates spatial data with day-to-day operational information and companies' financial data (Figure 2).

Infoscope is typically sold to companies with sizeable physical assets and large-scale use of land, such as mining and utility companies, railroad operators and Telecom companies. Through the online Infoscope platform users can manage a wide range of aspects related to the use and management of land, such as:

- Ground disturbance permits and rehabilitation commitments with audit trails;

- Environmental obligations, i.e. approval recording, rehabilitation and reporting;

- Cultural heritage and native title, including survey management, native title agreements and management of objections and obligations;

- Tenement Management, including leases and agreements, compliance, financial forecasting;

- Stakeholder engagement, and

- Land access, i.e. access agreements, entry notices etc.

Infoscope uses a variety of different data sources, such as council and state department tenement data, shire data, drilling databases, ground disturbance plans, GIS (geographic information system) systems, land information databases as well as specific flora and fauna databases.

Additionally, companies' own data that is already available in SAP can be integrated with Infoscope. SAP is the most widely used Enterprise Resource Planning (ERP) software suites in the Mining industry.

FIGURE 2: INFOSCOPE LAND USE PERMITS DASHBOARD

Source: TMT Analytics, K2Fly

K2F sells its Infoscope solution on a per seat basis, i.e. between ~A$ 1,000 and A$ 2,500 per seat per year depending on the number of licenses a customer buys. The company currently has around 350 subscribers to the Infoscope platform, a number which we expect will grow rapidly on the back of the recent integration of Infoscope into SAP.

We will elaborate on this important integration with SAP below.

The Keeping Place

In addition to commercial customers, such as Mining and Utility companies that use Infoscope for commercial purposes, K2F is involved in a pilot project called The Keeping Place, which is a map-first Infoscope solution developed to provide a central and secure way to manage digital cultural heritage data for the rightful custodians of that data – the aboriginal people.

The Keeping Place is a Heritage Knowledge Repatriation Project in which BHP Billiton, Fortescue Metals Group and Rio Tinto contribute vast amounts of data, collected over the last 60 years, around archaeological heritage, ethnographies and other types of data related to Aboriginal land. Through The Keeping Place, participating Aboriginal communities will be able to easily access all this historical information and drive socio-economic benefits.

Currently, two Aboriginal communities have joined this initiative as founding members; the Nyiyaparli People and the Yinhawangka People. It is expected that more communities will join The Keeping Place going forward.

Not only will The Keeping Place generate training and employment opportunities, the project will also enable cross-generational knowledge transfer and local access and control over cultural heritage information for Aboriginal people.

As the project's technology partner, K2F generates approximately A$ 100,000 in annual software revenues from The Keeping Place through Western Australia National Trust, which provides project administration and support. This figure is likely to grow significantly in 2019 and beyond.

2. Consultancy and Advisory Services: critical friends and trusted advisers

Most of K2F's revenues are currently generated through Consultancy and Advisory Services, i.e. A$ 2M in FY18, or approximately 80% of revenues.

This project-based work can be very diverse in nature and scope, but generally involves K2F consultants and advisors being deployed on a time and materials basis, i.e. hourly or daily rates plus expenses, to assist enterprise clients with technology deployment, development and strategic planning.

In many of these projects, K2F's role could be described as that of critical friend or trusted adviser to its clients, many of whom are tier 1 enterprises, i.e. multi-billion-dollar companies.

Examples include client-specific development of new Infoscope features and the selection and procurement processes of new enterprise software suites, such as ERP and CRM suites.

3. Reselling 3rd party software

K2F also generates revenues from third-party software providers, albeit revenues are modest compared to the other two business lines. In FY18, the company generated approximately A$ 100k in revenues by reselling third-party software. This third-party software is related to K2F's own products and services, i.e. it addresses similar customers and is therefore highly complementary in terms of sales efforts.

The largest contributor to K2F's third-party reseller revenues is Capita's Fieldreach product. K2F is primarily targeting prospective customers in the Oil & Gas, Rail and Utility sectors with Capita's solution.

Fieldreach is a Mobile Inspection and Workflow Management tool that enables companies to efficiently plan remote workflows, provides on-site access to assets' inspection and maintenance history and helps to locate assets, above and below ground.

K2F signed up ARC Infrastructure as its first Fieldreach licensing customer in 2017 and is bidding to a number of other prospective customers.

Other third party software solutions K2F is reselling include Pointerra's 3D data solution, and Kony's Mobile Application Development Platform.

Aspiration is 50/50 revenue split between recurring and non-recurring revenues

K2F's revenue break down by recurring and non-recurring revenues amounted to 20% / 80% in FY18. Before the company acquired Infoscope in 2017, essentially all of its business was non-recurring consultancy and advisory based with the exception of some revenues from third-party software providers.

Following the consolidation of Infoscope, which has brought approximately A$ 950k in additional revenues in FY18, the balance has obviously shifted towards more recurring revenues.

Going forward, however, K2F aims to move this revenue break down towards 50/50, i.e. more Infoscope subscription revenues generated through a SaaS model.

Companies with a high level of recurring revenues as percentage of total sales are typically valued substantially higher by investors compared to companies that typically generate one-off, transactional, revenues, such as consultancy companies.

In this respect, K2F's collaboration with SAP is likely to have a very substantial impact on the company. Not only should this collaboration provide a strong driver for recurring Infoscope sales, it should also help K2F make the transition towards the 50/50 revenue split in favor of said recurring revenues.

Integration of Infoscope into SAP is a game-changer

As mentioned, K2F recently announced that Infoscope had been integrated into SAP's S/4 HANA software suite. This is a very significant milestone, in our view.
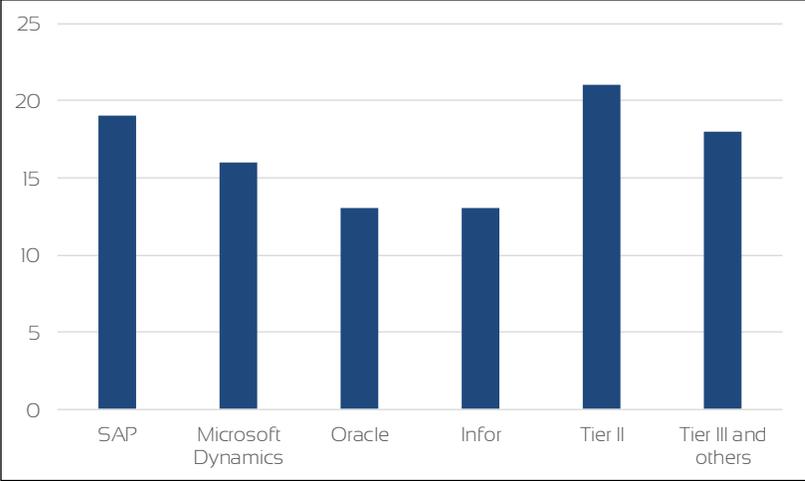
Source: TMT Analytics, Statista

SAP (GR:SAP) is the world's largest provider of ERP (Enterprise Resource Planning) software (Figure 3). In 2018 SAP is expected to generate EUR 24.4BN in revenues from its ERP software offerings. It has 770 mining companies in its client portfolio. Furthermore, 17 of the 20 largest mining companies globally use SAP in their enterprise resource planning.

> In other words, teaming up with SAP makes a lot of commercial sense for a company that is targeting the mining industry.

Infoscope is now available on SAP HANA, which is a database server that can not only store and retrieve data, but also facilitates analytical tasks, such as spatial data processing, predictive and streaming analytics as well as text analytics and search.

S/4 HANA is SAP's proprietary business suite that only runs on SAP HANA. It combines the functionalities of different enterprise software suites, such as ERP and CRM (Customer Relationship Management), into one single platform. As such, S/4 HANA is highly efficient for enterprises.

Infoscope now native in SAP's S/4 HANA

During the first stage of integration, K2F ported Infoscope onto SAP HANA. The second integration phase, which was completed in late March 2018, integrated Infoscope to S/4 HANA Cloud Platform, which allows Infoscope to be deployed as an SAP Cloud Platform solution. In a third step, Infoscope has recently been made available on SAP's App Center (Figure 4), meaning Infoscope is now native in SAP's ecosystem.

> SAP's customer base, which includes nearly 800 mining companies, can now directly purchase Infoscope through SAP. This enables an easier sales process for SAP's own sales force and is expected to result in a significant ramp up of new Infoscope subscription sales in FY19 and beyond.

FIGURE 4: INFOSCOPE WITHIN SAP APP CENTER
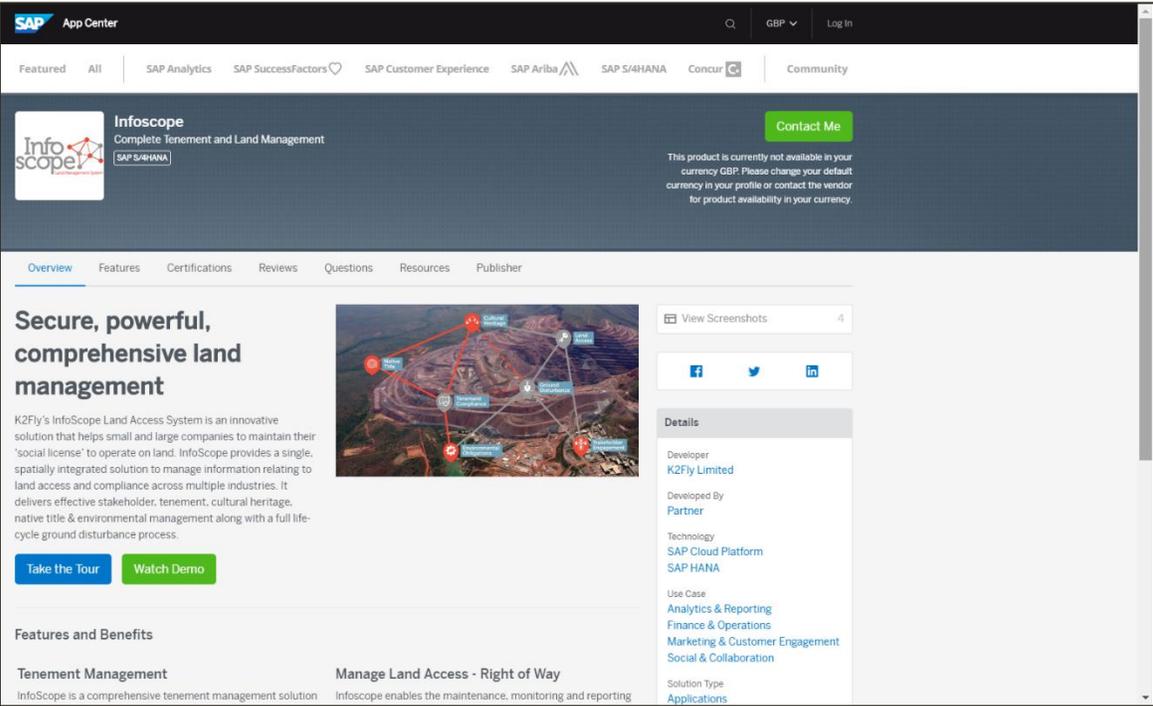
Source: TMT Analytics, K2Fly, SAP

When selling Infoscope to its customers, SAP works collaboratively with K2F to ensure the best outcomes for its clients. In other words, the earlier-mentioned prices per user are all net revenue to K2F.

While there may be scope to partner with industry players other than SAP, specifically for the Mining vertical we believe SAP is by far the most valuable partner for K2F.

ERP and EAM are K2F's key addressable markets

Targeting a niche segment within the vast ERP market

Enterprise Resource Planning (ERP) software is business process management software that allows an organization to manage the business and automate core functions, such as planning, operations, product development, manufacturing, accounting, human resources, sales and marketing. ERP systems further monitor the utilization of resources and workflow schedules to better understand the total cost of operations on a real-time basis.

Dart Consulting estimates that the global ERP market was worth US$ 31.6BN in 2016 and is poised to grow at a 7.3% CAGR during 2016 2022 to reach US$ 48.2BN by 2022 (Figure 5).

FIGURE 5: GLOBAL ERP MARKET (IN US$ BN)

Source: TMT Analytics, Dart Consulting

North America contributed more than 40% to global ERP revenues. Increasing technological advancements and rising adoption of ERP software by enterprises to achieve greater transparency in financial transactions are expected to augment the market demand in the region.

Western Europe is the second largest market for ERP solutions. Growth in this region is driven by increased deployment of cloud-based ERP systems, such as SAP HANA, and hybrid ERP systems (combination of cloud and on-premise solutions).

According to Allied Market Research, Asia Pacific is projected to register the highest growth in the ERP software market and reach US$ 9.8BN by 2020 owing to the rising number of enterprises and booming manufacturing industry. In addition, the growing number of start-ups and government initiatives, particularly in the emerging economies of China and India to implement IT infrastructure, are expected to drive market demand.

SaaS/Cloud transforming the ERP software landscape

Allied Market Research estimates that the global cloud-based ERP market was valued at US$ 13.2BN in 2016 and is projected to reach US$ 32.2BN by 2023, growing at a CAGR of 13.6% between 2017 and 2023. Businesses are increasingly integrating cloud-based ERP applications with conventional ones, thereby creating hybrid ERP systems that can support new business models and can be scaled to serve new customer demands.

The rising adoption of cloud services and mobile applications, along with the increasing demand from small and medium-sized enterprises (SMEs) to attain optimum business process efficiency and transparency, are the major factors driving the global cloud ERP market.

In addition, the increasing support from governments worldwide for the advancement of IT infrastructure across enterprises is also expected to boost the demand for such solutions.

This trend is also evident from the Panorama Consulting annual ERP survey of more than 300 companies with average annual revenue of US$ 439M (Figure 6).

FIGURE 6: ERP DEPLOYMENT BY SOFTWARE TYPE
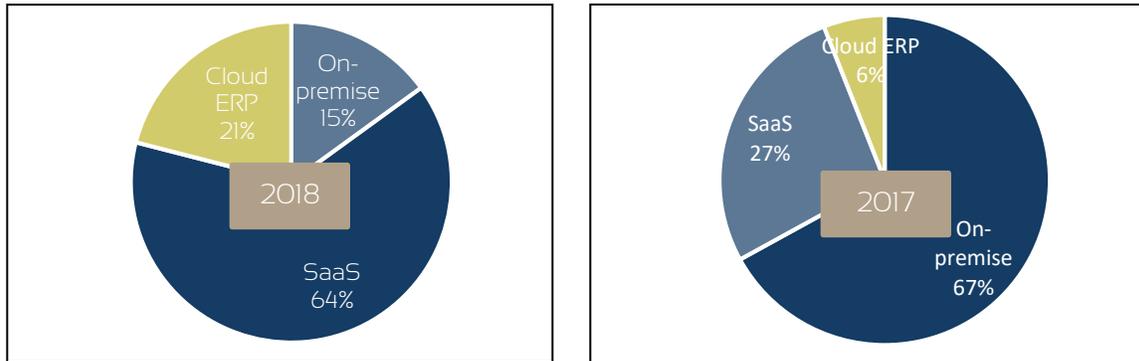
Source: TMT Analytics, Panorama Consulting

In 2018, the respondent companies who implemented SaaS models increased dramatically by 37%-points. This is primarily due to ERP vendors, including SAP, heavily pushing their customers to the cloud. They are continuously building out their service platform and infrastructure to host solutions at both the business and enterprise levels. In addition, SaaS and cloud-based ERP solutions are faster to implement, easier to scale, more agile and cost effective   as they do not require physical on-site servers and in-house IT support services   resulting in these solutions being rapidly deployed.

SaaS ERP gaining traction with large enterprises

Large multinationals are increasingly demanding ERP systems that combine global features, such as multinational currency support, addresses and language translations, with localized compliance features, including tax support, accounting rules and regulatory reporting at a country-specific level. SaaS ERP solutions are better capable of supporting global as well as local features due to their scalability and adaptive features.

According to Forrester Research, its large enterprise clients are showing a significant interest in replacing aging on-premise ERP systems with SaaS models, particularly for core functions, such as financial accounting, spend management, orders and fulfilment as well as human capital management. Very large enterprises (US$ 5BN and higher in revenues) remain cautious about migrating from on-premises to SaaS ERP, but accelerated migration is expected as software vendors demonstrate more product maturity and referenceable use cases at the enterprise scale.

Internet of Things (IoT), Artificial Intelligence (AI) and Advanced Analytics to drive next phase of ERP market growth

According to Juniper Research, the total number of connected IoT sensors and devices is projected to exceed 50BN by 2022, an increase of ~140% from an estimated 21BN in 2018, producing one billion gigabytes of data every day. ERP systems, compounded with its business intelligence skills, will be empowered with real-time data through IoT, enabling organizations to make actionable decisions. Market leaders such as SAP, Plex, IFS, Epicor and SYSPRO are focusing on integrating their ERP products with IoT functionality to extend the value delivered to customers.

Recently, SAP launched Leonardo, which combines and implements technologies such as Big Data, IoT, machine learning, AI and advanced analytics. The software is positioned as a Digital Innovation System to help enterprises take on new business models and better leverage the in-memory capabilities delivered with the S/4HANA platform. K2F and SAP have recently made a joint bid involving the Leonardo product to a major prospective client.

Similarly, IFS has been investing in its Field Service Management solution, including an embedded integration with the IFS IoT Business Connector in the latest version of the software. The Connector helps customers more easily connect devices to start analyzing data, leading to improved service levels and value for customers.

Mining companies moving to the Cloud are consultancy opportunity for K2F

According to Deloitte Consulting, many mining companies have started to replace their on-premise ERP systems with cloud-based, IoT-integrated ERP solutions to generate insights capable of supporting their operational decisions in areas such as maintenance, safety, and compliance to mine planning, fleet movement and resource allocation. The companies adopting these integrated cloud-based ERP solutions have typically seen 10 20% productivity benefits, according to Deloitte Consulting.

While many vendors are in the initial stages of deploying these technologies, the initial returns for customers demonstrate that IoT, AI and advanced analytics have a great future in ERP environments. However, the high cost of implementation, lack of skilled personnel and inadequacy of strategic planning post-installation are identified as major restraints, impacting the market growth on a global level, especially in some of the developing economies. We believe this is a great market opportunity for K2F's consultancy business.

SME's increasingly adopting Enterprise Asset Management solutions

Enterprise Asset Management (EAM) provides the visibility required to manage assets and operations within an organization. The key functional areas include asset information, work orders, MRO materials, labor skills, service contracts, finance and analytics. EAM software is primarily used by the enterprises across different industry verticals that are heavily dependent on complex and expensive physical assets, such as plants, heavy equipment and vehicles. The technology is used to manage uptime, control costs, ensure safety of operations, and increase asset longevity. Key end-users include industries such as Mining, Oil & Gas, Manufacturing, Energy & Utilities and Telecommunications.

FIGURE 7: GLOBAL EAM MARKET (IN US$ BN)

Source: TMT Analytics, ARC Advisory Group

ARC Advisory Group estimates that the global EAM market was worth US$ 2.3BN in 2015 and is poised to grow at a CAGR of 4.4% during 2016 2022 to reach US$ 3.1BN by 2022 (Figure 7).

EAM solutions are witnessing increasing adoption due to tangible and intangible benefits offered, such as a higher Return on Investment (ROI) and a complete view of asset performance and usage history by performing utility rate analyses.

Future Market Insights projects that on-premise EAM deployment will continue to dominate in the next several years, contrary to the trend observed in the ERP space. However, the revenue contribution from the Cloud segment will increase at a steady pace and will continue to outperform the on-premise deployment in terms of annual growth.

SME's are expected to drive the next phase of market growth. Previously, SME's typically refrained from investing in EAM solutions due to high initial investments associated with legacy on-premise software. But cloud-based EAM has drastically reduced the initial investment costs along with the implementation risk compared with perpetual licenses.

Given that Infoscope is a Cloud-based SaaS offering, we believe this trend will be highly beneficial to K2F and is likely to see the company attract a relatively high proportion of SME's for Infoscope.

Through SAP, asset-intensive industries are key areas of opportunity for K2fly

Typically, Mining, Oil & Gas, Energy & Utilities, Telecom and Railroad are considered to be asset-intensive industries. Although the overall enterprise applications market for asset-intensive sectors is projected to experience subdued growth, the ERP segment is anticipated to outperform and witness significant growth. This is mostly on account of companies increasingly adopting ERP solutions for real-time monitoring of aging assets, improving production efficiency, ensuring compliance under tightening regulatory frameworks, and enhancing security and safety.

SAP is the dominant ERP provider in asset-intensive industries

According to Deloitte Consulting, the European utilities industry, driven by rising consolidation, is witnessing increased investments by parent companies in ERP solutions to standardize processes, improve the customer experience and reduce the total cost of IT ownership. During 2018-2020, the UK alone is expected to witness > US$ 660M in investments in ERP services in the utilities industry, taking into consideration only those organizations operating on or moving to the SAP platform. Similar levels of investments are expected in most asset-intensive industries (Figure 8).

In our view, SAP's dominant position in many asset-intensive industries positions K2F's Infoscope's solution as a key contender in the EAM space.

FIGURE 8: OPPORTUNITY ANALYSIS – KEY ASSET-INTENSIVE VERTICALS

Parameter / Vertical		Mining*	Utilities	Oil & Gas	Telecom
Spending on Enterprise Applications (US$BN)	2016	2.2	3.3	7.7	9.1
	2021	2.8	3.4	7.9	9.9
	CAGR (%)	4.9	0.6	0.5	1.7
Top Vendors (ERP Space)		SAP, ABB, IBM, SAGE, RPM Global, Infor, NetSuite, Oracle, Epicor, IFS, BlueCielo	SAP, Oracle, Microsoft, IBM, Infor, ABB, IFS, ClickSoftware, BlueCielo	SAP, Microsoft, IBM, Oracle, ABB, IFS, Epicor	Microsoft, Oracle, SAP, IBM, IFS, Epicor
Market Leaders' Highlights		SAP serves >700 mining companies worldwide Oracle customers include 8 of the top 20 metal and mining companies ABB has at least 250 mining customers	Globally, 45 of the top 50 utilities run SAP solutions	SAP serves >3,500 oil and gas customers worldwide In August 2017, IFS was identified as the number one vendor in enterprise asset management (EAM) software for oil & gas industry by ARC Advisory Group	Oracle's customers include 20 of the 20 top telecom companies in 2017

Source: TMT Analytics; Apps Run the World; Research and Markets

*Global spend on mining automation market

K2F teamed up with the largest player

The ERP market is highly fragmented with clear differentiation between very large enterprises and SME's. ERP vendors could be classified as Tier I, Tier II or Tier III depending on their size and complexity of solutions (Figure 9). In general, Tier I vendors' ERP products have a high cost of ownership and they are able to support companies with a presence in multiple geographic regions.

SAP, Microsoft Dynamics, Oracle and Infor qualify as Tier I vendors. Tier II vendors are mid-sized companies and offer products specifically built to handle a specific market and cater to a single or multiple locations of deployment. This tier has considerable competition with presence of more than 20 companies.

Tier III companies are small-sized ERP companies that offer solutions that are relatively simple to implement and have a lower cost of ownership. Many ERP companies in this group are single location installations built for single verticals.

According to Panorama Consulting's Clash of the Titans Report 2017, SAP has the largest share (19%) in the ERP market globally, followed by Microsoft Dynamics and Oracle. The top four players account for more than 60% of the total market.

FIGURE 9: ERP MARKET SHARE BY COMPANIES
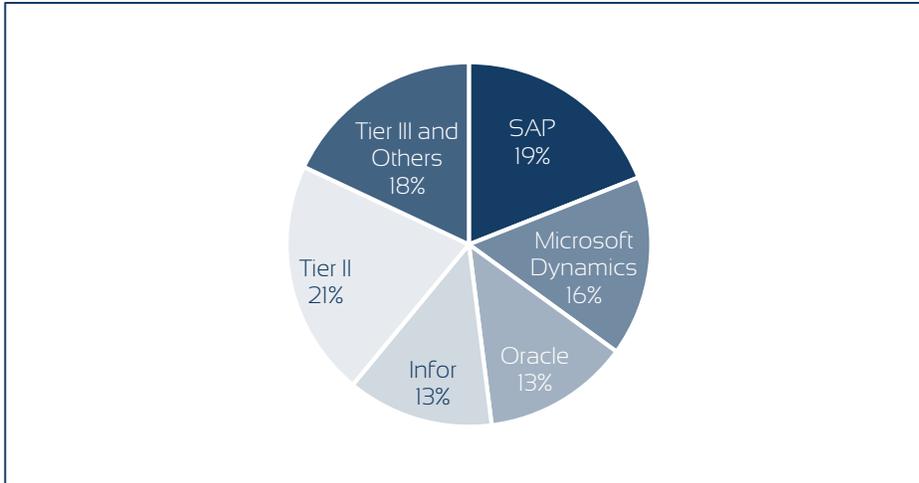
Source: TMT Analytics, Panorama Consulting

Following the integration of Infoscope with SAP S/4HANA, K2F has access to SAP's customer base of 700+ mining companies. With this move, K2F has gained a significant foothold in the Mining and Utilities' ERP space, but this also indirectly places K2F in competition with tier I and tier II ERP players.

Targeting prospects directly and through channel partners

To date, K2F has predominantly been selling its products and services directly to customers, i.e. through its own sales force. In FY18 this has resulted in A$ 2.6M in revenues.

However, with the porting to SAP S/4 HANA completed in 4Q18 (June quarter), K2F now has a massive, potential third party sales force at its disposal. The company will still need to put a lot of effort into educating the SAP sales staff on Infoscope in order to get good traction with them, i.e. SAP's sales force needs to be "on board" before they will start to include Infoscope in their overall commercial conversations with customers.

Since January 2018 K2F has worked closely with SAP at a number of joint marketing events. K2F is presenting at the SAP global mining clients' event in Prague in October and has already been involved in more local events in Sydney and Brisbane. In August, K2F presented Infoscope's capabilities to the SAP North American Mining Community of Interest Group and in September, K2F will be presenting to the SAP Industry Advisory Council for Mining, which comprises most of SAP's major mining clients from around the world.

Once K2F has onboarded sufficient SAP sales reps, though, we believe SAP may turn out to be K2F's main sales channel. The company is already in advanced Infoscope sales conversations with multiple SAP customers.

Reseller deal with Capita to sell Fieldreach

We already mentioned K2F's reseller agreement with UK-based Capita to sell their Fieldreach solution. This is currently K2F's largest third-party software revenue generator. In another channel partner deal, K2F resells ABB's Ellipse Enterprise Asset Management (EAM) tool to SME's as well as larger companies. Ellipse enables the day-to-day and lifecycle management of assets, logistics, financials and human resources for asset-intensive industries, such as Mining and Utilities.

In addition to generating monthly recurring revenues, which are split on a 50/50 basis with ABB, reselling Ellipse also provides a good inroad into prospective customers for K2F's Consultancy and Advisory work. For instance, K2F has conducted a substantial amount of consultancy work for Western Power as a result of the Ellipse roll-out at this customer.

While the revenues from reselling Ellipse are not substantial as a percentage of K2F's overall revenues, the follow on work on the consultancy side is. Furthermore, there are opportunities for K2F to develop these customer relationships into long term engagements, initially for Ellipse and consultancy work.

K2F to benefit from IT outsourcing trend

K2F's Infoscope solution is a niche software solution for companies that are rich in physical assets. Consequently, not a lot of software has been developed for this market segment other than customized solutions developed by miners' and utility companies' in-house development teams.

In other words, K2F is competing with prospects' proprietary, legacy Enterprise Asset Management systems rather than with third parties.

A major trend in the last few years, however, has been for enterprises to start outsourcing such specific tasks to companies such as K2F, i.e. replacing often expensive legacy IT systems with agile, third party solutions offered in SaaS models. We expect K2F will also be able to benefit from this trend going forward.

Financials: EBITDA positive in the current financial year

K2F derives revenues from three sources, i.e. the company's proprietary Infoscope solution, consultancy and advisory services as well as from sales of third party software.

Infoscope is sold in a SaaS model, which generates monthly recurring subscription revenues for K2F. Infoscope pricing per seat/user depends on the number of licenses customers purchase.

The company has set three pricing tiers with prices ranging from approximately A$ 1,000 to A$ 5,000 per user. The company's largest Infoscope customer, FMG, currently uses ~250 licenses with pricing per license at the lower end of that range. Smaller companies can take off a minimum of 5 licenses at the higher end of the pricing range.

With the SAP porting completed recently, Infoscope can be sold through SAP. K2F's net revenue per user will be similar to the revenue per user in a direct sale. In selling Infoscope to its customers, SAP works collaboratively with K2F to provide the best solution.

Consultancy and advisory projects are priced on a per project basis with the main variables being the number of consultants, their hourly rate and the amount of time they work on projects.

Lastly, K2F generates revenues from third-party software it sells to its customers in a revenue sharing agreement with the providers of this software.

Infoscope revenues driven by uptake in licenses sales

Based on K2F's existing sales efforts and the integration with SAP's S/4 HANA, we anticipate a strong uptick in growth of Infoscope licenses from FY19 (Figure 10). We expect the monthly Average Revenue Per User (ARPU) to tick up in 2019 as new customers, paying full price, come on board, both through direct sales and through SAP. We expect ARPU to plateau around A$ 150 to A$ 160 per month as the customer mix matures, i.e. we expect a good mix of large, mid-tier and smaller new customers to be won. Based on these projections we anticipate revenues from Infoscope to grow to A$ 5.8M by 2021.

FIGURE 10: PROJECTED GROWTH OF INFOSCOPE LICENSES AND ARPU
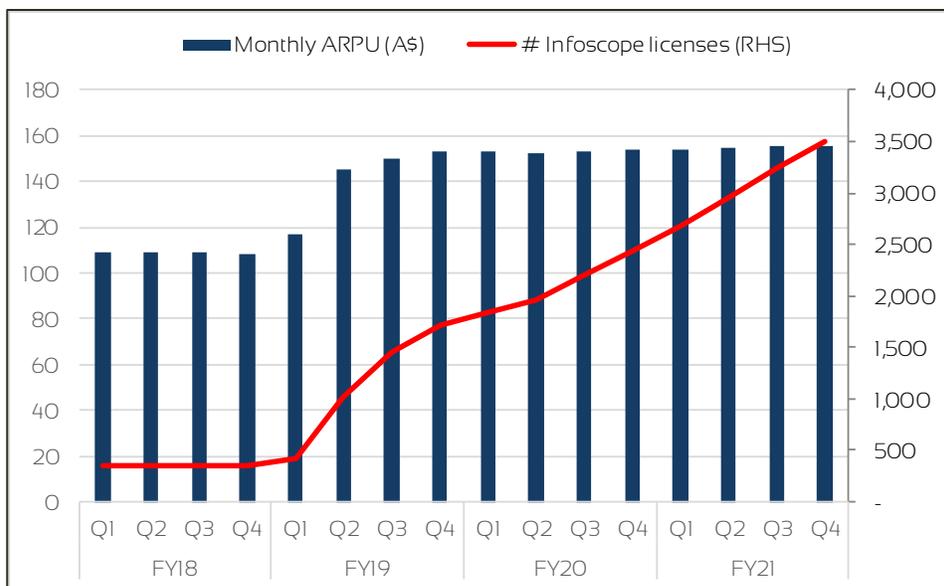
Source: TMT Analytics

Regarding revenues from Consultancy & Advisory services, going forward we assume K2F will be able to retain existing customers, such as Western Power, Programmed and ARC Infrastructure. At the same time, we expect additional consultancy work can be won through direct sales and on the back of cross sell from Infoscope and third-party software customers. This cross sell has proven effective in the past, i.e. in situations where new software customers also starting using K2F's consultancy services. We have projected K2F's consultancy service to grow to A$ 3.4M by 2021.

Lastly, we have projected K2F's third-party software sales to grow to A$ 1.9M by 2021 on the back of Fieldreach and Kony revenues in particular.

Infoscope is expected to become the main revenue generator for K2F longer term, as our projected revenue breakdown (Figure 11) clearly illustrates.

FIGURE 11: K2F PROJECTED REVENUE BREAKDOWN THROUGH 2021
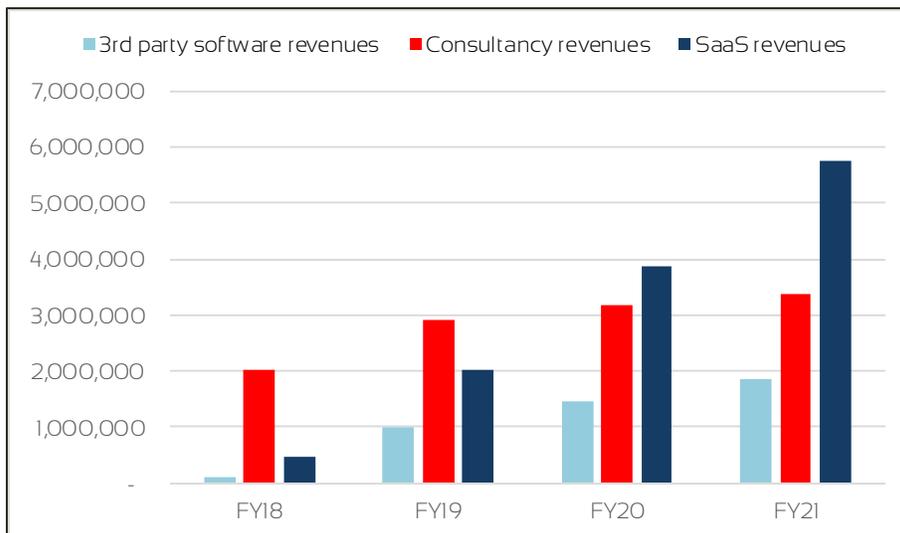
Source: TMT Analytics

We have summarized our Profit & Loss projections in Figure 12. In terms of gross margins, we expect the SaaS business to generate gross margins upwards of 80%, while Consultancy Services and third-party software sales are expected generate margins of around 25% and 35% respectively.

We have penciled in a relatively small, final, capital raise of A$ 500k in FY19 before the company reaches cash flow break even, anticipated in FY19. However, a capital raise may not be required should K2F be able to win more customers than currently assumed in our model, especially if the company can generate higher than expected revenues from its high margin SaaS business.

FIGURE 12: SUMMARIZED PROFIT & LOSS ACCOUNT

A$ M	2017A	2018F	2019F	2020F	2021F
Revenues	0.6	2.6	5.9	8.5	11.0
EBITDA	-1.8	-2.2	0.1	0.9	1.9
EBITDA margins	-292%	-87%	2%	11%	18%
EBIT	-2.3	-2.9	-0.6	0.2	1.8
EPS fully diluted (c)	-0.17	-0.06	0.001	0.003	0.02

Source: TMT Analytics

New revenue recognition rules to have limited impact on K2F

On 1 January 2018 a new accounting rule came into effect, AASB 15, which essentially states that companies' revenues must be recognized at the moment their customers consume their products and services, i.e. when they use them.

For software companies that invoice an entire year's worth of SaaS revenues upfront, like K2F does with its Infoscope SaaS product, it may mean that these software companies will have to start recognizing these revenues on a monthly basis, i.e. spreading it out over the year.

While this will have no impact on cash flows, given that an invoice raised at the start of the year will be paid around that time as well (taking into account payment terms), it will impact the top line, i.e. the large, upfront revenue number at the start of the year will be substantially lower. Instead, 25% of those revenues will be visible in the Profit & Loss account each quarter.

The implementation of AASB 15 will have a one-off impact on the top line, but companies have some leeway in determining how they want to implement the new rule.

Given that K2F's SaaS revenues only accounted for about 20% of revenues in FY18, we expect the impact of AASB 15 implementation on the company to be rather limited. Furthermore, the company's software support and maintenance revenues are already recognized on a use-basis, i.e. when customers use these services.

Valuation

We have valued K2F using several methods, including a peer group valuation and the Discounted Cash Flow (DCF) method. We have also looked at a take-over scenario in which K2F is potentially taken out by one of the larger ERP or EAM players.

DCF valuation suggest initial upside to A$ 0.58 per share

On our financial projections for the next six years and using a theoretical WACC of 11.7%, we believe K2F's shares have upside to A$ 0.58 (Figure 13). If and when the company further de-risks, e.g. on the back of additional Enterprise customer wins and further channel partnerships, we could see room to potentially lower our discount assumption towards 10% in due time, leaving further upside towards A$ 0.70 per share.

FIGURE 13: DCF VALUATION PER SHARE USING VARIOUS DISCOUNT RATES (WACC) UPDATE

7%	1.06
8%	0.91
9%	0.79
10%	**0.70**
11%	0.62
11.7%	**0.58**
12%	0.56
13%	0.51

Source: TMT Analytics

Peer group is valued substantially higher than K2F

There are no pure play peers for K2F listed on the ASX, i.e. companies that specifically sell EAM software to Enterprise customers in a SaaS-based revenue model. However, there are companies selling various other types of Enterprise software in recurring revenues models listed on the ASX, including Nearmap (ASX:NEA), Skyfii (ASX:SKF), Integrated Research (ASX:IRI) and TechnologyOne (ASX:TNE).

FIGURE 14: PEER GROUP EV/REVENUE MULTIPLES

Company	Ticker	EV/Revenue		
		2018	2019	2020
NearMap	NEA	9.6	7.2	5.4
Skyfii	SKF	8.8	4.9	3.3
Integrated Research	IRI	5.0	4.3	3.8
TechnologyOne	TNE	5.2	4.7	4.2
Average		*7.1*	*5.3*	*4.2*
K2Fly	**K2F**	**6.9**	**3.1**	**2.1**

Source: TMT Analytics, S&P Capital IQ

We have summarized the EV/Revenue multiples for these companies in Figure 14. Given that K2F is still in ramp up mode, i.e. EBITDA is still negative, we have abstained from an EV/EBITDA multiple comparison.

The peer group average EV/Revenue multiple for FY20, which starts in July next year, is 4.2x. By contrast, K2F is currently trading at a multiple of 2.1x for that year. While K2F is obviously smaller

than NEA, IRI and TNE, and hence should arguably be valued somewhat lower than these larger peers, we would argue that K2F's revenue growth rate should offset that lower valuation.

Our average projected revenue growth rate for K2F of 87% in FY19 and FY20 clearly outstrips the average revenue growth for the peer group of 37% across these two years. In our view, this should compensate for K2F's smaller revenue base.

Valuing K2F in line with the peer group average EV/Revenue multiple for FY20 yields a share price of A$ 0.60.

Valuation range of A$ 0.61 - A$ 0.72 per share in a takeover scenario

In a scenario where one of K2F's larger peers potentially wants to acquire the company, we believe a likely valuation exercise for K2F would involve valuing the three separate revenue lines individually, i.e. monthly recurring SaaS revenues are typically valued substantially higher than Consultancy revenues. Not only are revenues from Consultancy and Advisory services one-off as opposed to the recurring nature of SaaS revenues, they also carry a lower gross margin than SaaS revenues. Reselling third-party SaaS products also carries a lower gross margin than proprietary software, but these revenues are typically recurring in nature. Consequently, valuation multiples for third-party SaaS products sit in between proprietary SaaS revenues and Consultancy revenues.

To value K2F in an M&A scenario we have used the following revenue multiples; 5x for K2F's SaaS revenues, 1x for the company's Consultancy revenues and 4x for revenues from third-party software sales. We have applied these multiples to our 2021 projected revenues, i.e. as if the company were to be acquired two years from now.

FIGURE 15: VALUATION IN SUM-OF-THE-PARTS VALUATION IN M&A SCENARIO

	Revenues	Multiple	Equity value
SaaS revenues	5,750,000	5x	28,750,000
Consultancy	3,385,000	1x	3,385,000
3rd party software resales	1,850,000	4x	7,400,000
Total	**10,985,000**		**39,535,000**
# outstanding shares			61,884,109
Value per share			**0.64**

		Value per share
Takeover premiums	20%	0.77
	30%	0.83
	40%	0.89
Discounted 2 years at WACC	20%	0.61
	30%	0.67
	40%	0.72

Source: TMT Analytics

We have divided the resulting equity value by the number of shares outstanding to derive a potential value of A$ 0.64 per K2F share in a takeover scenario (Figure 15).

However, this value of A$ 0.64 per share does not include any takeover premium. Typically, acquisitions in the Technology sector are done at substantial premiums to the market price. Applying takeover premiums, ranging from 20% to 40%, to K2F's equity value per share, yields valuations ranging from A$ 0.77 to A$ 0.89 per share.

Discounted these valuations back to today, using the theoretical WACC in our DCF model, provides us with a valuation range in a takeover scenario of A$ 0.61 - A$ 0.72 per K2F share.

Conclusion: Substantial share price upside

In determining our price target for K2F we have only taken our DCF calculation and peer group valuation into account. While we certainly believe K2F could become a potential takeover target at some point, we believe it is too early include that scenario in our current valuation.

Based on our DCF and peer group valuations of A$ 0.58 and A$ 0.60 respectively, we believe A$ 0.58 per share is a good reflection of K2F's share price potential in the next twelve months.

Conclusion: K2F well-positioned for strong growth

We believe K2F has a solid product portfolio in the Enterprise Asset Management space that solves problems that many asset-rich companies in the Mining, Utility, Infrastructure and Telecom verticals struggle with, i.e. how to effectively manage land assets, integrate this management process with ERP software suites and simultaneously comply with environmental and cultural heritage legislation.

K2F's current customer base, which includes several leading Mining, Utility and Infrastructure companies such as FMG and Western Power, is testament to the company's strong product and service offering. We expect the company to be able to strongly expand its revenue base in the next five years, in part driven by the recent integration into SAP's S/4 HANA. This integration with SAP has given K2F access to the richest global ERP customer base in the Mining sector.

We derived a price target for K2F of A$ 0.58 per share. This represents substantial share price upside from today's level, which is why we start our research coverage of K2F with BUY recommendation.

Near term share price drivers

- Announcement of new Infoscope customers through the SAP partnership and the porting to S/4 HANA, i.e. confirmation that this partnership "works".
- Expansion of business with existing customers, either additional business in the same vertical or cross-sell between the SaaS and Consultancy businesses, e.g. expansion of Infoscope seats or cross selling consultancy work to Fieldreach and Ellipse customers.
- Increasing visibility on the transition to a higher percentage of recurring SaaS-based revenues as a percentage of total revenues.

SWOT

Strengths:

- Infoscope is quite a unique product with little direct competition, other than legacy systems developed by customers and prospects in-house.

- Infoscope's integration with SAP S/4HANA has strengthened K2F's position in asset-intensive industries, providing it access to SAP's >700 mining ERP clients.

- Licensing partnerships with global companies such as Capita, ABB, Kony and OBI Partners further expands K2F's customer base and provides additional revenue opportunities through consulting and software maintenance businesses, as well as through cross-sell.

- Acquisition integration track record (Infoscope) can be used to acquire additional companies, similar to Infoscope in terms of functionality and market segment.

- K2F's in-house technical skill set can be leveraged to develop more functionality, products and services, e.g. servicing Enterprises migrating to SAP S/4 HANA.

Weaknesses:

- In scaling up Infoscope sales, the lack of a large sales force makes K2F in part commercially dependent on partnership agreements with third-party providers of ERP and EAM solutions, such as SAP and ABB.

- K2F's size relative to some of its channel partners, customers and prospects may lead to lack of bargaining power, which could potentially lead to sub-optimal business outcomes for the company.

- K2F may have to raise additional equity if it wants to accelerate growth and/or if working capital requirements increase, for instance if larger customers extend payment terms unilaterally.

Opportunities:

- Asset-intensive companies are increasingly transitioning to cloud-based ERP and EAM solutions, thereby creating significant growth potential in the SaaS space for asset management tools.

- Increasing manufacturing activity, a rising number of start-ups and increasing government expenditure on strengthening IT infrastructures are all expected to boost ERP and EAM solutions in the Asia Pacific market.

- Combined with AI, predictive analytics etc., increasing integration of IoT with ERP and EAM solutions offers substantial potential for growth.

- The market K2F is addressing is a global market. Therefore, expansion outside of Western Australia (WA) is a clear opportunity, especially in light of the integration with global ERP player SAP.

Threats:

- More established and global players such as IFS, Infor, IBM and ABB have extensive product portfolios, a better ability to scale up as per customer requirements and greater capability to bring new IoT-enabled ERP and EAM solutions to the market.

- A downturn in the Mining industry would likely inhibit K2F's growth potential in that vertical.

Appendices

Board members

Jeni Cutri (Non-Executive Chairperson): Mrs. Cutri is a highly experienced legal practitioner and compliance specialist with over 20 years' experience, in both the private and public sectors. She has extensive experience in the regulatory environment previously having been: Assistant Manager, Listings Compliance at ASX in Perth for 7 years and National Disclosure Supervisor, WA Compliance Manager (Financial Services Regulation) and Senior Legal Officer with the Australian Securities and Investments Commission (ASIC). She has also worked with Bankwest heading up their Marketing Compliance.

Brian Miller (CEO and Executive Director): Mr. Miller is a 30 year veteran of the IT sector. He is founding member of the Institute of Asset Management (UK), having influenced the development of the initial BS5750 standard for asset management within the UK energy sector. He worked closely with various UK industry regulators including Energy, Water and Rail. Mr. Miller held board directorships with UK and Australian IT companies and has an extensive network of contacts, opportunities and experience within the mobility in asset intensive sectors.

Neil Canby (Non-Executive Director): Mr. Canby has an extensive history of senior roles across a variety of industries, including energy and utilities with responsibilities ranging from business development, project and operational delivery and commercial and financial management. He has a BA (Hons.) in Accounting and Financial Management and is the current Executive Director of Sunrise Energy Group.

James Deacon (Non-Executive Director): Mr. Deacon is a veteran with a proven track record in successful business transformation in IT services across a number of industries including utilities, mining and airlines. He has held senior positions at Horizon Power, US Airways and the Department of Foreign Affairs in Washington. Mr. Deacon is currently a Director of leading technology insights, market intelligence and advisory firm, Information Services Group (ISG).

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