

7 May 2018

Konekt Limited (KKT)

BUY

Share Price: A\$0.33

Earnings headaches persist into 2H18

Target Price: A\$0.58

Notwithstanding downside earnings risks in FY19, our base case is for the prevailing headwinds to subside, clearing the way for a return to modest organic growth, supplemented by acquisitions. Buy.

Trading update – key points

- Management has lowered its earnings guidance for FY18 to revenue and EBITDA of \$87-89m and \$8.5-9.5m, respectively. This compares to previous implied guidance for baseline revenue and EBITDA before one-off costs of \$90.3m and \$9.9m, respectively.
- The trading update was prompted by “continued softness in workers compensation in NSW and SA” and lower case volumes from MHS. While Konekt’s other revenue streams are performing to expectations, the net impact at the Group level is lower FY18 guidance.

Trading update – key takeaways

- Management noted at Konekt’s 1H18 results that the above earnings headwinds reduced revenue during the period by \$1.7m on pcp. At the time, management anticipated “the market steadying and returning to low single digit growth”, although no timeframe was given.
- Management also noted that Konekt has, in response to the evident weakness in workers compensation cases in NSW and SA, “implemented initiatives to align its costs in relevant businesses to the lower volumes and maintain margins”.
- The fact that management has since downwardly revised its FY18 guidance, with a lower implied margin, suggests to us that the continuation of these ‘earnings headwinds’ have, to date, been difficult to contain. The risk now is that these same headwinds prevail in FY19.

Earnings forecast revisions

- In response to Konekt’s trading update, we have reduced our EBITDA forecast by circa 5 percent in each of the next three years. Based on our revised forecasts before one-off costs and acquired amortisation, Konekt is trading at a PER of 7.4x FY18 and 5.8x FY19.

Investment view

- Konekt’s trading update highlights the company’s inherent complexities and adds further uncertainty to earnings ahead of key contract renewals. That said, we retain a Buy on the strength of management, its growth strategy, the active buy-back and the current entry price.
- Key catalysts include (i) jobactive’s Star Ratings for the March quarter, which are due in the next week or so, (ii) an update on the Garrison Health Solutions contract tender, with a decision expected by calendar year-end, and (iii) a normalisation in injury management workflow.

Company Data

Shares – ordinary (M)	105.7
Dilution (M)	0.7
Total (fully diluted) (M)	106.4
Market capitalisation (\$M)	35.4
12 month low/high (\$)	0.31 - 0.61
Average monthly turnover (\$M)	0.7
Index	Nil
GICS Industry	Healthcare Services

Financial Summary (fully diluted/normalised)

Year end June	2016A	2017A	2018F	2019F	2020F
Revenue (\$M)	43.8	53.0	88.2	102.2	105.1
Costs (\$M)	39.8	46.8	79.3	91.0	93.5
EBITDA (\$M)	4.0	6.2	8.9	11.2	11.6
NPAT (\$M)	2.5	3.6	1.8	2.5	3.4
EPS (¢ps)	3.4	4.8	1.8	2.4	3.2
EPS Growth (%)	72.7	42.2	-63.2	33.8	34.6
PER (x)	9.8	6.9	18.8	14.1	10.4
Free Cashflow (\$M)	1.8	4.3	1.2	5.6	7.5
FCFPS (¢ps)	2.5	5.7	1.2	5.3	7.0
PFCFPS (x)	13.4	5.8	28.7	6.3	4.8
Enterprise Value (\$M)	26.4	23.5	48.4	43.6	37.3
EV / EBITDA (x)	6.6	3.8	5.4	3.9	3.2
Payout ratio (%)	14.5	15.3	21.3	17.2	22.6
Dividends (¢ps)	0.5	0.8	0.5	1.0	1.5
Yield (%)	1.5	2.2	1.5	3.0	4.5

KKT – performance over one year



Disclosure and Disclaimer

This report must be read with the disclosure and disclaimer on the final page of this document.

James Lennon
+61 2 9239 9618

Analysis

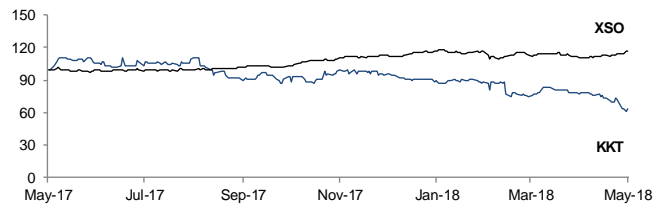
Konekt Limited

Year End June

MARKET DATA

Recommendation		Buy
Price	\$	0.34
Price target (12-month)	\$	0.58
52 week high / low	\$	0.31 - 0.61
Market capitalisation	\$m	35.4
Shares on issue (basic)	no.	105.7
Performance rights	no.	0.7
Other equity	no.	0.0
Shares on issue (diluted)	no.	106.4

12-MONTH SHARE PRICE PERFORMANCE



INVESTMENT FUNDAMENTALS		2016A	2017A	2018F	2019F	2020F
Reported net profit	\$m	2.5	3.6	(0.4)	2.5	3.4
Underlying net profit	\$m	2.5	3.6	1.8	2.5	3.4
Underlying NPATA (i.e. jobactive)	\$m	2.5	3.6	4.5	6.2	7.0
Reported EPS (diluted)	€	3.4	4.8	(0.4)	2.4	3.2
Underlying EPS (diluted)	€	3.4	4.8	1.8	2.4	3.2
...Growth	%	72.7	42.2	(63.2)	33.8	34.6
Underlying PER (diluted)	x	9.8	6.9	18.8	14.1	10.4
Operating cash flow per share	€	3.1	6.6	4.2	8.0	9.4
Free cash flow per share	€	2.5	5.7	1.2	5.3	7.0
Price to free cash flow per share	x	13.4	5.8	28.7	6.3	4.8
Free cash flow yield	%	7.4	17.2	3.5	15.9	20.9

Dividend per share	€	0.5	0.8	0.5	1.0	1.5
Payout ratio	%	14.5	15.3	21.3	17.2	22.6
Yield	%	1.5	2.2	1.5	3.0	4.5
Franking	%	100.0	100.0	100.0	100.0	100.0
Enterprise value	\$m	26.4	23.5	48.4	43.6	37.3
EV/EBITDA	x	6.6	3.8	5.4	3.9	3.2
Price to book (NAV)	x	1.9	1.6	1.1	1.1	1.0
Price to NTA	x	128.2	8.2	(3.1)	(6.0)	520.4

KEY RATIOS		2016A	2017A	2018F	2019F	2020F
EBITDA margin	%	9.2	11.7	10.1	10.9	11.0
EBIT margin	%	7.6	9.7	3.1	4.1	4.7
Underlying net profit margin	%	5.7	6.8	2.0	2.5	3.2
Return on average equity	%	22.0	25.4	7.5	7.7	9.9
Return on average assets	%	16.6	19.4	5.1	5.3	6.4
Net tangible assets per share	€	0.3	4.1	(11.0)	(5.6)	0.1
Net debt/(cash)	\$m	1.6	(1.3)	12.8	8.0	1.7
Interest cover (EBIT / net interest)	x	20.5	16.6	5.5	4.1	7.6
Leverage (net debt / EBITDA)	x	0.4	n/a	1.4	0.7	0.1
Gearing (net debt / net debt plus equity)	%	11.5	n/a	28.5	19.2	4.6

DUPONT ANALYSIS		2016A	2017A	2018F	2019F	2020F
Net Profit Margin	%	5.7	6.8	2.0	2.5	3.2
Asset Turnover	x	1.8	1.9	1.1	1.3	1.4
Return on Assets	%	10.1	12.7	2.3	3.2	4.4
Financial Leverage	x	2.0	1.8	2.5	2.3	2.2
Return on Equity	%	19.9	22.9	5.6	7.5	9.6

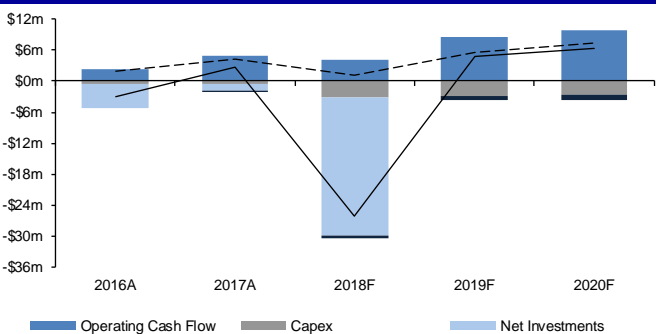
CASH FLOW		2016A	2017A	2018F	2019F	2020F
EBITDA	\$m	4.0	6.2	8.9	11.2	11.6
Change in working capital	\$m	(1.2)	(0.0)	(3.1)	(1.1)	(0.2)
Net interest	\$m	0.0	0.0	(0.5)	(1.0)	(0.7)
Tax paid	\$m	(0.0)	(1.7)	(1.1)	(0.5)	(0.7)
Other	\$m	(0.5)	0.4	0.0	0.0	0.0
Operating cash flow	\$m	2.3	4.9	4.2	8.5	10.0
Capital expenditure	\$m	(0.5)	(0.6)	(3.0)	(2.9)	(2.5)
Acquisitions/divestment/other	\$m	(4.8)	(1.1)	(29.3)	0.0	0.0
Investing cash flow	\$m	(5.2)	(1.7)	(32.3)	(2.9)	(2.5)
Free cash flow	\$m	1.8	4.3	1.2	5.6	7.5
Equity	\$m	(0.1)	(0.2)	15.7	0.0	0.0
Increase / (decrease) in borrowings	\$m	0.3	0.0	15.9	(4.0)	(4.0)
Dividend/other	\$m	0.0	(0.4)	(1.9)	(0.8)	(1.2)
Financing cash flow	\$m	0.2	(0.6)	29.7	(4.8)	(5.2)

PROFIT AND LOSS		2016A	2017A	2018F	2019F	2020F
Total revenue	\$m	43.8	53.0	88.2	102.2	105.1
EBITDA	\$m	4.0	6.2	8.9	11.2	11.6
Depreciation & amortisation	\$m	0.7	1.1	6.1	6.9	6.6
EBIT	\$m	3.3	5.1	2.8	4.2	5.0
Net interest	\$m	0.2	0.3	0.5	1.0	0.7
Non-operating income	\$m	0.0	0.0	0.0	0.0	0.0
Pretax Profit	\$m	3.2	4.8	2.3	3.2	4.3
Tax expense	\$m	0.7	1.3	0.5	0.7	0.9
Minorities	\$m	0.0	0.0	0.0	0.0	0.0
Underlying NPAT	\$m	2.5	3.6	1.8	2.5	3.4
Significant items	\$m	0.0	0.0	(2.2)	0.0	0.0
Reported NPAT	\$m	2.5	3.6	(0.4)	2.5	3.4

GROWTH PROFILE		2016A	2017A	2018F	2019F	2020F
Operating revenue	%	25.0	21.0	66.4	15.8	2.9
EBITDA	%	68.6	54.7	43.2	25.3	3.6
EBIT	%	82.1	53.8	(46.4)	53.2	17.6
Underlying NPAT	%	70.1	42.7	(50.2)	41.3	35.0
Underlying EPS	%	72.7	42.2	(63.5)	32.9	34.6
DPS	%	0.0	50.0	(33.3)	100.0	50.0

BALANCE SHEET		2016A	2017A	2018F	2019F	2020F
Cash	\$m	0.2	2.8	4.5	5.3	7.6
Receivables	\$m	8.4	9.0	15.9	18.4	18.9
Inventory	\$m	0.4	0.4	0.7	0.8	0.8
Other	\$m	0.4	0.3	1.8	1.8	1.8
Current	\$m	9.4	12.5	22.8	26.3	29.1
Prop, plant & equip	\$m	1.2	1.3	5.4	5.6	5.7
Goodwill	\$m	11.7	11.5	24.2	24.2	24.2
Other	\$m	2.6	3.0	26.9	22.7	18.6
Non current	\$m	15.4	15.8	56.6	52.6	48.5
Total assets	\$m	24.8	28.3	79.4	78.8	77.6
Accounts Payable	\$m	5.0	5.6	9.7	11.2	11.6
Borrowings	\$m	0.3	0.3	16.3	12.3	8.3
Other	\$m	6.8	6.7	21.3	21.7	22.4
Total liabilities	\$m	12.2	12.6	47.3	45.3	42.2
Net assets	\$m	12.6	15.7	32.1	33.6	35.4
Equity	\$m	12.6	15.7	32.1	33.6	35.4
Minorities	\$m	0.0	0.0	0.0	0.0	0.0
Shareholder's equity	\$m	12.6	15.7	32.1	33.6	35.4
Shares on issue	m	72.7	72.9	105.7	106.4	106.4

CASH FLOW SUMMARY



Source: Petra Capital

Petra Capital
 Level 17, 14 Martin Place, Sydney NSW 2000

ABN 95 110 952 782
 ACN 110 952 782
 AFSL 317 944

Director:	George Marias	+61 (0)2 9239 9601	gmarias@petracapital.com.au
Research (Resources):	Brett McKay	+61 (0)2 9239 9605	bmckay@petracapital.com.au
Research (Resources):	Matthew Schembri	+61 (0)2 9239 9630	mschembri@petracapital.com.au
Research (Resources):	Craig Brown	+61 (0)2 9239 9629	cbrown@petracapital.com.au
Research (Resources):	Peter Chilton	+61 (0)2 9239 9634	pchilton@petracapital.com.au
Research (Industrials):	Killian Murphy	+61 (0)2 9239 9607	kmurphy@petracapital.com.au
Research (Industrials):	James Lennon	+61 (0)2 9239 9618	jlennon@petracapital.com.au
Research (Industrials):	Mark Tomlins	+61 (0)2 9239 9625	mtomlins@petracapital.com.au
Research (Property):	Jonathan Kriska	+61 (0)2 9239 9633	jkriska@petracapital.com.au
Sales:	Frank Barila	+61 (0)2 9239 9603	fbarila@petracapital.com.au
Sales:	Neil Watson	+61 (0)2 9239 9602	nwatson@petracapital.com.au
Sales:	Vincent Pisani	+61 (0)2 9239 9617	vpisani@petracapital.com.au
Sales:	Jamie Campbell	+61 (0)2 9239 9620	jcampbell@petracapital.com.au
Sales:	Peter Veldhuizen	+61 (0)2 9239 9609	pveldhuizen@petracapital.com.au
Sales:	Colin Redmond	+61 (0)2 9239 9613	credmond@petracapital.com.au
Sales:	Vince Barila	+61 (0)2 9239 9627	vbarila@petracapital.com.au
Sales:	Michael Casey	+61 (0)2 9239 9608	mcasey@petracapital.com.au
Sales:	Richard Macphillamy	+61 (0)2 9239 9604	rmacphillamy@petracapital.com.au
Corporate (ECM):	Conrad Anderson	+61 (0)2 9239 9610	canderson@petracapital.com.au
Corporate (ECM):	Verity Barritt	+61 (0)2 9239 9622	vbarritt@petracapital.com.au
Administration:	Krystle Garven	+61 (0)2 9239 9635	kgarven@petracapital.com.au
Administration:	Samantha Tingley	+61 (0)2 9239 9636	stingley@petracapital.com.au
Administration:	Silvia Fratta Pasini	+61 (0)2 9239 9621	spasini@petracapital.com.au
Administration:	Larissa Falvo	+61 (0)2 9239 9611	lfalvo@petracapital.com.au
Legal & Compliance:	Stephen Newton	+61 (0)2 9239 9612	snewton@petracapital.com.au
Financials:	Tony Christelis	+61 (0)2 9239 9615	tchristelis@petracapital.com.au

Disclosure

This document has been prepared in Australia by Petra Capital Pty Ltd which holds an Australian Financial Services License AFSL 317 944. Petra Capital Pty Ltd is an ASX Market Participant. Petra Capital Pty Ltd and its associates, officers, directors, employees and agents, from time to time, may receive brokerage, commissions, fees or other benefits or advantages, hold securities in companies researched by Petra Capital Pty Ltd and may trade in these securities either as principal or agent. Petra Capital was Exclusive Broker for Kangaroo Island Plantation Timbers' Placement and Entitlement Offer to raise \$33.5M at \$2.00/share on 12 April 2017 and \$15M at \$2.00/share on 30 November 2017, for which a fee was received.

Disclaimer

The information or advice contained in this report has been obtained from sources that were accurate at the time of issue, however the information has not been independently verified and as such, Petra Capital Pty Ltd cannot warrant its accuracy or reliability. Persons relying on this information do so at their own risk. To the extent permitted by law, Petra Capital Pty Ltd disclaims all liability or responsibility for any direct or indirect loss or damage (including consequential loss or damage) caused by any error or omission within this report, or by persons relying on the contents of this report.

This report is published by Petra Capital Pty Ltd by way of general information or advice only. This report does not take into account specific investment needs or other considerations that may be pertinent to individual investors. Before making any investment decisions based on this report, parties should consider, with or without an investor adviser, whether any relevant part of this report is appropriate to their financial circumstances and investment objectives. Petra Capital Pty Ltd is a licensed institutional/wholesale stockbroking firm. The report is only intended for institutional and sophisticated clients to whom Petra Capital Pty Ltd has issued the report. Petra Capital Pty Ltd is not licensed to advise retail investors – retail investors should contact their own stockbroker or financial adviser/planner for advice.

Ratings

Information regarding the scope and expertise of our research services, processes for selection for coverage, and the management of conflicts of interest can be found on Petra Capital's website at <http://www.petracapital.com.au/research-disclosures>.

Petra Capital uses the following ratings system and definitions: Buy - Forecast to outperform the Market by more than 5%; Hold - Forecast to perform up to 5% above or below the Market; Sell - Forecast to underperform the Market by more than 5%; Speculative Buy - Speculative Investment; Take Profits - Recommend taking short term profits in a stock we remain fundamentally positive on a medium term view; Accept Offer - For a company under takeover where we see the offer as a fair price with low risk of a competing offer; No Rating - No rating at this time. Market performance is relative to the S&P/ASX Small Ordinaries Index which we assume generates a neutral return on a 12 month basis.

US Investors

This material is intended for use by major U.S. institutional investors (as such term is defined in the U.S. Securities Exchange Act of 1934) and "\$100 million investors" only and not the general investing public or retail customers. "\$100 million investors" means any entity, including any investment adviser (whether or not registered under the U.S. Investment Company Act of 1940) that owns or controls (or in the case on an investment adviser has under management) in excess of US\$100 million in aggregate financial assets (i.e. cash, money-market instruments, securities of unaffiliated issues, futures and options on futures and other derivative instruments). Transactions by or on behalf of any US person in any security mentioned in this document may only be effected through Global Alliance Securities, LLC ("Global Alliance"), a U.S. broker dealer. The information upon which this material is based was obtained from sources believed to be reliable, but has not been independently verified. Therefore, its accuracy is not guaranteed. Additional and supporting information is available upon request. This is not an offer or solicitation of an offer to buy or sell any security or to make any investment. Any opinion or estimate constitutes the preparer's best judgement as of the date of preparation and is subject to change without notice. Petra Capital Pty Ltd or Global Alliance and their associates or affiliates, and their respective officers, directors and employees may buy or sell securities mentioned herein as agent or principal for their own account.

Other International

International investors are encouraged to contact their local regulatory authorities to determine whether restrictions apply in buying/selling this investment.