

# Fundamental

## Research Corp.

*Investment Analysis for Intelligent Investors*

August 23, 2016

### Kontrol Energy Corp. (CSE: KNR) – Energy Efficiency Company / Growth by Acquisition – Initiating Coverage

Sector/Industry: Energy Efficiency

[www.kontrolenergy.com](http://www.kontrolenergy.com)

#### Market Data (as of August 23, 2016)

Current Price	\$0.20
Fair Value	\$0.83
Rating*	BUY
Risk*	4 (Speculative)
52 Week Range	n/a
Shares O/S	16,740,082
Market Cap	\$3.35M
Current Yield	n/a
P/E (forward)	n/a
P/B	n/a
YoY Return	n/a
YoY TSXV	52.6%

#### Summary of the Debenture Offering

Issuer	Kontrol Energy Corp.
Date of the OM	22-Aug-16
Offering	Min \$0.20 million / Max \$5.0 million
Securities Offered	Units / Each unit consists of 8% p.a. unsecured debentures and 100 common shares
Unit Price	\$1,000 per unit
Minimum Subscription	\$5,000
Time Horizon	3 years
Fees	up to 9% of the gross proceeds
Registered Plans	Eligible
<b>FRC Rating</b>	
Yield (est.)	8% p.a.
Rating	2-
Risk	3

\*see back of report for rating and risk definitions

#### Investment Highlights

- Kontrol Energy Corp. (“company”, “Kontrol”) is a newly formed company focused on the acquisition of controlling interests in private cash flowing businesses in the energy efficiency sector in North America.
- The company went public on August 9, 2016, through a reverse takeover. Management and insiders own approximately 80% of the total outstanding common shares.
- Management’s primary focus is on acquiring and developing technologies which can control energy consumption and energy usage. “Smart” objects are gaining significant popularity due to their ability to improve productivity and lower costs of businesses. The emerging and rapidly growing Internet of Things (IoT) market is expected to play a vital role in this sector.
- Management’s background is in corporate finance and renewable energy. Their goal is to pursue up to \$15 million in acquisitions over the next 12 months at an acquisition price of 3.5 to 4.0x forward EBITDA. If the acquisition price averages 4x EBITDA, we estimate Kontrol will be able to generate approximately \$25 million in revenues and \$3.75 million in EBITDA.
- The company is currently planning to raise up to \$5 million by offering 3-year 8% p.a. debentures. Investors will receive units at \$1,000 per unit, and each unit consists of a \$1,000 debenture and 100 common shares as a bonus. We are assigning an overall rating of 2-, and a risk rating of 3 on this offering.
- **We are initiating coverage with a BUY rating on Kontrol’s shares and a fair value estimate of \$0.83 per share.**

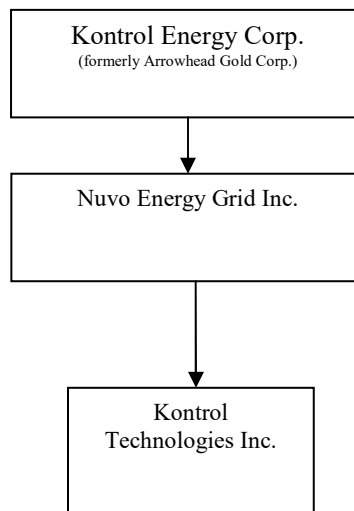
#### Risks

- The success of the current debenture financing will determine management’s ability to pursue acquisitions this year.
- Timely deployment of capital is crucial.
- Execution risk.
- Return of capital and/or interest payments on the debenture are not guaranteed.
- Macroeconomic risks and access to high-quality transactions at reasonable valuations.
- Cash from operations may not be sufficient to service interest payment on debentures.
- Ability to maintain or grow cash flows of acquired companies.

## Overview

Kontrol Energy Corp. based out of Toronto, Ontario, is focused on the acquisition of controlling interests in private cash flowing businesses in the energy efficiency sector in North America. Management's goal is to acquire and operate a portfolio of companies and technologies that can provide annual dividends to investors, as well as generate capital gains through operating synergies and organic growth.

The company went public on August 9, 2016 through, a Reverse Takeover ("RTO") of Arrowhead Gold Corp. Arrowhead acquired 100% of Nuvo Energy Grid Inc. by issuing 13.25 million common shares. Nuvo was formed in August 2015, under the laws of Ontario. Following the RTO, Arrowhead Gold Corp. changed its name to Kontrol Energy Corp.



Kontrol is currently completing a \$5 million raise by offering 8% p.a. debentures (term – 3 years) to fund acquisitions in 2016.

## Management

Kontrol's management has extensive experience in corporate finance and renewable energy. According to the company, management has been involved in over \$500 million in solar energy projects connected to the Ontario electricity grid, over \$850 million in solar projects globally, and more than 200 energy efficiency retrofits in Ontario. The company has four directors, of which, two are independent.

Management and insiders own approximately 80% of the total outstanding common shares. CEO, Paul Ghezzi, owns 69% of the total, or 11.50 million shares.

Shares held by management		
Paul Ghezzi	5,750,000	34.35%
The Ghezzi Family Trust	5,750,000	34.35%
Ed Blasiak	750,000	4.48%
Kristian Lavereau	500,000	2.99%
Patrizia Lavereau	500,000	2.99%
Total	<b>13,250,000</b>	<b>79.15%</b>

Brief biographies of team, as provided by the company, follow:

#### **Paul Ghezzi, CPA, CA - CEO and Director**

Mr. Ghezzi has been involved in the renewable energy sector since 2008. He created Canada's first Solar Energy Income Fund by securitizing cash flows from long term power purchase agreements. He most recently led the development of one of North America's largest solar PV commercial rooftop portfolios, spanning over 143 commercial rooftops under the Ontario Feed-in Tariff program. Mr. Ghezzi has more than 20 years of corporate finance and M&A experience with a special focus on renewable energy development, renewable energy financing, solar project financing and distributed generation. He has global experience in power generation projects under feed and tariff programs and power purchase agreement programs for both commercial and utility-scale projects. Mr. Ghezzi has participated in the development of more than 100 Megawatts of renewable energy projects globally.

#### **Claudio Del Vasto, CPA, CA – CFO and Director**

Mr. Del Vasto is a senior finance executive with an extensive background in Corporate Finance, Strategy and Business Development. During his career in Structured Finance at Bombardier, Mr. Del Vasto provided customers around the globe with innovative financial solutions and arranged multi-billion dollar deal closings that involved equity, debt and capital markets funding. Prior to his career in industry, he was a public accountant managing accounting, tax and assurance services. His primary role is managing the overall finances of the company, securing financing, assisting in acquisitions and financial reporting. He is also involved with investment oversight on all acquisitions.

#### **Kristian Lavereau - COO and Director**

Mr. Lavereau is the former President of Kontrol Technologies Inc., a position in which he served from January 1, 2015 to February 25, 2016. He has more than 25 years of experience in the IT solutions (analytics and mobile computing), energy optimization and efficiency (intelligent control systems and lighting). Mr. Lavereau has built solutions for such clients such as Greenwin, Minto, Oxford and the Toronto Catholic School Board and participated in more than 200 energy efficiency retrofit projects. He has extensive experience with disruptive technology in the energy efficiency industry, especially when tenants and stakeholders are engaged in the process. His primary role will be the oversight and management of operating subsidiaries as well as managing large energy retrofit projects.

### **Andrew Bowerbank - Director**

Mr. Bowerbank is Director of Sustainable Building Services at EllisDon Corporation. Mr. Bowerbank is the former Executive Director/CEO of the World Green Building Council (2007-10) representing over 60 member nations. During his tenure with the WorldGBC, he acted as the member representative at the United Nations Environmental Programme. In addition to his current work as Director, Sustainable Building Services at EllisDon, Mr. Bowerbank is a Council member at the Federation of Canadian Municipalities in Ottawa, a Board member at CDML, and a member of the BRE Global Standing Panel of Experts (UK).

### **Steve Smith - Director**

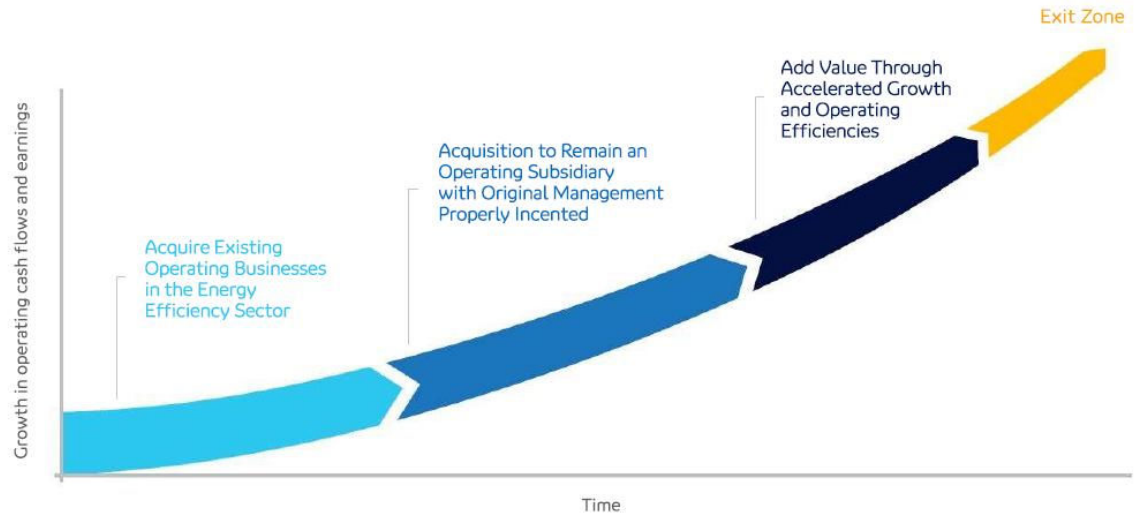
Mr. Smith has more than 27 years' experience in the capital markets. Mr. Smith is also President of Tangent Management Corp, a consulting firm assisting public and private companies with corporate operations, capital development, corporate communications and regulatory compliance activities. Mr. Smith is the former CEO of Arrowhead Gold Corp.

Kontrol's key focus is on the following sectors in North America – energy services, energy efficiency technology, energy storage and conservation, and renewable energy power generation. Their primary acquisition criteria are listed below:

- a history of profitable operations;
- forward EBITDA of between \$0.10 million and \$3 million;
- acquisition price of 3.5 to 4.0x forward EBITDA;
- acquire a controlling interest (over 50% of the equity) in the operating business

Kontrol will seek to target those companies with strong management in place, to allow Kontrol to adopt an acquisition and governance approach without the need to manage the day-to-day operations and reduce transitional risks. As the majority of the owners of small private companies are also involved in the day-to-day operations of their companies, it is essential for Kontrol to have those management teams to continue to work on the acquired businesses. In order to keep the incumbent managers motivated to run the businesses, after they are acquired, Kontrol intends to offer managers performance based compensation and other incentive plans. In certain cases, Kontrol intends to take on vendor take back loans (the seller lends a portion of the acquisition price to the buyer) to keep the owners motivated, and to ensure a seamless business transition.

Management's vision is illustrated in the charts below.



Source: Company

Management intends to pursue up to \$15 million in acquisitions over the next 12 months. **If the acquisition price averages 4x EBITDA, we estimate Kontrol will be able to generate approximately \$25 million in revenues and \$3.75 million in EBITDA.** Our discussions with management indicated that their goal is to reach \$50+ million in revenues by 2020 through organic growth and through acquisitions.

As part of the RTO with Arrowhead Gold Corp., in June 2016, Nuvo Energy acquired 100% of the shares of Kontrol Technologies Inc, a private company owned and operated by Kristian Lavereau, for 1 million shares of the company. In addition, the company has to pay up to 0.60 million shares and \$0.30 million in cash upon achieving certain milestones:

- on achieving \$150,000 in revenues – 200,000 shares and \$100,000 in cash;
- on achieving \$500,000 in revenues – an additional 200,000 shares and an additional \$100,000 in cash; and
- on achieving \$1,000,000 in aggregate revenues - an additional 200,000 Shares and an additional \$100,000.

Kontrol Technologies, founded in 2012 by Kristian Lavereau, offers turn-key energy efficiency retrofit services for commercial and multi-residential buildings, focusing on energy efficiency, conservation and sustainability. Mr. Lavereau operated as a sole proprietor under the business name Scientific Energy Solutions prior to setting up Kontrol Technologies. He has been active in the energy retrofit industry since 2005, and has been directly involved in more than 200 successful energy retrofit projects.

Kontrol Technologies' services include:

- LED lighting retrofits,

## First Acquisition

- parking garage lighting,
- heat and fan solutions,
- rooftop and parking solar (photovoltaic) solutions,
- boiler energy saving controls,
- tenant education programs which encourage tenants to become active members in conservation and sustainability, etc.

Current clientele includes large REITs and property management firms such as Greenwin Inc., Skyline, Minto, DMS, 20VIC and CapREIT. Their geographical focus has been primarily Ontario, and recently expanded to BC and AB. Management estimates the energy efficiency retrofit market to be approximately \$3 billion to \$3.5 billion over the next 5 years (approximately 1 million multi-residential units with average spending of \$3,000 to \$3,500 per unit).

In 2015, Kontrol Technologies generated \$0.32 million in revenues with a gross margin of 32%. Net profit in 2015 was \$3,983. The acquisition price of \$0.36 million reflects a price to revenue ratio of 1.1x. Management indicated to us that the valuation metrics may seem high for this transaction as the trailing revenues / earnings do not include the value of the acquired company's brand name, client base and technology distribution partners.

	Dec 31, 2015 (12M)
Cash	\$39
Working Capital	\$6,483
Shareholder Debt	\$2,475
Total Assets	\$8,024
Sales	\$323,707
Gross Profit	\$102,978
<i>Gross Margin</i>	32%
Selling Expense	\$23,927
G&A Expense	\$75,068
Total Operating Expense	\$98,995
Net Income	\$3,983

### Installation of cogeneration systems

Kontrol recently entered into an agreement for the procurement, purchase and installation of two 140 kW cogeneration systems for a client in Ontario, having a base contract price of \$1.21 million (gross margin is estimated to be 15%). The contract is expected to be completed by October 2016.

Combined Heat and Power / CHP (cogeneration) generates electricity from natural gas, and is able to capture heat produced for additional cost savings. With the current low price of

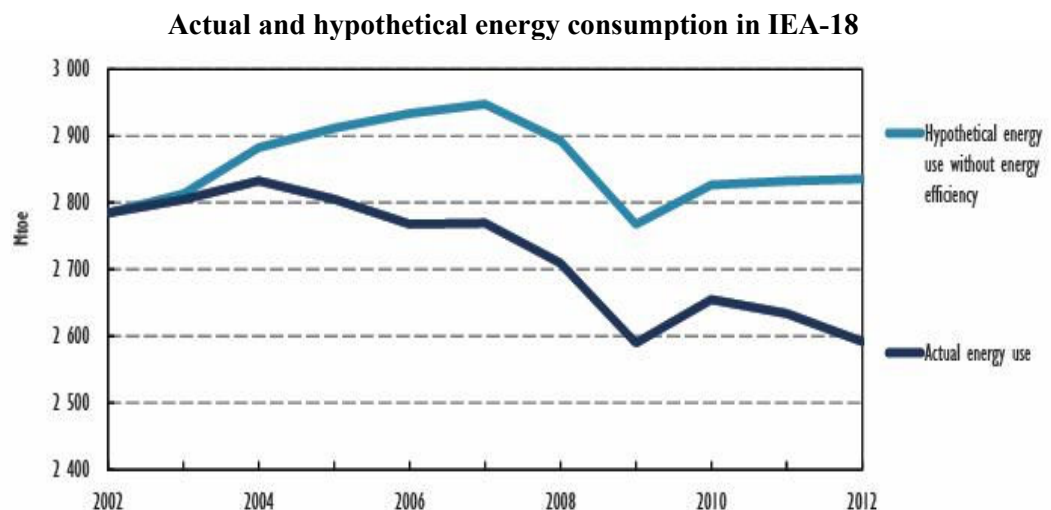
**Energy  
Efficiency  
Sector**

natural gas, and the high cost of electricity, cogeneration is attractive for commercial and industrial businesses. In Ontario, CHP installations may qualify for up to 40% in capital cost rebates subject to their operating specifications and performance metrics.

According to management, Kontrol has up to \$2 million in revenue order backlog including this CHP installation for 2016. Kontrol is currently in negotiations with multiple owners of commercial properties for the installation of cogeneration systems.

Rising electricity prices, energy consumption, and focus on environmentally friendly energy sources, have resulted in a significant increase in demand for energy efficiency products / technologies, especially in the past decade. According to the International Energy Agency (“IEA”), the global energy efficiency market is currently worth over US\$310 billion a year.

The following chart shows the significance of energy efficiency by showing the actual energy used among IEA member countries and the hypothetical energy used without energy efficiency.

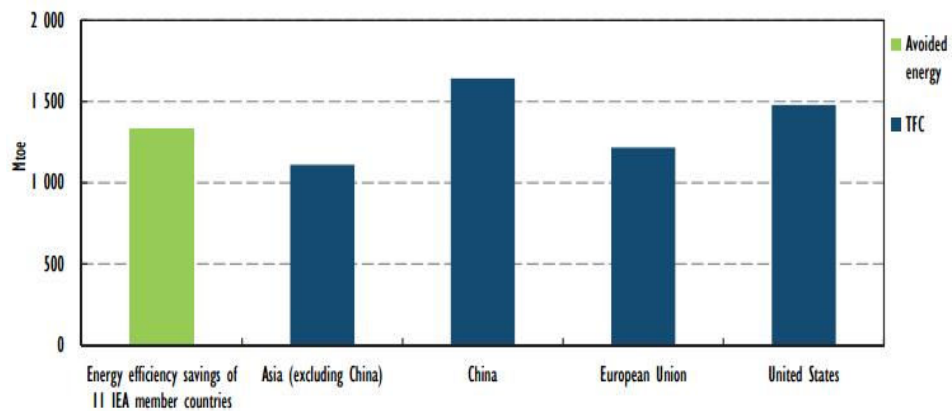


*Source: IEA*

To put it in perspective, the total energy efficiency savings of 1,337 Mtoe in 11 IEA member countries in 2011, were larger than the combined Total Final Consumption (“TFC”) of the European Union or of Asia (excluding China). These savings were equal to 80% of China’s TFC, and 87% of the U.S.’s TFC.



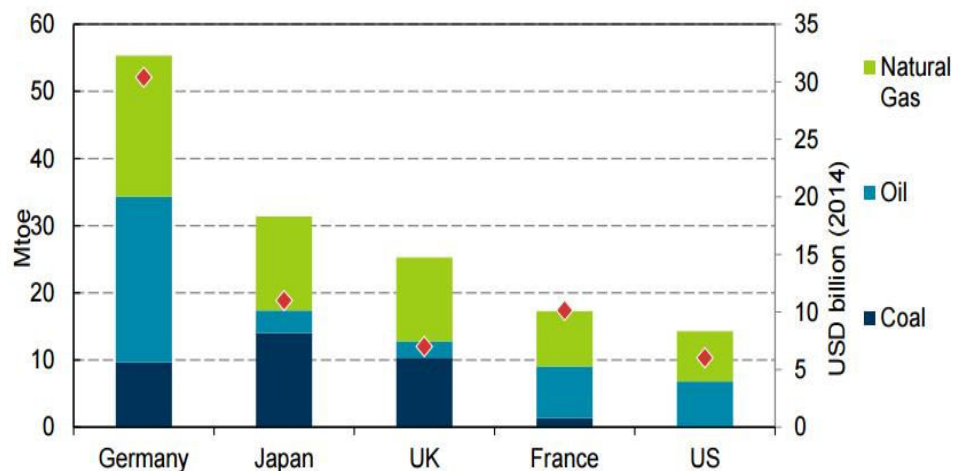
### Energy efficiency savings compared to TFC in selected regions and countries, 2011



Source: IEA

In 2014, IEA countries saved US\$80 billion worth of primary energy imports, totaling 190 Mtoe, as a result of energy efficiency investments since 1990.

### Avoided imports in 2014 as a result of energy efficiency investments

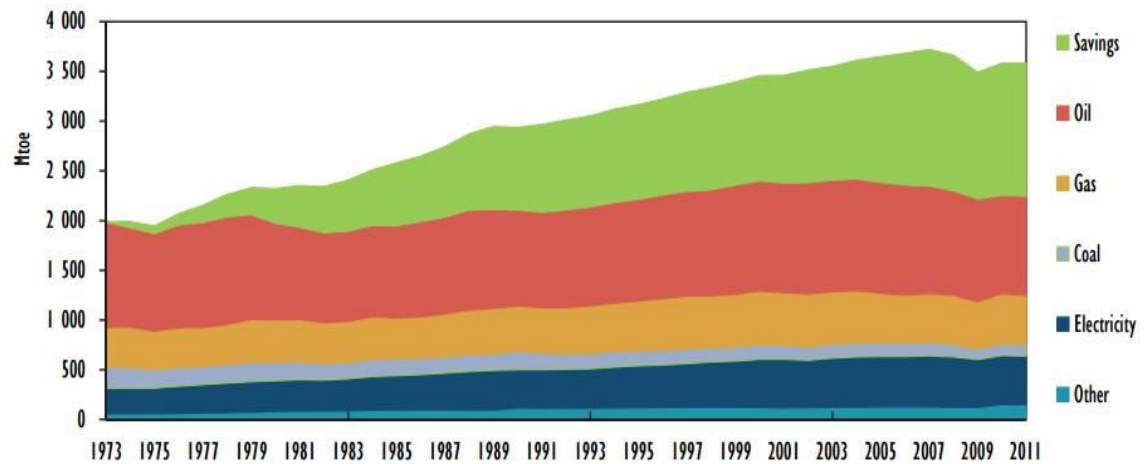


Source: IEA

The total savings from energy efficiency exceeded the amount of TFC met by any other single energy source in the member countries analyzed by the IEA.



### Energy savings from energy efficiency and energy consumption by energy source

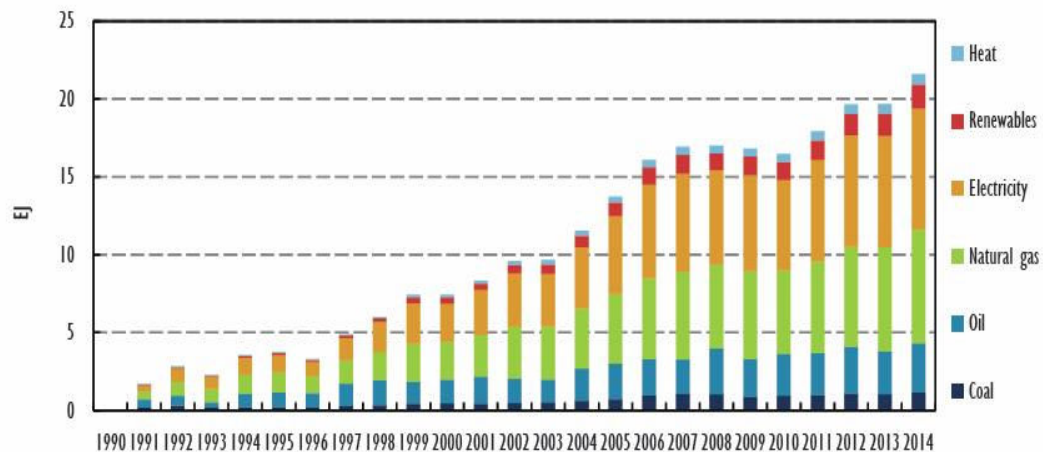


Notes: The 11 countries evaluated are Australia, Denmark, Finland, France, Germany, Italy, Japan, the Netherlands, Sweden, the United Kingdom and the United States.

Source: IEA

The following charts show the energy savings every year since the energy efficiency investments made in 1990.

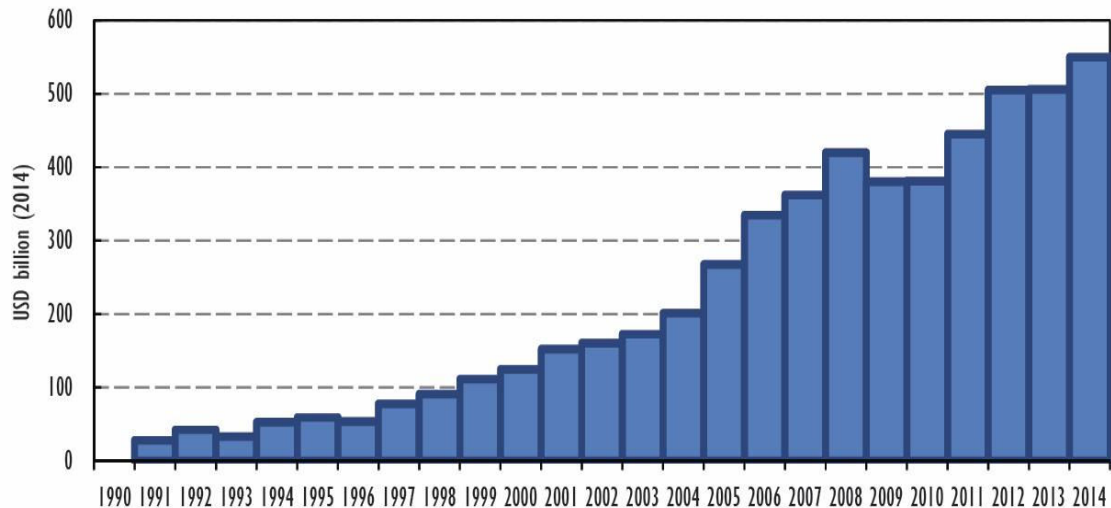
### Avoided TFC in IEA countries, by fuel type, from energy efficiency investments



Source: IEA (2013a), "Energy balances", *Energy Projections for IEA Countries* (database), available at <http://dx.doi.org/10.1787/data-00473-en> (accessed 1 and 2 May 2015).

The total energy savings in 2014 resulted in a savings of US\$550 billion. The total savings since 1990 are estimated to have been US\$5.7 trillion.

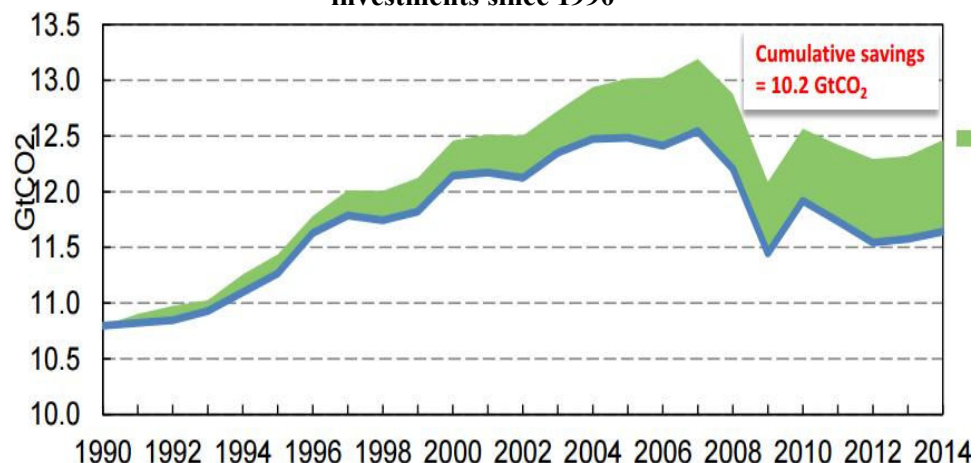
### Savings from Energy Efficiency



Source: IEA (2013a), "Energy balances", *Energy Projections for IEA Countries* (database), available at <http://dx.doi.org/10.1787/data-00473-en> (accessed 1 and 2 May 2015).

Investments in energy efficiency are expected to play the largest role (approximately 40%) in reducing Greenhouse Gas ("GHG") emissions by the energy sector through 2050. Investments in renewable energy are expected to deliver the second largest contribution at 30%. In 2014 alone, 870 Mt CO<sub>2</sub> were avoided due to energy efficiency. The IEA estimates that approximately US\$14 trillion in energy efficiency investments have to be made up to 2035, in order for temperatures not rise more than 2 degrees.

### IEA emissions from fossil fuel combustion and emissions savings (green) from energy efficiency investments since 1990



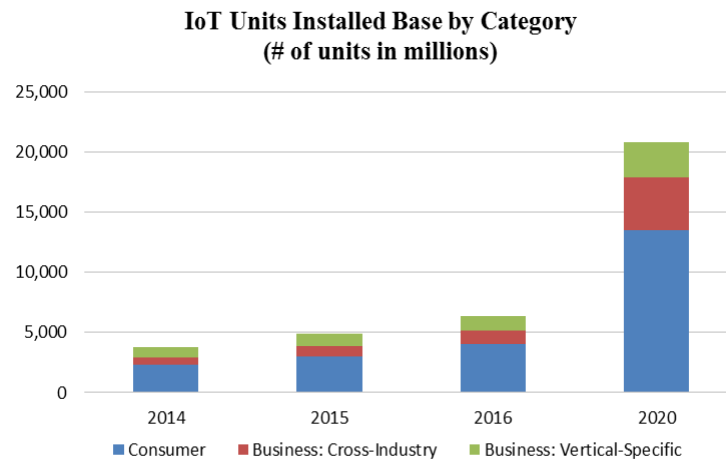
Despite the currently low oil and gas prices, we believe stricter government regulations worldwide to curb GHG emissions (such as the US Clean Power Plan, EU Energy Efficiency Directive, etc.), and the growing worldwide demand for energy, will continue to drive investments in energy efficiency technologies / products going forward.

**Technology and Internet of Things (IoT)**

Kontrol management's goal is to be a potential disruptor in the energy efficiency sector through their focus on acquiring and developing technologies which can control energy consumption and energy usage. The rapid emergence of Internet of Things (IoT) is expected to play a vital role in this sector.

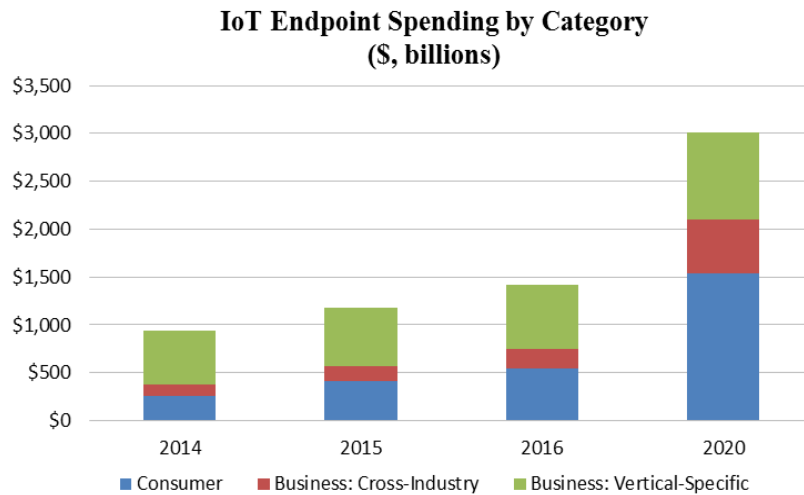
Internet of Things (IoT) is a network of equipment, vehicles, devices and other physical objects that allows for the collection, transmission and exchange of data via the internet. IoT has the potential to influence almost all aspects of life, significantly improve the quality of life for consumers, and the productivity of businesses, while cutting costs. **“Smart” objects are gaining significant popularity due to their ability to improve productivity and lower costs of businesses.**

**According to Gartner, in 2016, 6.4 billion connected things are estimated to be in use worldwide (up 30% YOY), rising to 20.8 billion by 2020.** Gartner predicts the aggregate economic benefit of IoT will exceed \$1.9 trillion per year by 2020.



*Source: Gartner*

Global spending on IoT is estimated to grow to \$3 trillion by 2020, reflecting a CAGR of 20.5% from 2014 to 2020.



- Cross - Industry implies devices used in multiple industries
- Vertical – Specific implies devices used in specific industries

*Source: Gartner*

**The IoT / Smart Technologies space has seen significant investments by major multi-national companies in recent years.**

- **In 2014, Google Inc. (Nasdaq: GOOG) acquired Nest Labs for US\$3.2 billion.** Nest Labs manufactures smart home appliances, such as thermostats and smoke detectors.
- In November 2015, Direct Energy, one of North America’s largest energy and energy-related services companies, **acquired Panoramic Power for \$60 million.** Panoramic Power is a provider of device level energy management solutions, enabling businesses to optimize their energy consumption.
- In 2012, **Honeywell (NYSE: HON) acquired INNCOM**, a Connecticut based private company. INNCOM was a manufacturer of software based energy management solutions and in-room controls for lodging, healthcare and educational institutions. Their solutions were primarily used to make hotel / hospital / school rooms and common areas “smarter” and more energy efficient by controlling various parameters, such as temperature, humidity, lighting, drapery control, security, operations, etc. At the time of acquisition, INNCOM’s devices were installed in over 800,000 hotel rooms around the world, and 10,000 rooms in hospitals, education institutions, and military housing facilities. The acquisition price was not disclosed. INNCOM had generated \$24 million in revenues in 2011.
- In 2015, **Duke Energy (NYSE: DUK)**, North America’s largest electric utility

acquired a majority share of Phoenix Energy Technologies for an undisclosed amount. Phoenix Energy is a provider of energy management systems and services for commercial customers.

- In 2014, energy firm **GDF Suez acquired** energy efficiency and utility consulting firm Ecova, based out of Spokane, U.S. Subsequently, in 2015, **Ecova acquired Retroficiency** for an undisclosed sum. Retroficiency is a provider of building energy data analytics software for the power utility sector.
- In 2015, Intel (Nasdaq: INTC) engaged in one of the largest deals in IoT, acquiring Altera Corporation for US\$16.7 billion. Altera produces microprocessors primarily used in networking equipment.
- IBM (NYSE: IBM) invested US\$3 billion to build an internal IoT division in 2015.

The following table shows the major M&A activities in the space since 2014.

Year	Acquirer	Target	Application	Acquisition Price	Revenues	Price / Revenue
2016	Nokia	Withings S.A	Connected Health - Wearables	\$191M		
2016	Microsoft	Solair	Manufacturing, Retail, Food & Beverage, Transportation	Undisclosed	\$1.5M (2015)	
2016	Cypress Semiconductor	Broadcom (IoT business)	Analog & Digital Semiconductor Connectivity Solutions	\$550M	\$189M (2015)	2.9
2016	Sony	Altair Semiconductor	Modern Chip Technology & Related Software for LTE	\$212M		
2016	Cisco Systems	Jasper	Cloud based IoT Service Platform	\$1.4B		
2016	Intel	Yogitech	Semiconductor Functional Safety and Related Standards	Undisclosed		
2016	Qorvo	GreenPeak Technologies	Smart Home	Undisclosed		
2016	ARM	Apical	Embedded Computer Vision Technology	\$350M	\$18.5M (2015)	18.9
2016	Mars Petcare	Whistle	Smart Dog Collars	\$117M		
2015	Qualcomm	Cambridge Silicon Radio	Platform solutions for BT, GPS, FM broadcast, Wi-Fi, etc.	\$2.4B	\$774.8M (2014)	3.1
2015	HP	Aruba Networks	Wired & WLAN Networks	\$3B	\$728.9M (2014)	4.1
2015	ARM	Sansa Security	IoT Security Platform	\$85M		
2015	NXP	Freescall	Semiconductor Design, Research, & Development	\$11.86B	\$4.6B (2014)	2.6
2015	Amazon	2lementary	Big Data Services	Undisclosed		
2015	BlackBerry Ltd.	Good Technology	Mobile Security Provider	\$425M	\$211.9M (2014)	2.0
2015	Intel	Altera	FPGA, SoC, & CPLD Solutions	\$16.7B	\$1.9B (2014)	8.7
2014	Samsung	SmartThings	Smart Home	\$200M		
2014	Amazon	Twitch	Video Game Streaming Service	\$970M		
2014	Google Inc.	Nest Labs	Smart home products	\$3.2B		
Average (excl outliers)						2.9

Source: S&P Capital IQ and FRC

These acquisitions clearly indicate the increasing focus on energy efficiency and the value of data analytics and connectivity among devices. **Kontrol's strategy is to acquire early stage technology companies with an IoT platform, at a reasonable valuation, which will provide them data management and analytics capability.** The strategy is to utilize the platform in one or more of the acquired businesses in their portfolio, and improve the valuations of such businesses.

The company currently holds a minority interest (4%) in a solar project in Ghana. In October 2015, management of Kontrol assigned the equity they received through a consulting agreement with a Ghana based third-party, EnergyOne (GH) Ltd. EnergyOne (GH) Ltd. is a developer of solar energy projects in Africa. The project, located in the Ashanti region of Ghana, is expected to have a capacity of 157 MW. The project is in the final stages of development and is currently in the process of reaching a 20-year definitive Power Purchase Agreement ("PPA") with the Government of Ghana. Construction is expected to commence

### Qualifying Transaction

*Share  
Structure and  
Debenture  
Financing*

this year upon receipt of the PPA.

The interest was originally earned by Mr. Paul Ghezzi in exchange for consulting services provided to EnergyOne (GH). Mr. Ghezzi originally assigned his interest to Nuvo Energy Grid Inc. in 2015. Based on comparable projects in the region, EnergyOne (GH) estimates the project is valued at \$25- \$30 million (on a pre-construction basis), implying a valuation of \$1.0 - \$1.2 million for the 4% equity.

This transaction served as part of the qualifying transaction for the company to complete the RTO. Our discussions with management indicated that they will seek to liquidate this interest shortly as their focus is on North American investments.

Kontrol currently has 16.74 million shares outstanding, and 211,333 warrants outstanding (exercise price of \$1.20 per share / maturity date – December 3, 2016).

In order to limit common share dilution, the company is currently planning to raise up to \$5 million by offering 3-year 8% p.a. debentures (paid on a quarterly basis). The company intends to utilize one or more Exempt Market Dealers (“EMDs”) to assist with the financing. Exempt market investment opportunities are typically offered by private companies. **Compared to typical exempt market offerings, we believe, this financing has an added benefit of the issuer being a publicly traded company.** Public companies tend to offer more transparency and disclosures to investors than private companies.

In the offering, Kontrol is issuing units to investors at \$1,000 per unit. A unit consists of a 8% p.a. / \$1,000 debenture and 100 common shares. **These common shares offer equity upside to investors, which is another feature that is not typical in exempt market offerings.** At the current price of \$0.20 per share, the additional 100 shares will give investors a 2% bonus immediately.

The following table shows a summary of the offering.



### Summary of the Debenture Offering

Issuer	Kontrol Energy Corp.
Date of the OM	22-Aug-16
Offering	Min \$0.20 million / Max \$5.0 million
Securities Offered	Units / Each unit consists of 8% p.a. unsecured debentures and 100 common shares
Unit Price	\$1,000 per unit
Minimum Subscription	\$5,000
Time Horizon	3 years
Fees	up to 9% of the gross proceeds
Registered Plans	Eligible

The following table shows the source of funds.

Source of Funds	Assuming Minimum Offering	Assuming Maximum Offering
Gross Proceeds Raised	\$200,000	\$5,000,000
Fees	\$18,000	\$450,000
Offering Costs	\$50,000	\$100,000
<b>Available Funds</b>	<b>\$132,000</b>	<b>\$4,450,000</b>

Use of Funds	Assuming Minimum Offering	Assuming Maximum Offering
Funds to be used to acquire Operating Businesses	\$127,000	\$4,200,000
Administrative and Legal	\$5,000	\$150,000
General Operating		\$100,000
<b>Total</b>	<b>\$132,000</b>	<b>\$4,450,000</b>

Management intends to pursue up to \$15 million in acquisitions in 2016 and 2017, of which, up to \$4.4 million will be funded by the debenture offering, and the remaining in equity (paid by issuing shares to sellers). The expected cash flows at various acquisition multiples are shown below.

*Preliminary  
Cash Flow  
Projections  
and Valuation*

### Cash Flow Summary

Acquisitions in 2016 and 2017 \$15,000,000

Equity (net proceeds) \$10,550,000

Debenture (net proceeds) \$4,450,000

	EBITDA Multiple - 3	EBITDA Multiple - 4	EBITDA Multiple - 5	EBITDA Multiple - 6
Expected Annual EBITDA	\$5,000,000	\$3,750,000	\$3,000,000	\$2,500,000
Other Expenses - 20% of EBITDA	-\$1,000,000	-\$750,000	-\$600,000	-\$500,000
EBIT	<b>\$4,000,000</b>	<b>\$3,000,000</b>	<b>\$2,400,000</b>	<b>\$2,000,000</b>
8% p.a. interest on debentures	\$400,000	\$400,000	\$400,000	\$400,000
EBT	<b>\$4,400,000</b>	<b>\$3,400,000</b>	<b>\$2,800,000</b>	<b>\$2,400,000</b>
EBIT Interest Coverage	10.00	7.50	6.00	5.00
<b>Net Profit (assuming a 20% tax)</b>	<b>\$3,520,000</b>	<b>\$2,720,000</b>	<b>\$2,240,000</b>	<b>\$1,920,000</b>
Yield on Equity Investment	31.7%	24.5%	20.2%	17.3%

As shown in the table above, the cash from operations can easily meet the interest payment on the debentures if EBITDA multiples for the acquisitions range between 3x and 6x.

The yield on equity investment ranges between 17.3% to 31.7% in the above listed scenarios.

At this time, we have decided to estimate the fair value of Kontrol's shares based on management's current plan to execute acquisitions totaling \$15 million at an average EBITDA multiple of 4x.

The following table shows the average P / E ratios of the various industries that Kontrol's portfolio is likely to be associated with.

Industry	P / E
Energy Management	25.2
Renewable Electricity	18.9
Energy	16.4
Industrial Electrical Equipment	23.1
Software and Services	27.2
Electronic Equipment, Instruments and Components	19.9
<b>Average</b>	<b>21.8</b>

The average P / E ratio of the industries is 22x. For conservatism, we used 50% of the average (P / E ratio of 11x) to evaluate Kontrol's shares at this time.

Based on our net profit estimate of \$2.72 million (as shown in the table above), and a P / E ratio of 11x, we estimate Kontrol's enterprise value should be approximately \$29.92 million. Deducting the \$5 million debenture implies an estimated market capitalization of \$24.92 million.

We extrapolated the fair value of Kontrol's shares based on the above estimate and the equity required to pursue acquisitions. The following table explains how we arrived at our \$0.83 per share estimate.

Current shares outstanding	16,740,082
Equity required (net proceeds)	\$10,550,000
<b>Average Issue Price</b>	<b>\$0.83</b>
New Shares Issued	13,379,835
Total Shares Outstanding	30,119,917
<hr/>	
<b>Estd. Enterprise Value</b>	<b>\$29,920,000</b>
Outstanding Debentures	\$5,000,000
<b>Estd. Market Capitalization</b>	<b>\$24,920,000</b>
Total Shares Outstanding	30,119,917
<b>Estimated Share Price</b>	<b>\$0.83</b>

We are initiating coverage on Kontrol with a BUY rating and a fair value estimate of \$0.83 per share (Risk 4: Speculative).

We are also assigning an overall rating of 2- with a risk rating of 3 on the debenture offering

#### FRC Rating

Yield (est.) 8% p.a.

**Rating** 2-

Risk 3

#### Risks

We believe the following are the key risks associated with the offering:

- The success of the current debenture financing will determine management's ability to pursue acquisitions this year.
- Timely deployment of capital is crucial.
- Execution risk.

- Return of capital and/or interest payments on the debenture are not guaranteed.
- Access to high-quality transactions at reasonable valuations.
- Interest rate risk on debt.
- Ability to maintain or grow cash flows of acquired companies.
- Cash from operations may not be sufficient to service interest payment on debentures.
- Acquisitions in the U.S. may be subject to exchange rate risks.
- The health of acquired companies may vary with macroeconomic conditions.
- Sellers may prefer to be paid in cash instead of Kontrol's common shares.

**Fundamental Research Corp. Equity Rating Scale (Public Companies):**

**Buy** – Annual expected rate of return exceeds 12% or the expected return is commensurate with risk

**Hold** – Annual expected rate of return is between 5% and 12%

**Sell** – Annual expected rate of return is below 5% or the expected return is not commensurate with risk

**Suspended or Rating N/A**— Coverage and ratings suspended until more information can be obtained from the company regarding recent events.

**Fundamental Research Corp. Risk Rating Scale (Public Companies):**

**1 (Low Risk)** - The company operates in an industry where it has a strong position (for example a monopoly, high market share etc.) or operates in a regulated industry. The future outlook is stable or positive for the industry. The company generates positive free cash flow and has a history of profitability. The capital structure is conservative with little or no debt.

**2 (Below Average Risk)** - The company operates in an industry where the fundamentals and outlook are positive. The industry and company are relatively less sensitive to systematic risk than companies with a Risk Rating of 3. The company has a history of profitability and has demonstrated its ability to generate positive free cash flows (though current free cash flow may be negative due to capital investment). The company's capital structure is conservative with little to modest use of debt.

**3 (Average Risk)** - The company operates in an industry that has average sensitivity to systematic risk. The industry may be cyclical. Profits and cash flow are sensitive to economic factors although the company has demonstrated its ability to generate positive earnings and cash flow. Debt use is in line with industry averages, and coverage ratios are sufficient.

**4 (Speculative)** - The company has little or no history of generating earnings or cash flow. Debt use is higher. These companies may be in start-up mode or in a turnaround situation. These companies should be considered speculative.

**5 (Highly Speculative)** - The company has no history of generating earnings or cash flow. They may operate in a new industry with new, and unproven products. Products may be at the development stage, testing, or seeking regulatory approval. These companies may run into liquidity issues, and may rely on external funding. These stocks are considered highly speculative.

The distribution of FRC's ratings are as follows: BUY (70%), HOLD (8%), SELL (5%), SUSPEND (17%).

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**Fundamental Research Corp. Rating Scale (Private Offerings):**

Rating – 1: Excellent Return to Risk Ratio

Rating – 2: Very Good Return to Risk Ratio

Rating – 3: Good Return to Risk Ratio

Rating – 4: Average Return to Risk Ratio

Rating – 5: Weak Return to Risk Ratio

Rating – 6: Very Weak Return to Risk Ratio

Rating – 7: Poor Return to Risk Ratio

A “+” indicates the rating is in the top third of the category, A “-” indicates the lower third and no “+” or “-” indicates the middle third of the category.

**Fundamental Research Corp. Risk Rating Scale (Private Offerings):**

1 (Low Risk)

2 (Below Average Risk)

3 (Average Risk)

4 (Speculative)

5 (Highly Speculative)

FRC Distribution of Ratings			
Rating - 1	0%	Risk - 1	0%
Rating - 2	27%	Risk - 2	4%
Rating - 3	47%	Risk - 3	36%
Rating - 4	9%	Risk - 4	38%
Rating - 5	4%	Risk - 5	10%
Rating - 6	1%	Suspended	12%
Rating - 7	0%		
Suspended	11%		

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