

Fundamental Research Corp.

Investment Analysis for Intelligent Investors

Siddharth Rajeev, B.Tech, MBA, CFA

Anthony de Ruijter, BA. Econ

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Kontrol Energy Corp. (CSE: KNR) – Strong Growth in Q1-2019, Next Acquisition to Close in Q3-2019

Sector/Industry: Energy Efficiency

www.kontrolenergy.com

Market Data (as of June 11, 2019)

Current Price	C\$0.78
Fair Value	C\$2.22
Rating*	BUY
Risk*	4
52 Week Range	C\$0.46 – C\$0.99
Shares O/S	29,186,823
Market Cap	C\$22.77 M
Current Yield	N/A
P/E (forward)	N/A
P/B	7.9x
YoY Return	-12.4%
YoY CSE	-25.5%



Highlights

- Kontrol Energy Corp. (“company”, “Kontrol”) continues its trend of high growth, with strong top-line growth and expense reduction in Q1-2019, punctuated by progress in its operational initiatives.
- **Portfolio Update:** Kontrol has completed six acquisitions so far, with the portfolio having historically generated annualized revenues of \$16.5 million. As we mentioned in our previous update, the company has signed a Letter of Intent to acquire an undisclosed electrical efficiency company, and Kontrol recently announced that this acquisition is to close in Q3-2019.
- **Outsized YoY Revenue Growth:** Q1-2019 revenue was \$3.68 million, up 67.46% YoY, though Kontrol did experience a QoQ decline.
- **We are maintaining our 2019E revenue forecast of \$16.50 million, and our 2020E revenue forecast of \$23 million.** Our 2020 revenue forecast is based upon the potential 2019 revenue run-rate of the company if Kontrol goes through with the energy efficiency acquisition.
- **We are maintaining our fair value per share estimate at \$2.22.**

Key Financial Data (FYE - Dec 31) (\$)	2018	2019E	2020E
Cash	\$ 1,022,061	\$ 437,055	\$ 425,653
Working Capital	\$ -6,922,818	\$ 1,114,090	\$ 2,027,971
Total Assets	\$ 17,396,142	\$ 17,066,111	\$ 18,225,133
LT Debt to Capital	3.51%	95.98%	85.66%
Revenues	\$ 10,727,301	\$ 16,500,000	\$ 23,000,000
Net Income	\$ -2,226,167	\$ -1,399,951	\$ -264,946
EPS	\$ -0.08	\$ -0.05	\$ -0.01

*For recently acquired businesses, we are assuming revenues to equal historical figures with no growth or decline.

Portfolio Update

Kontrol’s acquisitions and announced Letters of Intent (“LOI”) to date are shown in the table below:

Target	Revenues (Est.)
Kontrol Technologies Inc	\$2.25
Ortech Consulting Inc.	\$5.00
EE Inc.	\$2.25
MCW Dimax Ltd.	\$1.00
CEM Specialties Inc.	\$6.00
Total	\$16.50
Electrical Efficiency LOI	\$6.50
Total	\$23.00

Source: Management Guidance (in \$M)

As reported in our last update, we estimate that the current revenue-base of the company is \$16.50 million per annum, based on the historical revenues of the acquired portfolio. Note that this assumes no further growth or synergies, and assumes that the company generates revenues equal to historical levels.

As mentioned in our previous update, the company has recently entered into an LOI to acquire an undisclosed electrical efficiency company. The reported features of the target include:

- A 15+ year operating history.
- Approximately \$6.50 million in annual revenue over the past 3 years.
- Approximately \$0.70 million in annual normalized EBITDA over the past 3 years.

The company has advised that the purchase price has been estimated at \$3 million to acquire the potential target. On May 28, 2019, the company announced that they intend to complete this acquisition within Q3-2019. **If the acquisition is completed, we anticipate that the company’s revenue base will increase to \$23 million, again assuming that revenues are equal to historical figures with no growth or decline.**

To repeat sentiment from our previous update, management has also disclosed that they are targeting an acquisition in the HVAC space during 2019, that could potentially bring Kontrol’s revenue run-rate to between \$33 and \$34 million, but as further information has not been publicly disclosed, we will exclude this from our models for the time being.

Electrical Efficiency Acquisition

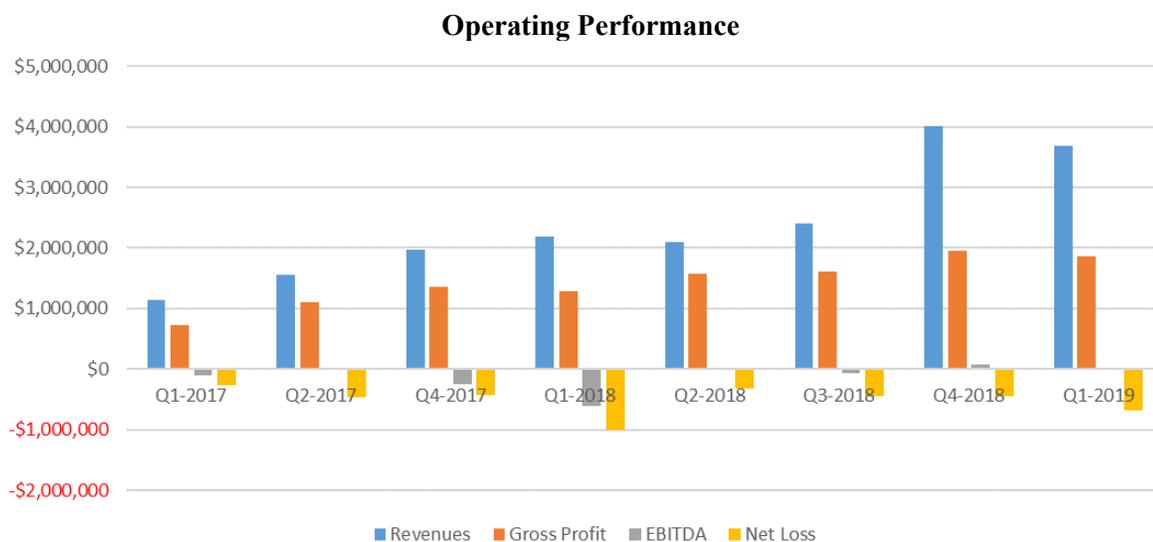
Operational Updates

In the short time since our previous update last month, the company has announced several material operational updates. These include:

- With regards to their smart factory joint venture (“JV”) with Toyota Tsusho Canada Inc. (“TTCI”), a subsidiary of Toyota Motor Corp (TSE: 7203), Kontrol anticipates that initial orders from customers should begin this quarter. Readers may refer to our previous update for details of the smart factory JV with TTCI.
- With regards to cannabis energy efficiency initiatives, Kontrol announced a new contract with an undisclosed cannabis producer in Ontario. The client appears to have contracted Kontrol to provide energy retrofit services. We look upon this news favorably as it implies that management’s decision to pursue opportunities in the cannabis sector is well-founded.
- On May 16, 2019, Kontrol announced that their subsidiary ORTECH had received a \$0.57 million order from an undisclosed global cement company.
- On June 11, 2019, the company announced receipt of a \$0.25 million contract for installation of a Combined Heat and Power (CHP) system.

Financials

Q1-2019 revenue was \$3.69 million, up 67.46% YoY. Revenue growth was attributable to continued consolidation of revenues from operating subsidiaries acquired during 2017 and 2018. However, revenues were down 8.41% QoQ, which management indicated was due to the seasonality of acquired businesses, wherein revenues in the second half of a year tend to be higher.



Source: Company Data, FRC

We are maintaining our previous 2019 revenue forecast of \$16.50 million and our 2020 revenue forecast of \$23 million. Our 2020 revenue forecast is based on the company achieving a \$23 million revenue run-rate within 2019, through the acquisition of the electrical efficiency company mentioned previously. Though on an annualized basis Q1-2019’s revenue suggests revenue less than \$16.50 million, we believe that acquired subsidiary’s revenue is still being consolidated and QoQ revenue growth in subsequent

quarters should fill in the short-fall.

Gross profit was up 45.06% YoY to \$1.86 million, reflecting a gross margin of 50.57%, which is lower than Q1-2018's gross margin of 58.38%. However, this gross margin deterioration was expected, and management had provided guidance in the previous quarter that gross margins will continue to trend lower as Kontrol's portfolio companies mature. Our 2019 gross margin forecast is 50%, and 45% for 2020 (unchanged). The following table shows the company's margins.

Margins	2018 (3M)	2019 (3M)
Gross	58.38%	50.57%
EBITDA	-27.93%	0.21%
EBIT	-40.07%	-12.28%
Net	-45.57%	-18.52%

Expenses / Sales	2018 (3M)	2019 (3M)
G & A	78.56%	43.45%
Stock Based Compensation	7.76%	6.91%
Listing Expense	0.00%	0.00%
Total	86.3%	50.4%

Source: Company Data, FRC

EBITDA in Q1-2019 was \$7.74k versus -\$0.61 million in Q1-2018. The improvement was due to both increased topline as well as a 7.37% YoY reduction in SG&A expenses.

The company reported net income of -\$0.68 million (EPS: -\$0.03) in Q1-2019, versus net income of -\$1 million (EPS: -\$0.04) in Q1-2018. **We are maintaining our 2019 net earnings forecast of -\$1.40 million (EPS: -\$0.05), and our 2020 net earnings forecast of -\$0.26 million (EPS: -\$0.01).**

A summary of the company's current cashflows is shown below. Positive free cash flows were largely attributable to the company's improved EBITDA as well as net positive cash from working capital items.

Summary of Cash Flows	2018 (3M)	2019 (3M)
Cash Flows from Operations	\$ -821,613	\$ 353,883
Cash Flows from Investing	\$ -45,851	\$ -183,240
Cash Flows from Financing	\$ 1,552,559	\$ -110,917
Net Change	\$ 685,095	\$ 59,726
Free Cash Flows	\$ -867,464	\$ 170,643
Normalized Free Cash Flows	\$ -841,037	\$ 351,478

Source: Company Data, FRC

At the end of Q1-2019, the company had \$1.08 million in cash, working capital of -\$6.16 million and a current ratio of 0.40x. Note that whilst the table below suggests that the majority of the company's debt is current, as we mentioned in our previous update, Kontrol exchanged a large portion of debentures maturing in 2019 (totaling \$6 million) for new debentures maturing in 2020, subsequent to the quarter.

Liquidity Analysis	Q1-2019
Cash	\$1,081,787
Working Capital	-\$6,164,936
Current Ratio	0.40
Debt / Capital	74.9%
LT Debt / Capital	21.7%

Source: Company Data, FRC

Stock Options and Warrants: We estimate that the company currently has 2.78 million stock options (weighted average price of \$0.75 per share) and 1.72 million warrants (weighted average price of \$0.87 per share) outstanding. Of the outstanding options and warrants, 2.45 million stock options and 1.02 million warrants are currently in the money. We believe that the company could raise up to \$2.45 million if all the in the money options are exercised.

Valuation

We are maintaining our BUY rating and fair value estimate at \$2.22 per share. As shown below, Kontrol continues to trade at a lower valuation (on a P/S and Enterprise Value to Revenue basis) relative to the other Canadian-listed energy-efficiency companies like Universal McCloud Corp. (TSXV: MCLD), Eguana Technologies Inc. (TSXV: EGT) and Legend Power Systems Inc. (TSXV: LPS).

Company	Market Cap (\$, M)	Enterprise Value (\$, M)	Revenues (\$, M - LTM)	EBITDA (\$, M - LTM)	Net Earnings (\$, M - LTM)	EV/R	P/S
Kontrol Energy (CSE: KNR) - forward	\$ 22.77	\$ 30.28	\$ 16.50	\$ 0.56	\$ -1.40	1.84	1.38
Universal McCloud Corp. (TSXV: MCLD)	\$ 33.40	\$ 33.20	\$ 2.30	\$ -9.43	\$ -11.78	14.60	14.52
Legend Power Systems Inc. (TSXV: LPS)	\$ 29.50	\$ 20.90	\$ 4.60	\$ -3.90	\$ -3.90	4.60	6.41
Equana Technologies Inc. (TSXV: EGT)	\$ 30.60	\$ 36.40	\$ 3.30	\$ -5.00	\$ -6.10	11.00	9.27
Energy Focus Inc. (NASDAQ: EFOI)	\$ 9.69	\$ 4.16	\$ 24.32	\$ -11.35	\$ -12.24	0.17	0.40
Orion Energy Systems Inc. (NASDAQ: OESX)	\$ 64.00	\$ 59.70	\$ 78.40	\$ -7.00	\$ -9.70	0.76	0.82
Connected IO Limited. (ASX: CIO)	\$ 5.11	\$ 5.76	\$ 1.66	\$ -3.31	\$ -3.38	3.48	3.09
Avanceon Limited (KASE: AVN)	\$ 90.16	\$ 91.07	\$ 34.08	\$ 4.44	\$ 6.93	2.67	2.65
Limbach Holdings Inc. (NASDAQ: LMB)	\$ 90.30	\$ 125.90	\$ 734.00	\$ 9.60	\$ -2.50	0.17	0.12
SustainCo Inc. (TSXV: SMS)	\$ 2.76	\$ 3.47	\$ 15.77	\$ -0.29	\$ -0.53	0.22	0.18
XsunX Inc. (OTC: XSNX)	\$ 1.23	\$ 1.43	\$ 1.31	\$ -0.19	\$ -3.35	1.10	0.94
Universal Electronics Inc. (NASDAQ: UEIC)	\$ 815.60	\$ 921.90	\$ 939.70	\$ 51.40	\$ 15.50	0.98	0.87
Average (Excluding Outliers)						3.47	3.39

Source: S&P Capital IQ, FRC

Risks

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

- The success of future financings will determine management's ability to grow through acquisitions.
- 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.

We are maintaining our risk rating of 4 (Speculative).

Appendix

STATEMENTS OF OPERATIONS				
(in C\$)- YE Dec 31st	2017	2018	2019E	2020E
Net Revenues	6,888,265	10,727,301	16,500,000	23,000,000
Cost of Sales	2,270,839	4,307,482	8,250,000	12,650,000
Gross Profit	4,617,426	6,419,819	8,250,000	10,350,000
Expenses				
Selling				
G & A	4,619,364	6,707,420	7,378,162	8,115,978
Stock Based Compensation	188,000	282,000	310,200	341,220
Listing Expense				
EBITDA	-189,938	-569,601	561,638	1,892,802
Amortization	252,041	394,600	434,060	477,466
Amortization (Financing Fees)	293,180	673,759	741,135	815,248
Depreciation	81,169	108,026	118,829	130,711
EBIT	-816,328	-1,745,986	-732,386	469,376
Interest & Bank Charges	-575,401	-606,878	-667,566	-734,322
Exchange rate and Unusual items				
EBT	-1,391,729	-2,352,864	-1,399,951	-264,946
Income Taxes	-80,964	-126,697		
Net Earnings for the period	-1,310,765	-2,226,167	-1,399,951	-264,946
EPS	-0.06	-0.08	-0.05	-0.01
Shares	22,563,482	26,710,807	29,167,123	29,167,123

BALANCE SHEET (in C\$)- YE Dec 31st	2017	2018	2019E	2020E
Assets				
Cash	675,594	1,022,061	437,055	425,653
Accounts receivable	1,963,342	4,259,464	4,537,500	5,750,000
Accrued Revenue		164,818	164,818	164,818
Inventory	300,953	194,021	330,000	460,000
Prepaid expenses	121,559	108,516	165,000	230,000
Current Assets	3,061,448	5,748,880	5,634,373	7,030,471
Property and equipment	396,982	551,621	532,809	512,115
Intangible	7,316,216	6,453,074	6,256,362	6,039,979
Goodwill		4,642,566	4,642,566	4,642,566
Investments	1	1	1	1
Total Assets	10,774,647	17,396,142	17,066,111	18,225,133
Liabilities & Shareholders' Equity				
Accounts payables	1,168,264	2,982,526	3,300,000	4,427,500
Def Rev / Tax	302,444	128,889	165,000	230,000
Vendor Takeback				
Loans payable/ borrowings	790,127	2,635,283	710,283	
Holdback Payable	640,389	1,635,000	300,000	300,000
Debentures		5,245,000		
Related Party		45,000	45,000	45,000
Shareholder loans	200,000			
Current Liabilities	3,101,224	12,671,698	4,520,283	5,002,500
Shareholder loans				
Deferred Income Taxes	858,290	1,270,849	1,270,849	1,270,849
LT Debt/Others		176,814	2,101,814	176,814
Debenture/Loans	4,048,631	398,165	7,384,300	9,909,831
Shareholder's Equity				
Common Stock	4,462,970	6,465,051	6,465,051	6,465,051
Obligation to Issue Shares	120,000			
Contributed Surplus	257,000	503,200	813,400	1,154,620
Warrant Reserve		210,000	210,000	210,000
Deficit	-2,073,468	-4,299,635	-5,699,586	-5,964,533
Total Liabilities & Shareholders' Equity	10,774,647	17,396,142	17,066,111	18,225,133

STATEMENTS OF CASH FLOWS				
(in C\$)- YE Dec 31st	2017	2018	2019E	2020E
Operating Activities				
Net earnings for the period	-1,310,765	-2,226,167	-1,399,951	-264,946
Items not involving cash				
Depreciation	81,169	108,026	118,829	130,711
Amortization	252,041	394,600	434,060	477,466
Amortization (Financing Fees)	293,180	673,759	741,135	815,248
SBC	200,000	282,000	310,200	341,220
Deferred Taxes Recovery	-80,964	-126,697		
Listing				
	-565,339	-894,479	204,272	1,499,699
Accounts Receivable	-80,429	-1,206,405	-278,036	-1,212,500
Prepaid Expenses	-38,639	47,835	-56,484	-65,000
Inventory	34,129	-5,141	-135,979	-130,000
Accrued Revenue		172,592		
Deferred Revenue	190,024	-173,555	36,111	65,000
Accounts payable and accrued expenses	10,430	1,046,643	317,474	1,127,500
Changes in working capital	115,515	-118,031	-116,914	-215,000
Cash from (used in) operations	-449,824	-1,012,510	87,358	1,284,699
Financing activities				
Shareholder	-82,671	-155,000		
Holdbacks			-1,335,000	
Equity	1,931,439	1,664,448		
Loans				-1,925,000
Debt	3,891,715	3,191,689	1,000,000	1,000,000
Cash provided by financing activities	5,740,483	4,701,137	(335,000)	(925,000)
Investing activities				
PP&E	-14,092	-90,924	-100,016	-110,018
Product Development	-114,944	-215,771	-237,348	-261,083
Acquisitions	-4,921,359	-3,484,795		
Cash from Acquisitions	208,327	449,330		
Cash used in investing activities	-4,842,068	-3,342,160	-337,365	-371,101
Increase (decrease) in cash	448,591	346,467	-585,006	-11,402
Cash beginning of period	227,003	675,594	1,022,061	437,055
Cash end of period	675,594	1,022,061	437,055	425,653

Fundamental Research Corp. Equity Rating Scale:

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:

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.

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