8Common Limited

ASX: 8CO

8Common Limited (8CO) is the holding company of Expense8, a leading card, travel and expense management platform to federal, state government and corporate clients. It also owns CardHERO and PayHERO, which provides employee and fund disbursements alongside procurement payments.

SP as of 13/02/2021: 17.5c
SOI: 300.52m
Market Cap: 35.07m
Current P/E ratio: -
Industry: Software and Services

Industry Snapshot

The Travel and Expense Management Software (TEMS) market size is expected to post a CAGR of close to 12 percent during the period 2019-2023, reported in the latest research report by Technavio.

According to IDC MarketScape (2019), Travel and expense management software (TEMS) provides travel, expense, and invoice management services that work with finance, HR, and procurement systems to create a single, connected process for managing organisational spend. Users can use TEMS to submit, process, reimburse and track employees spending while employees can input their expenses for approval. Administrators afterwards can track these expenses through the software, and enforce company policies for expenses and travel, set up approval routings, and generate reports for specific projects or company departments.

In the article "6 Ways to Save Using Travel and Expense Management", by CPA Practice Advisor (2017), it is reported that the average finance worker spends 49 percent of their time processing transactions. Organisations with poor expense and travel spend management can lead to frustrated employees, productivity inefficiencies and mounting costs (Travel Weekly 2020). Financial leaders are constantly on the lookout on ways to save on Company's expenses. Some of attractive benefits of adopting a TEMS include:

1. Stop overspending on errors: Human inputs leads to errors, and these mistakes can be costly (think how many purchases are made on a business trip – some still require you to save the receipt).

2. Reduce management time (some TEMS come with built-in automation features, such as receipt recognition, excel spreadsheet uploading, removing the need for manual processes).

3. Negotiate discounts (by using TEMs it is easier to track every dollar with each vendor, which may result in discounts when a product/service is used repeatedly with the vendor.

The 8Common Story

Identify – Acquire – Grow, the History of 8CO (2014 – 2017)

To understand the Company's story, we must first learn about the history.

On 22 August 2014, 8Common listed on the ASX at 25 cents a share with a market cap of $13.5m, raising $3.5m with total SOI of 54,000,000. The operating companies under 8Common are Expense8 (formerly Business Information Services Pty Ltd) and Realtors8 (formerly Combustion Labs Media Inc.). Together, this formed the core organic products to market, with management having the view to develop these products with further capabilities organically and inorganically via bolt-on acquisitions where they make sense and introducing them into the fast growing Asia Pacific region (Singapore, Malaysia, Hong Kong, Thailand).

The flagship product **Expense8** is a travel and expense management cloud-based platform. This product has been operating since 1998, as Business Information Services (BIS) based in Australia, is profitable from day 1, recording past consistent NPAT of $307k (2010), $328k (2011), $206k (2012) and $404k (2013) as laid out in the prospectus. Expense8 operates under a SaaS model with a large portfolio of mostly organisations in the government and corporate space including Federal and state agencies, large corporations including Woolworths, Boral and Amcor. **Realtors8** on the other hand was operating from Canada and had around 2,000 clients at time of IPO with a NPBT of 415k.

On 3 November 2014, The company acquired an undisclosed HR product group, adding a third product called **Perform8**, which specialises in measuring employee engagement to maximise productivity. The rationale for this acquisition was it being highly complementary to Expense8, being earnings per share accretive and created cross-sell opportunities. Perform8 at the time of acquisition was to contribute $350k EBITDA.

The Divestment of Realtors8

On 30 June 2016, it was announced that whilst all three products continued to grow, management made the decision to divest Realtors8, as it no longer fit within the new strategic vision to focus on its travel and expense management platform, Expense8, where management saw increasing opportunities arising.

It is important here to note that Realtors8 did not perform poorly and in contrast, quite well as revenue was up 34% from 2015 to 2016, from $1.28m to $1.71m (Adjusted EBITDA was up $224,337, NPAT $4,290). This was helped with the acquisitions of RPM and Clicksold, which would add a further 1000 clients and a modest amount of revenue. The divestment would eventually occur on 3 April 2017, when 8Common signed a non- binding sheet to sell for approx. A$4.3 million at the time, which was completed on 16 Feb 2018 with 8Common receiving SGD $470,000 (AUD $458,000) and 39,413,450 shares of Cloudaron Group Berhad (second tranche was not met) paid to 8Common. As of the 2020 8Common annual report, these shares in Cloudaron Bhd Bloomberg (CLOUD:BK) are worth A$1.3 million.

This divestment was a significant change for the business direction. As with every turnaround, it occurred after management's strategic review of which product had the highest growth/interest, which subsequently allowed the Company to pivot its business model to refocus itself on its strong organic growth through Expense8 rather than a diversified business.

> *"The divestment follows strong positive customer reaction to 8Common's expense8 product suite, which has been enhanced over the last 18 months and 8Common's decision to focus on the significant opportunity in Expense8".*

Source: from 3 April 2017 announcement.

***Quietly growing at pace*: Expense8 (2017 – Current)**

Since pivoting, 8Common has made significantly progress towards organic Expense8 growth. There has been no further bolt-on acquisitions made, instead, management decided to focus on acquiring new Federal government customers through Federal shared service mandates for Expense8. This makes sense as Federal government account for the highest Annual Average Revenue Per User (ARPU), despite only accounting for 30% of its total customer base (32% corporate, 38% state government).

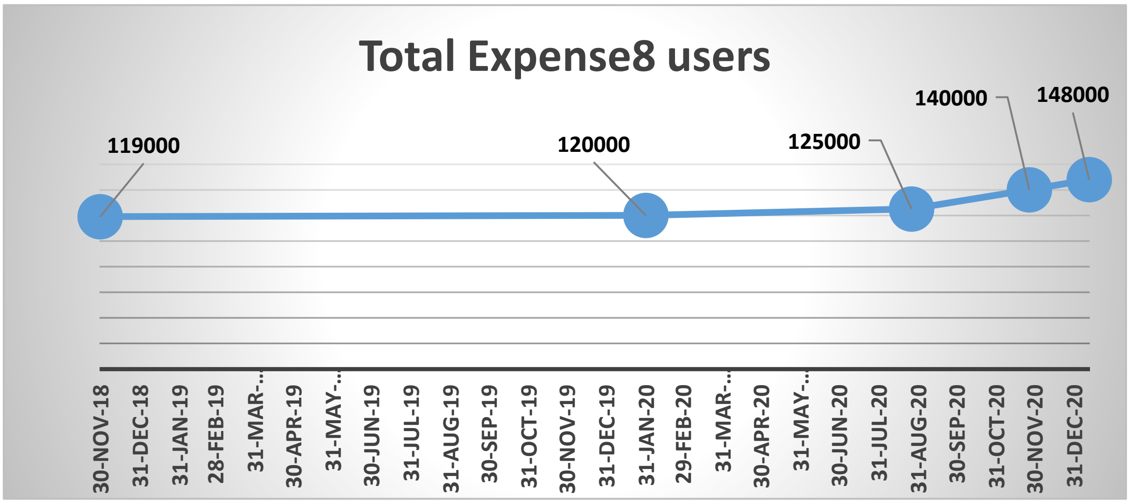
At any given time, there are 150-160 federal entities in Australia. As of 12/01/2021, Expense8 has 27 federal entities signed with 17,000 users. At an average ARPU of $48 per user, this is equivalent to $816,000 SaaS revenue per annum. The tailwinds for further federal entities wins are there, as the Company has agreements for Expense8 to be included in the Federal Shared Service Program for the Department of Industry, Innovation & Science (DIIS) and Department of Finance (DoF). These DIIS and DoF shared services are referred to as "hubs", which are essentially a part of a long term goal by the Australian government to drive productivity and reduce system and software duplication among its large number of entities. Agencies that have yet to on board to a shared service hub are encouraged to do so, as there are financial benefits through gaining economies of scale and access to shared funding arrangements.

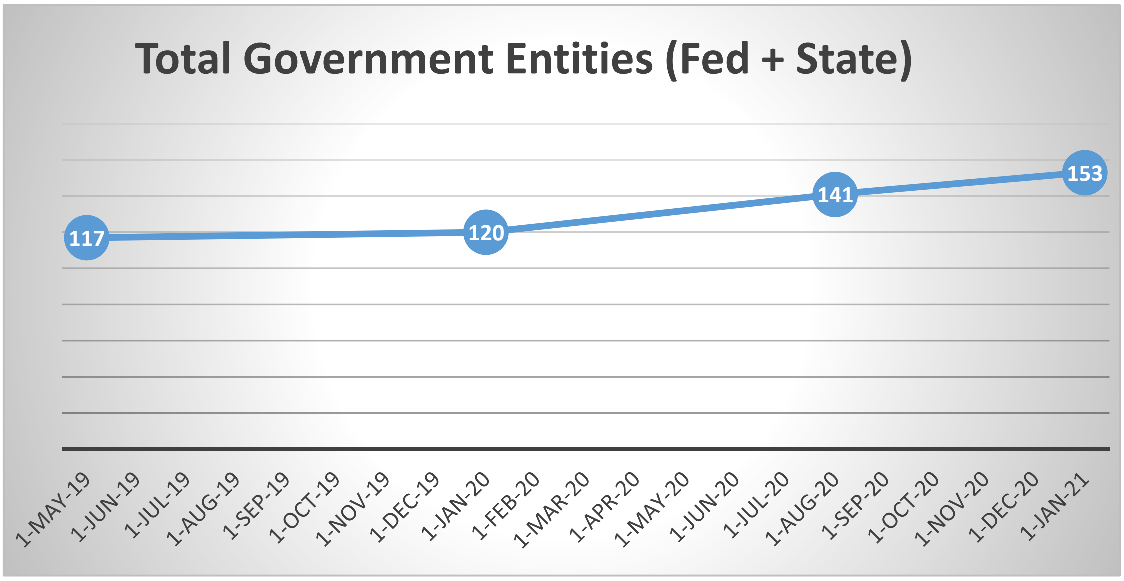
> Entities access financial benefits through economies-of-scale and shared funding arrangements. They will also have access to better corporate services data which will enable more informed strategic decision-making.

Source: https://www.finance.gov.au/government/setting-commonwealth-entity/shared-services

It is worth noting here one important advantage by being part of the Shared Service Program is that Expense8 allows these "hubs" to become the vendors on their behalf. This helps the Company to operate a capital light and cost efficient business model, where instead of investing in hiring and training new sales people, they can dedicate these resources to other areas such as improving user experience via product innovation and having the best implementing team ready to service entities to onboard Expense8. The continuous innovation here is perhaps also a testimony to the stickiness of the product. Some of Expense8's clients have been around for over a decade, and in the government space, they have never lost a customer.

In FY21, so far there were a total of 5 new federal entities which onboarded Expense8 from the DoF shared services hub in H1 2021 for a total contract value of $545,000. It was also announced there exist a pipeline of over 40 agencies, with a growing acceptance of the Expense8 product. Although it is not guaranteed that all of the agencies sign there, there is reasonable grounds that a number of them will. This opportunity currently stands at 2.5m in implementation revenue and 1.6m in SaaS revenue, providing further runway for growth. In a meeting with Management last year, Management stated that a good job would be to have signed up at least 10 government entities by FY21. As we are halfway past it now, it is pleasing to see that this goal seems more likely than not as management has had 8 agencies sign up so far in H1 FY21. The following figure below collated the total government entities signed up overtime (including State Gov), along with total users.

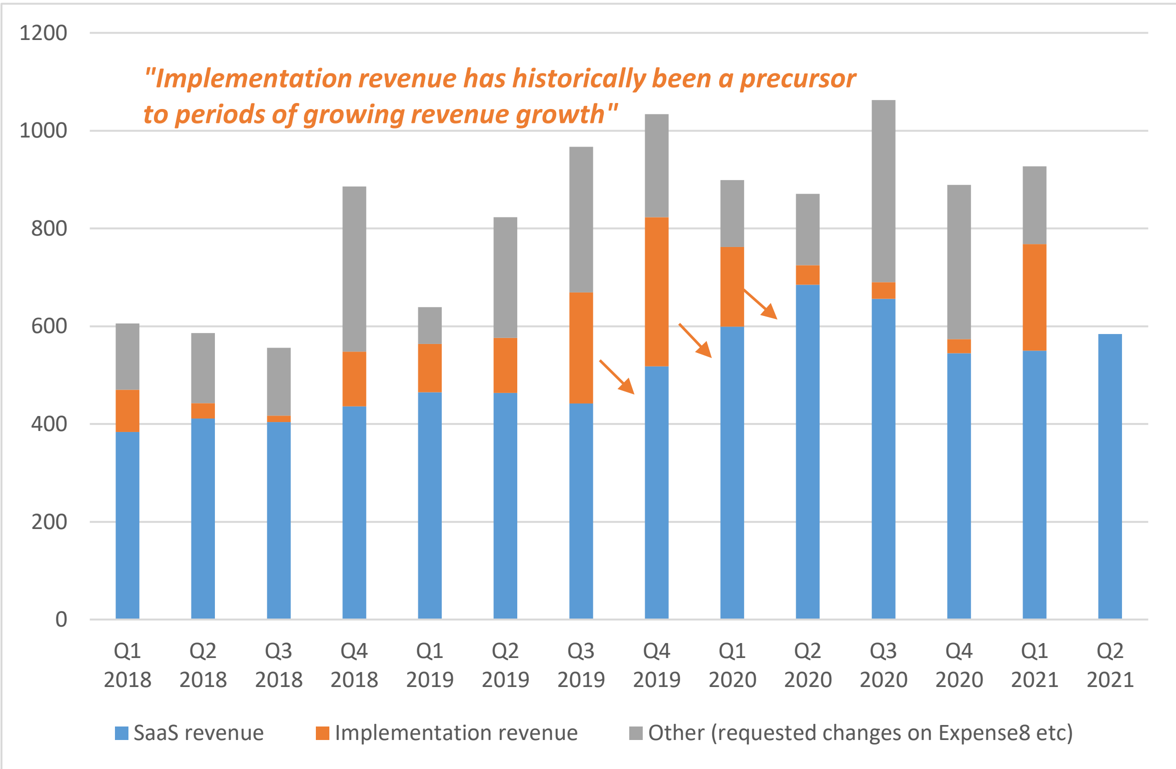




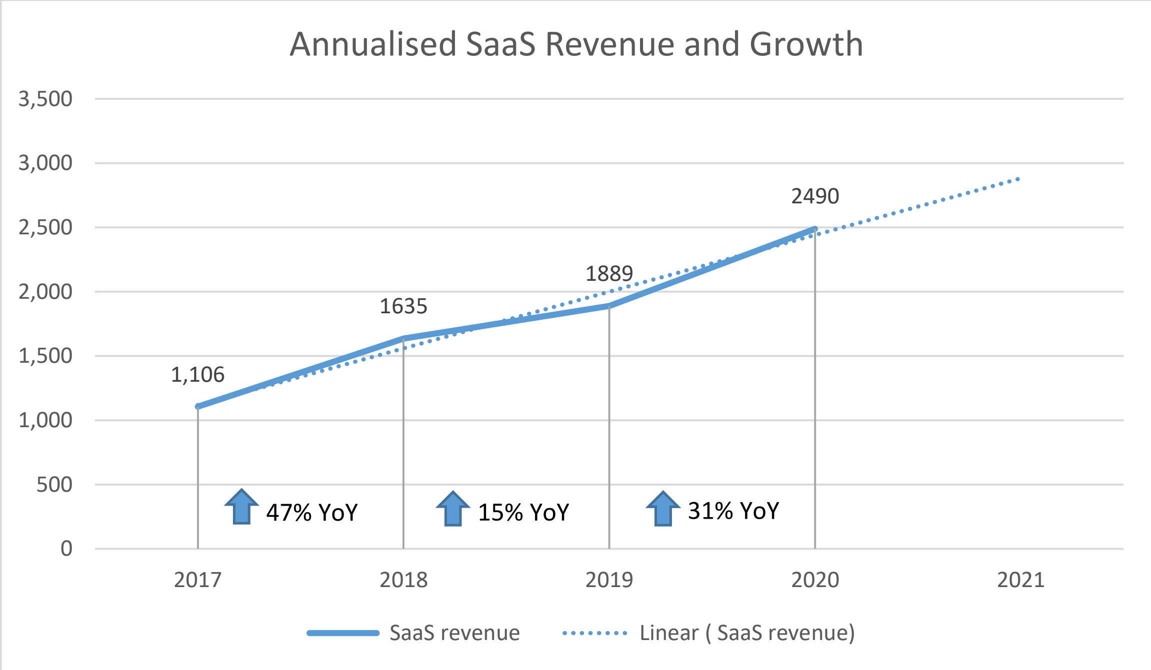
***Interesting observation from charts above**: While it took over 6 months for the Company to go from 117 to 120 Gov entities (May 19' to Jan 20'). It only took 12 months after that for the Company to go from 120 to 153 (an additional 33 from a mix of Fed + State Gov). This validates what management is saying about the "growing acceptance" of Expense8. Additionally, it is evident to see that with the uptick of entities signing up that the users are increasing. With an average ARPU of $20, 148,000 total users equal ~2.96m SaaS annualised (compared to back at the start of 2020, where 120,000 users equalled 2.4m SaaS annualised).*

Although the number of users and government entities signed have been encouraging, when examining the cash receipt, it is evident that revenue remained largely flat. The main reason for this was due to the impact of COVID-19. As SaaS revenue for Expense8 is made up from a combination of monthly recurring and transactional based fees, the lessened expenditure by users over the lockdown period meant that SaaS revenues were impacted by about 20% on a monthly basis. Another reason is that planned implementations (on-boarding work of Expense8) over Q3 and Q4 2020 was delayed as a result of the access to Government facilities being restricted and WFH. This was made up in Q1 2021, where periods of lower economic activity and removal of restrictions has enabled the implementations to take place, resulting in revenue of $218k, the third highest implementation revenue on record. Implementation revenue has historically been a precursor to periods of growing recurring revenue.

Had there not been a negative effect on expenditure due to extenuating circumstances, there would have been strong grounds to reason that based on the user growth from the government space and the fact that from Q1 and Q3 2020 YoY SaaS growth was tracking at 48%, that the 31% SaaS growth annualised YoY growth for FY20 could be outperformed in FY21 (without consideration given to the CardHero).



Note: Q2 2021 Implementation and other revenues has not been announced in the latest quarterly. As a result, it is not reflected in the chart above.



For now, the Company's plan to recover from the COVID-19 hit is to essentially grow out of it. By increasing the number of users overtime, Expense8's underlying bottom-line continues to grow. The recent H1 2021 for this FY have been encouraging, as even though total SaaS revenue were down by about 20%, the Company was still able execute on increasing the number of users by winning a number of new contracts in both Government and the signing of an inaugural contract with Life Without Borders for its new product, CardHero.

New product and addressable market: CardHERO (2019 – Current)

On 24 December 2020, 8CO shareholders were rewarded with an early Christmas present. One of the largest deals in 8CO's history. A 3-year CardHERO contract worth 1.6m with one of the largest NDIS providers, Life Without Barriers (LWB), which has been a customer of Expense8 for over 9 years. This deal is projected to bring in annualised SaaS revenue of approx. $500k (a large 20% of their total FY20 SaaS revenue). This was made possible only due to lengthy consultations with existing Expense8 customers on what organisational problems exist, and what products could be delivered to solve their problems, which begun all the way back in November 2019.

According to Technavio (2020), the major trend in the travel and expense management software industry for 2020 – 2024 is the requirement to reduce employee travel and expense reimbursement frauds. In a recent article by the ABC (2020), within the NT Government there were more than 73,000 transactions worth $16 million for the 9 months to March 2020. In one case, a NT Police, Fire and Emergency Services (NTPFES) credit card was used to pay a $225 parking infringement, while in other cases, there was a mistaken iTunes purchase and multiple transactions classified as "accidental" or "personal expenses".

The major contributor to frauds happening is the traditionally method of deploying bank cards for employee purchasing or fund disbursements. For example, an organisation that issues an employee a purchasing bank card for a business trip has no method of A) controlling what the employee spends the money on, and B) monitoring the spending for expense reporting purchases until the next bank statement comes out, which generally takes around 30 days or require a manual request. Additionally, there are also inefficiencies to retrieve remaining balances, which may require a manual process once again.

CardHERO is a product that offers both virtual and physical prepaid CardHERO branded Mastercards combined with travel and expense management solutions which solves this exact problem. It does this by offering capabilities such as the ability to monitor employee purchasing for government and corporate clients and fund disbursements in the non for profit, NDIS and education providers space.

When an organisation chooses to implement CardHERO technology, they are essentially replacing an existing service provided through their corporate bank cards. For example, the traditional way with the bank cards for the NDIS provider Life Without Barriers (LWB) would be to issue multiple bank cards to a carer within a disability home. These bank cards would each serve a function, such as for transportation, participants and carer allowances. By LWB adopting the CardHERO technology, LWB can expect a lot of benefits, as laid out in the comparative study below.

Use Case: LWB Fund Disbursement – Traditional Bank Cards vs CardHERO		
	Traditional Bank Cards	**CardHERO**
Physical Card and Mobile friendly	Yes	Yes
Ability to Retrieve Unused Funds Efficiently	Not efficiently (requires logging in to multiple accounts, viewing remaining balance, retrieving).	Yes
Real-time Administrative Monitoring of Available funds, Past transactions and Recent Top-ups.	Generally 30 days for a bank statement to auto-generate, or could be requested manually by logging on to online banking	Yes
Fraud Detection	No	Yes
Near Real Time Reporting (Reduced Time Spent on Validation and Reconciliation of Expenses).	No	Yes
Merchant Management	Yes	Yes

According to the NDIS Fraud Prevention – Financial Crime Guide (2020), NDIS fraud can be committed by participants, providers, plan managers or staff. LWB is one of the largest NDIS providers within Australia and is responsible for disbursing around $300m p.a. Should the roll-out to ~15% of the total employee and client base be successful, this will likely provide further validation for NDIS-wide industry use for disbursements. Management believes within the NDIS, CardHERO may be appropriate for up to 50% of total disbursements. To put this into perspective, should roll-out then continue to another 35% of LWB's employee and client base on a 3-year deal, this would be worth a total of $4.8m, adding 1.1m p.a. on top of the 500k p.a. SaaS revenue from the recent deal. Quite a significant figure if you consider that 1.6m p.a. is approx. 60% of SaaS revenue based on FY20.

The other important thing to note here is that LWB is part of Alliance20, which brings together the 20 largest NDIS providers in the country. Together, with 30,000 staff working directly in disability services and $2 billion in funding for these services, Alliance20 supports around 75,000 people with disability across the country. Should LWB be a success case, it is likely that word of mouth may well be a strong marketing tool to attract other large NDIS providers that are part of this group. This could ultimately become the 'blue-skies' for the business, with 8Common overlaying it's Expense8 with CardHero Fintech capabilities. According to Fintech Scales Vertical SaaS (2020), by adding fintech, SaaS businesses can increase revenue per customer by 2-5x and open up new SaaS markets that previously may not have been accessible due to a smaller software market or inefficient customer acquisition. The figure below shows the SaaS revenue possible from the Alliance20 group.

Alliance20 Blue Skies Potential Through CardHERO		
NDIS Disbursements within Alliance20	**Per Annum SaaS Revenue**	**SaaS Revenue on 3-Year Deal**
45m (current deal at 15% of disbursements with LWB)	500k p.a.	1.5m
150m (assuming 50% of disbursements with LWB)	1.6m p.a	4.8m
300m	3.2m p.a.	9.6m
600m	6.4m p.a.	19.2m
$1b (assuming CardHero captures 50% of total NDIS disbursements within Alliance20)	10.6m p.a.	32m

When looking at CardHERO from this blue-skies point of view, it can be useful to find a similar vertical for comparison. A good story is with EML Payments in the early days when it launched its salary packaging vertical in 2017.

The goal for EML was to take advantage of the exit by both ANZ and NAB from providing reloadable cards to the salary packaging industry (where cards are used to purchase various products and services through salary sacrifice arrangements). Over a seven-month period, EML signed contracts with six salary packaging providers and launched over 107,000 Reloadable salary packaging cards. EML was able to take advantage of this opportunity by undertaking the necessary regulatory and ATO approvals to be a provider to this industry. It's reloadable cards also had its own benefits, such as the Cardholder having access to a range of discounts from participating merchants who wants to incentivise them to shop at their store. EML captured and executed on it's blue-skies potential by A) Identifying the opportunity early and B) replacing the previous offering with a better product. Likewise, with CardHERO, 8CO has already executed on this opportunity with its first deal and replaced bank cards by offering a simpler and all-in-one solution. There is a similar level of structural shift, in that banks do not want to deal with the customer side of the equation. Within the NDIS space, some of these include the issuing of bank statements on demand and dealing with potential usage fraud. This is where CardHERO has its competitive advantage and can command further wins.

Management Snapshot

Nic Lim is the Founder and Executive Chairman of the Company and currently holds ~13% of the Company. The other noticeable large shareholders include NED Larry Gan with ~7% and Kok Fui Lau with ~5%. There has been no selling from management in the last 12 months, whilst the most recent buying occurred on 31 December 2020, where approx. $16,000 worth of shares were bought by Nic and NED Adrian Bunter. Per the Incentive Option Plan, Directors have up to 125,000 incentive options (1:1 ordinary shares) which are exercisable at 20 cents per share. This represents a premium to today's share price and helps to align the Director's incentive with driving the share price. As per 30 June 2020, under the Employee Option Plan, there are also 1,800,000 options exercisable at 0.091c and 7,340,000 at 16.8 cents per share.

Operationally, the Company has approximately 30 staff based in Sydney, NSW and headed by CEO Andrew Bond and COO Ben Brockoff. It is interesting to note both upper management members have a considerable amount of experience, rising through the junior ranks over 5+ years' time with the Company. This can be an advantage, as management has hands-on experience with the ins and outs of the products. In a meeting with management last year, it was also evident there was a positively high level of energy and management was goal-driven.

Valuation

SaaS revenue (FY21 exit run-rate)	6x ARR	7x ARR	8x ARR	9x ARR	10x ARR	11x ARR	12x ARR	13x ARR	14x ARR
2m	0.06	0.07	0.08	0.09	0.10	0.11	0.12	0.13	0.14
2.5m	0.075	0.0875	0.10	0.1125	0.125	0.1375	0.15	0.1625	0.175
3m	0.09	0.105	0.12	0.135	0.15	0.165	0.18	0.195	0.21
3.5m	0.105	0.1225	0.14	0.1575	0.175	0.1925	0.21	0.2275	0.245
4m	0.12	0.14	0.16	0.18	0.20	0.22	0.24	0.26	0.28
4.5m	0.135	0.1575	0.18	0.2025	0.225	0.2475	0.27	29.25	0.315
5m	0.15	0.175	0.20	0.225	0.25	0.275	0.30	0.325	0.35

Bear case

The bear case stipulates that the FY21 exit run rate would stagnate. It also assumes that the Company in the months leading up to FY21 will not win any additional contracts in Expense8 nor CardHero, and that the Company will be further affected by extenuating circumstances leading up to and throughout CY22 such as COVID-19 intensifying domestically which will further disrupting travelling patterns. Under this assumption, this would subsequently have a knock on effect as less travelling will mean less spending overall (corporate bookings, dinners, allowances etc), reducing the annualised SaaS revenue by about 20% to roughly $2.8m ARR run-rate, comprising from 500k CardHero and 2.3m from Expense8. This would ultimately lead to a reduce in the ARR multiple to 10, as investor look for better quality opportunities elsewhere in the absence of further growth.

Base case

The base case stipulates that the FY21 exit run-rate would continue in its current trajectory. It follows historical evidence that suggest that the Company in the months leading up to end of FY21 will experience a stronger Q3 and particularly Q4, which is seasonally the strongest quarter. It also assumes no further contract is won in Expense8 nor the CardHero space, however, domestic travel will make a strong recovery in Australia and annualised SaaS revenue will recover to pre-Covid levels. This will lead annualised SaaS revenue to roughly 3.5m run-rate, comprising of 500k from CardHero and 3m from Expense8. ARR multiple will remain at 12, as investors see further potential for CardHero to develop alongside a recovering travel industry.

Bull case

The bull case stipulates that the FY21 exit run-rate will continue to outperform its current trajectory. It follows the recent FY20 and HY21 contract wins and assumes further wins will continue leading up to FY21 and throughout CY22. It also assumes domestic travel will make a strong recovery back to pre-Covid levels. With the recent momentum and wins in the Expense8 and CardHero space, continuous contract wins within both spaces will lead to increased annualised SaaS revenue to roughly 4m run-rate, comprising of either 1m/500k from CardHero and 3m/3.5m from Expense8. ARR multiple here has been risen to 13, as investors see momentum building and further validation for the CardHero platform.

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