

## ENTELLECT LTD (ESN)

### ***KNeoWORLD Making Inroads into Lucrative Online Educational Games Market; Revenue Opportunities from US PTA Initiative***



#### **SPECULATIVE**

**15 July 2013**

##### **Share Trading Info**

ASX Code	ESN
Sector:	Information Technology (Software)
Current Share Price (Aust. cps)	0.2
Trading Low /High (Rolling Year) (cps)	0.1 - 0.5
Shares on Issue (m)	1,426
Mkt Capitalisation (\$m)	2.9

##### **Board of Directors**

Andrew Plympton	Non Executive Chairman
James Kellett	Chief Executive Officer
Jeffrey Bennett	Non Executive Director

##### **Major Shareholders**

Citigroup Nominees P/L	11.9%
Barrjag P/L (Hadley Super Fund)	10.5%
Dentost P/L	5.8%
Mining Investments Ltd	2.8%

##### **Key ASX Announcements Made Recently**

###### **10 July 2013**

*'Upgrade Release of KNeoWorld and Launch of US PTA National Sales Initiative'*

###### **29 January 2013**

*'KNeoWORLD Games Portal Upgrade for iPad and Android'*

##### **Important Disclosure**

*Investors should be aware that Entellec Ltd is a corporate client of Alpha and that Alpha will receive a consultancy fee from Entellec Ltd for compiling this research report*

***This update on Entellec ('ESN') follows our detailed Initiating Coverage report on the Company published on 31 July 2012 and aims to provide further details on the market opportunities following the launch of the KNeoWorld educational games portal and the recently-announced US Parent Teacher Association (PTA) initiative.***

- Following the launch of KNeoWORLD bundles (or 'KNeoPACKS') into the online and mobile applications (i.e. tablet) distribution channel over the past year, ESN remain still on track to expand the distribution of KNeoWORLD by launching into the lucrative US PTA channel at the end of July 2013.
- ESN believe that there is a substantial net revenue opportunity from the US PTA fund raising distribution channel, assuming very modest take-up rates of the initiative. Once established in the US, the Company intends to expand this model into the UK and Australia.

#### **Possible Regulation on In-App Purchases Highlight ESN's Competitive Advantage**

Currently, games publishers have two paths to monetisation: in-app purchases (IAPs) and advertising.

There is an expectation that regulation and restriction of IAPs is going to be introduced in order to prevent children purchasing IAPs via their parents' preloaded credit cards. ESN would therefore be well placed to benefit from a crackdown on IAP in childrens' games.

Both the US and European Union are hostile to online marketing to, and data collection from, children, particularly those aged under 13 years. The legal rules against this already exist and in some cases have already been applied against gaming companies with significant fines ensuing.

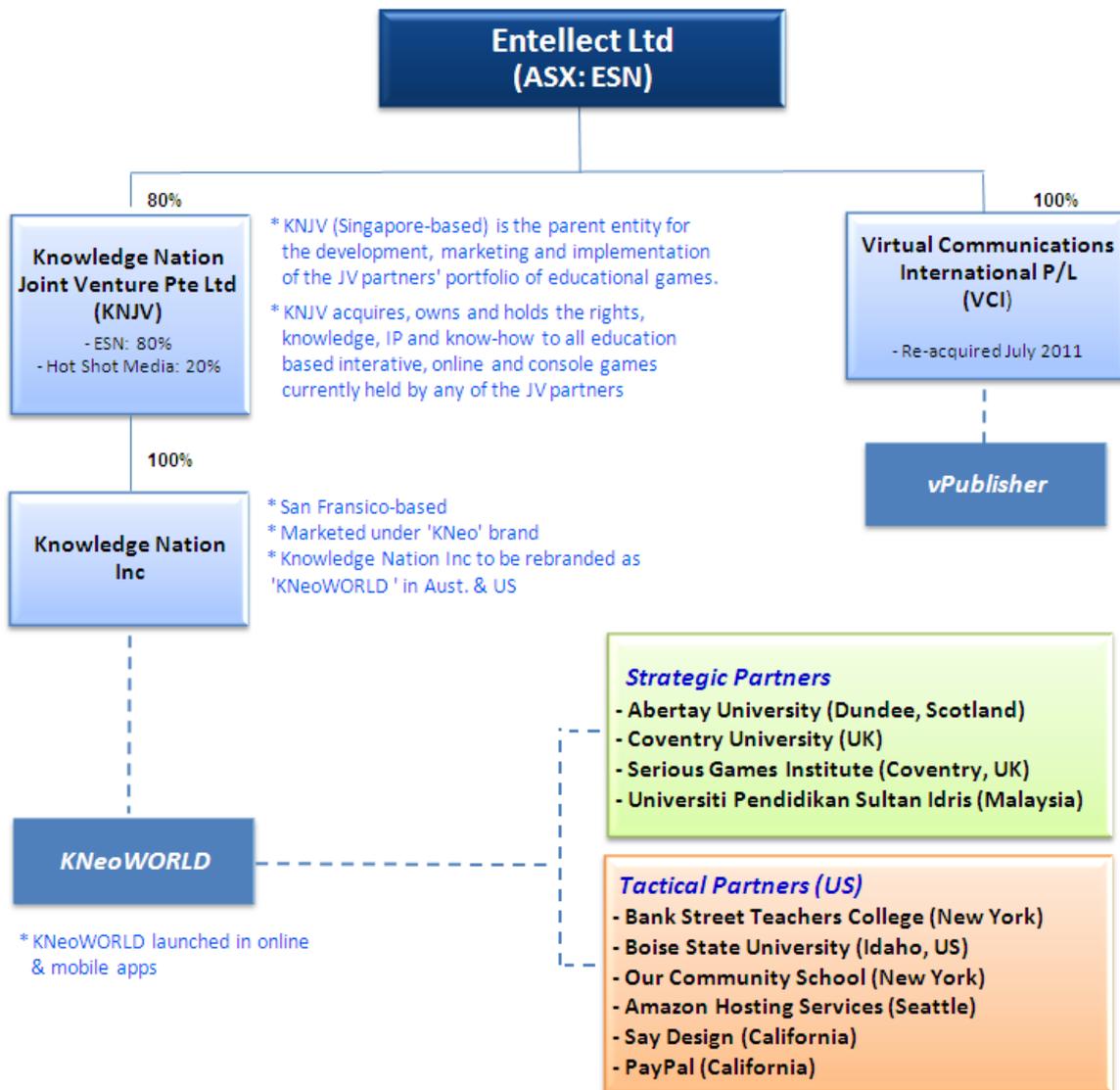
Any regulation introduced may potentially entail at least guidance, and possibly restrictions, on IAP marketed to children, with a consensus on the issue needing to be reached between app producers, platforms and regulators in order to protect children from overt selling techniques.

## A Brief Recap of Entellect's Business Model

Entellect Ltd is an educational games company, which licenses and publishes independently-developed games with an educational content and sells them on a subscription basis. ESN's core asset is an 80% interest in the Knowledge Nation JV (KNJV)<sup>1</sup>.

Knowledge Nation (now rebranded as 'KNeoWORLD Pty Ltd' in Australia and 'KNeoWORLD Inc' in the US) integrates a licensed curriculum-based content for interactive games and learning. The content can be delivered via a variety of methods, such as computer, web and mobile devices.

Chart 1: Updated ESN Corporate Structure



<sup>1</sup> KNJV (Singapore-based) is the parent entity for the development, marketing and implementation of the JV partners' portfolio of educational games. KNJV acquires, owns and holds the rights, knowledge, IP and know-how to all education-based interactive, online and console games currently held by any of the JV partners.

ESN acquired a further 20% of the Knowledge Nation Joint Venture (KNJV) from Mooter Media (ASX: MMZ) in April 2013. ESN's current holding in KNJV is 80%, with the remaining 20% owned by Hot Shot Media. The consideration for the acquisition of MMZ's 20% stake is MMZ's right to 10% of Knowledge Nation's net profit before tax for the two financial years ending to June 2014 and June 2015.

## Key Product Developments

The launch of the KNeoWORLD games portal provides the Company with exposure to the rapidly-expanding mobile and educational games industry. According to the GSV Education Factbook 2012, the overall educational games sector is poised for massive growth from US\$2 billion in 2012 to US\$4.4 billion in 2015 and US\$7.4 billion by 2017.

According to Ambient Insight (August 2012), mobile 'edugames' are already outselling non-mobile (PC/web/console) 'edugames'. Further, the compound annual growth rate (CAGR) of the mobile 'edugames' sector is 16.9%, and based on this CAGR, North American revenues from 'edugames' will reach \$359.3 million by 2016. In comparison, the CAGR for non-mobile 'edugames' is 4.9% and based on this rate revenues will reach \$155.5 million by 2016.

In September 2012, ESN launched its first bundle of the KNeoWORLD games portal in the US market - via the website channel in San Francisco, followed by the of the second bundle of the KNeoWORLD games portal in December 2012. Both of the bundles include world-class educational interactive games that have been validated by educators and have been augmented to enhance learning for young students.

Further enhancements to the online portal have since been completed, including a major update of content and player interaction. ESN expect that the new enhancement and content will result in an increase in subscription participation levels.

## Launch of US PTA National Sales Initiative

On 10 July 2013, ESN announced the launch of its US Parent Teacher Association (PTA) fund raising initiative, PTA.KNeoWORLD.com, in collaboration with the US National PTA organisation that will open up at least 50,000 elementary and middle schools and 23 million students in ESN's target market.

ESN are planning a number of national PTA initiatives that are due to start at the end of July 2013 to coincide with the US summer commencement of the new scholastic year. To maximise the potential of the PTA initiative, ESN management have secured the name and email address of every primary school principal within every US state education department.

The program is being run as a PTA fund raising initiative with a royalty paid to the individual school PTA for each subscription taken out by parents for their children. PTAs offer families US\$5 monthly access and receive 50% of all sales, with no cost to the PTA.

The benefit for the local school PTA is that it receives half of the generated revenue via a unique school identifier embedded in the registration process and provided via the individual school sales collateral that ESN provide electronically. In addition, this initiative is an attractive alternative to PTAs, given that:

- i. Fund raising for PTAs is now extremely difficult, because of safety bans on home cooking and bans on many sweets/chocolate-based initiatives for child obesity reasons and
- ii. The traditional low margin, high involvement activities such as selling perishable items.

ESN believe that there is a substantial net revenue opportunity from the PTA model, assuming very modest take-up levels - of 0.1% per month of the accessible target market, with 70% paying US\$5.00 monthly and 30% paying a discounted US\$50.00 annually.

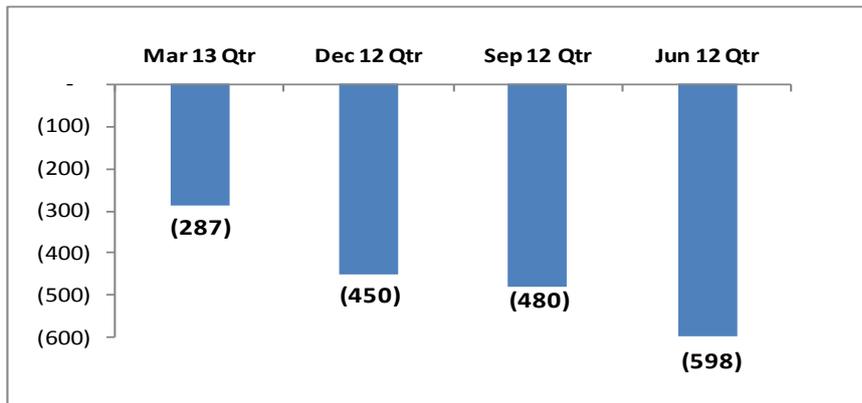
The PTA.KNeoWORLD.com online portal will run parallel with the direct online consumer portal, with both portals sharing the majority of content including the games library which is being continually expanded.

### Funding and Recent Cashflow Trends

ESN have successfully raised an additional \$771,000 in funds this year, via three separate share placements. The Board is considering raising further funds to support working capital. In addition, the Company is making progress in reducing the net operating cash outflows over the previous several quarters, as illustrated in Figure 1.

In the March 2013 quarter, the net operating cash outflow was -\$287,000 and the Company does not expect that the net operating cash outflows will have increased for the June 2013 quarter, given the increase in revenue generated from the launch of the KNeoWORLD educational games portal.

Figure 1: Reduction in Quarterly Operating Cash Outflows (June 2012 to March 2013)



Source: Company Financials

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