

TerraNet Holding

Irons in the fire

Q317 results release

Software & comp services

17 November 2017

Price **SEK15.70**

Market cap **SEK376m**

Net cash (SEKm) at 30 September 2017 74.4

Shares in issue 24.0m

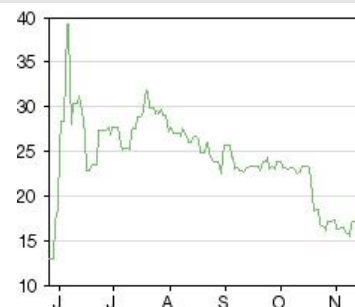
Free float 41%

Code TERRNT

Primary exchange Nasdaq First North

Secondary exchange N/A

Share price performance



% 1m 3m 12m

Abs (30.5) (40.8) N/A

Rel (local) (30.1) (43.0) N/A

52-week high/low SEK39.2 SEK15.5

Business description

TerraNet is an early commercialisation-stage firm with patented software technology enabling intelligent machine-to-machine comms and data streaming without external networks. Products include chip integration software, IoT, V2V, headsets comms, multimedia streaming and GridD.

Next events

FY17 earnings 27 February 2018

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TerraNet (TERRNT) is an early-stage software group with a range of products under development deriving principally from its industrial IoT, chip integration and peer-to-peer communications and transactions know-how. During Q317 the group reported external revenue of SEK1.6m, up 133% y-o-y, with a cash burn comprising operating and investing cash flow of SEK18.0m, in line with our full year forecasts. Significant events during the quarter included the securing of a SEK2.2m order to integrate TERRNT's software into a multinational conglomerate's hardware, the development of peer-to-peer payments software for offline transactions and an order for optimisation of LTE-V for V2V communications. We value TERRNT at SEK12.6-14.4 per share, but see significantly more upside to c SEK31/share if it is able to fully exploit its more prospective opportunities.

Year end	Revenue* (SEKm)	EBITDA (SEKm)	EPS** (SEK)	Net operating cash flow (SEKm)	Net debt/(cash) (SEKm)	EV/revenue (x)
12/15	0.4	(17.2)	(2.4)	(13.3)	(5.2)	1155.2
12/16	2.7	(25.0)	(3.2)	(22.6)	(4.1)	168.8
12/17e	6.5	(58.3)	(3.5)	(54.7)	(54.3)	69.3
12/18e	39.7	(70.7)	(3.2)	(70.1)	22.0	11.4
12/19e	121.2	(24.4)	(1.2)	(29.5)	60.8	3.7

Note: *External revenues excluding own work capitalised. **Normalised.

Five new strategic development orders won in Q317

During Q317 TerraNet booked five new strategic commercial development orders in the areas of active vehicle safety, tactical radio, production and process monitoring and off-line data transfers, with customers including Alfa Laval, Saab Defense and Orange. Entirely customer funded, the projects have the potential for distribution and licensing in 2019. The group also launched a campaign in China and India to supply encrypted offline payments functions for secure off-grid transactions. For more information see [Orders in industrial IoT/Qualcomm delays](#), 18 October 2017.

Cash flow burn reflecting multi-project activity

At end Q317 TerraNet had a consolidated net cash balance of SEK74.4m after cash burn of SEK18m in Q3, reflecting the scale and numbers of products under development and marketing. Our forecasts indicate free cash flow break-even in 2020 with a net funding requirement of SEK75m (gross SEK90m) to end-2020.

Valuation: A multi-play investment

TerraNet shares have fallen back in recent months which we believe reflects in part the delays to the Qualcomm chip integration project in China. While our base case scenario gives rise to a valuation range of SEK12.6-14.4 per share, it should be noted that with a large number of scalable projects already at the stage of having attracted partners willing to fund development, we see the potential for the group to achieve a SEK31.0 share value in the case of realisation of the full potential of only a handful of current projects. These include the V2V comms projects and targeted proximal connectivity and off-grid payment apps and SDK's in China/India.

Q317 results review

During Q317 TerraNet generated external revenue of SEK1.6m, up 133% y-o-y, with EBITDA losses of SEK13.4m and negative PBT of SEK13.5m, up 89% y-o-y. Cash burn comprising operating and investing cash flow reached SEK18.0m, reflecting operating cash outflow of SEK17.4m and capitalised development costs of SEK0.6m.

Exhibit 1: TerraNet Q317 quarterly consolidated results summary

IFRS, SEKm	Q317	Q316	Chg. %	9M17	9M16	Chg. %	Q217	Q117	FY17e
Earnings statement									
Consumer IoT external revenue	0.1	N/A	N/A	0.3	N/A	N/A	N/A	N/A	N/A
Industrial IoT external revenue	1.5	N/A	N/A	4.0	N/A	N/A	N/A	N/A	N/A
External revenue	1.6	0.7	133.0	4.3	1.5	189.0	2.2	0.4	6.5
Total revenue	1.6	0.7	133.0	4.3	1.5	189.0	2.2	0.4	6.5
Staff	(5.0)	(1.8)	183.6	(18.8)	(5.5)	241.4	(8.3)	(5.6)	(28.4)
Other expenses	(10.4)	(7.7)	35.4	(33.1)	(17.1)	93.4	(12.4)	(10.3)	(46.2)
Total expenses	(15.4)	(9.4)	63.0	(51.9)	(22.6)	129.5	(20.7)	(15.9)	(74.6)
Own work capitalised	0.3	1.7	(80.3)	5.3	4.2	23.8	1.9	3.1	9.8
Consumer IoT external EBITDA	-6.7	N/A	N/A	-23.7	N/A	N/A	N/A	N/A	N/A
Industrial IoT external EBITDA	-6.3	N/A	N/A	-17.0	N/A	N/A	N/A	N/A	N/A
Group wide and eliminations	-0.4	N/A	N/A	-1.6	N/A	N/A	N/A	N/A	N/A
EBITDA	(13.4)	(7.1)	89.4	(42.4)	(16.9)	150.9	(16.6)	(12.4)	(58.3)
Amortisation and impairment of intangible assets	(0.1)	(0.1)	3.6	(0.2)	(0.2)	3.0	(0.1)	(0.1)	(7.1)
Operating income	(13.5)	(7.1)	88.8	(42.6)	(17.1)	149.4	(16.6)	(12.4)	(65.4)
Net finance costs	0.0	0.0	N/A	0.0	0.0	N/A	0.0	0.0	0.0
PBT	(13.5)	(7.1)	88.8	(42.6)	(17.1)	149.4	(16.6)	(12.4)	(65.4)
Profit after tax	(13.5)	(7.1)	88.8	(42.6)	(17.1)	149.4	(16.6)	(12.4)	(65.4)
EPS basic (SEK)	(0.6)	(0.6)	(6.7)	(2.2)	(1.6)	36.5	(0.9)	(0.8)	(3.5)
EPS diluted (SEK)	(0.6)	(0.6)	(6.7)	(2.2)	(1.6)	36.5	(0.9)	(0.8)	(3.5)
Adj EPS basic (SEK)	(0.6)	(0.6)	(6.7)	(2.2)	(1.6)	36.5	(0.9)	(0.8)	(3.5)
Adj EPS diluted (SEK)	(0.6)	(0.6)	(6.7)	(2.2)	(1.6)	36.5	(0.9)	(0.8)	(3.5)
Cash Flow									
Operating income	(13.5)	(7.1)	88.8	(42.6)	(17.1)	149.4	(16.6)	(12.4)	(65.4)
Amortisation of other intangibles	0.1	0.1	3.6	0.2	0.2	3.0	0.1	0.1	7.1
Changes in working capital	(4.0)	1.4	(390.7)	(0.4)	(3.1)	(85.6)	(0.3)	3.8	3.5
Tax paid	0.0	0.0	N/A	0.0	0.0	N/A	0.0	0.0	0.0
Total operating cash flows	(17.4)	(5.7)	204.0	(42.8)	(20.0)	114.4	(16.9)	(8.5)	(54.7)
Purchase of property, plant and equipment	0.0	0.0	N/A	0.0	0.0	N/A	0.0	0.0	0.0
Capitalised development costs	(0.6)	(1.7)	(65.8)	(6.0)	(4.2)	40.5	(2.3)	(3.1)	(9.1)
Total investing cash flows	(0.6)	(1.7)	(65.8)	(6.0)	(4.2)	40.5	(2.3)	(3.1)	(9.1)
Dividends	0.0	0.0	N/A	0.0	0.0	N/A	0.0	0.0	0.0
Share repurchase/issue	0.0	15.8	(100.0)	128.6	32.7	293.5	100.7	28.0	128.1
Increase/decrease in borrowing	0.0	0.0	N/A	0.0	0.0	N/A	0.0	0.0	(0.0)
Interest paid	0.0	0.0	N/A	0.0	0.0	N/A	0.0	0.0	0.0
Other	0.0	(1.6)	(102.8)	(9.3)	(1.6)	462.0	(7.3)	(2.0)	(14.0)
Total financing cash flow	0.0	14.1	(99.7)	119.4	31.0	284.6	93.3	26.0	114.0
Key data									
Total cash burn (operating + investing CF)	(18.0)	(7.4)	143.5	(48.8)	(24.2)	101.4	(19.2)	(11.7)	(63.8)
Net change in cash	(17.9)	6.8	(365.2)	70.6	6.8	936.6	74.2	14.3	50.2
Closing cash	75.0	12.0	525.1	75.0	12.0	525.1	92.9	18.7	54.6
Closing net debt (cash)	(74.4)	(11.3)	556.5	(74.4)	(11.3)	556.5	(91.6)	(18.7)	(54.3)

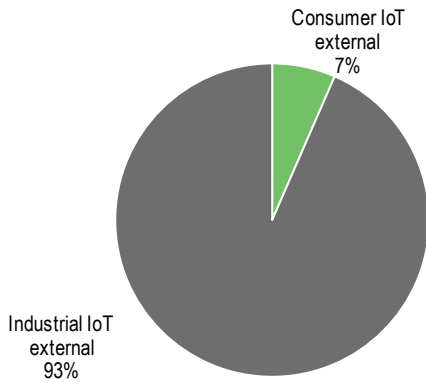
Source: TerraNet, Edison Investment Research

During the third quarter the group established segment reporting with the creation of consumer and industrial IoT segments. The bulk of revenues during the first nine months of 2017 (see Exhibits 1 and 2) were generated by the industrial IoT segment (SEK4.0m of the SEK4.3m total in 9M17). This reflects the high number of project development agreements ongoing with major industrial partners as discussed in our report, Orders in industrial IoT/Qualcomm delays, 18 October 2017. In terms of EBITDA losses, however, the consumer IoT segment has been responsible for the greater part of

EBITDA losses reflecting to a large degree TerraNet’s work in creating software for integration into the Qualcomm Snapdragon chip for proximal connectivity. In our view, this project was rightly given priority given the potential for it to generate substantial revenues for TerraNet from the sales of SDKs to Chinese app developers to enable them to utilise the proximal connectivity functions created by its on-chip software.

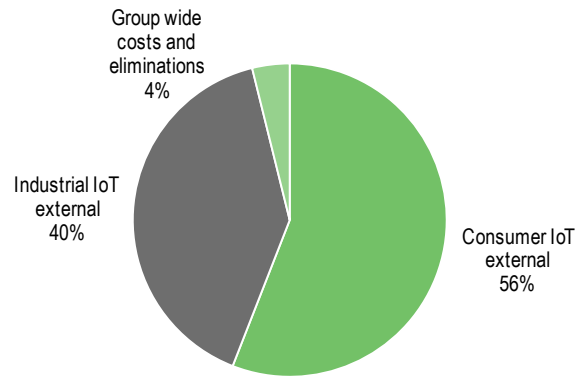
In recent months, however, progress in selling to app developers has been affected by third-party delays in the development of enabling software for the implementation of proximal connectivity applications. We do not believe that development of this software has yet been completed. Nevertheless, the group reported in its Q3 interim report that the project is now progressing according to plan. We await further development which could lead to the generation of a return on the group’s significant development and marketing outlays. We assume that the company will start to generate initial revenues from this product in 2018, principally from non-recurring engineering work for Chinese app developers.

Exhibit 2: Group breakdown external revenues 9M17



Source: TerraNet financial reports

Exhibit 3: Group breakdown EBITDA losses 9M17



Source: TerraNet financial reports

Exhibit 4: Financial summary

	SEK'm	2015	2016	2017e	2018e	2019e
		IFRS	IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT						
31-December						
Revenue		0.4	2.7	6.5	39.7	121.2
Employee and consultant expenses		(14.7)	(21.3)	(54.2)	(87.7)	(120.3)
Other operating expenses excl. D&A		(2.9)	(6.4)	(10.6)	(22.7)	(25.2)
EBITDA		(17.2)	(25.0)	(58.3)	(70.7)	(24.4)
Normalised operating profit		(18.0)	(37.6)	(65.4)	(75.7)	(26.7)
Amortisation of acquired intangibles		0.0	0.0	0.0	0.0	0.0
Exceptionals		0.0	0.0	0.0	0.0	0.0
Share-based payments		0.0	0.0	0.0	0.0	0.0
Reported operating profit		(18.0)	(37.6)	(65.4)	(75.7)	(26.7)
Net Interest		0.0	0.0	0.0	0.1	(1.2)
Joint ventures & associates (post tax)		0.0	0.0	0.0	0.0	0.0
Exceptionals		0.0	0.0	0.0	0.0	0.0
Profit Before Tax (norm)		(18.0)	(37.6)	(65.4)	(75.7)	(27.9)
Profit Before Tax (reported)		(18.0)	(37.6)	(65.4)	(75.7)	(27.9)
Reported tax		0.0	0.0	0.0	0.0	0.0
Profit After Tax (norm)		(18.0)	(37.6)	(65.4)	(75.7)	(27.9)
Profit After Tax (reported)		(18.0)	(37.6)	(65.4)	(75.7)	(27.9)
Minority interests		0.0	0.0	0.0	0.0	0.0
Discontinued operations		0.0	0.0	0.0	0.0	0.0
Net income (normalised)		(18.0)	(37.6)	(65.4)	(75.7)	(27.9)
Net income (reported)		(18.0)	(37.6)	(65.4)	(75.7)	(27.9)
Basic average number of shares outstanding (m)		7.5	11.7	18.9	24.0	24.0
EPS - basic normalised (SEK)		(2.40)	(3.22)	(3.46)	(3.16)	(1.16)
EPS - diluted normalised (SEK)		(2.40)	(3.22)	(3.46)	(3.16)	(1.16)
EPS - basic reported (SEK)		(2.40)	(3.22)	(3.46)	(3.16)	(1.16)
Dividend (SEK)		0.00	0.00	0.00	0.00	0.00
Revenue growth (%)		N/A	584.4	143.5	510.5	205.4
Gross Margin (%)		N/A	N/A	N/A	N/A	N/A
EBITDA Margin (%)		-4399.4	-937.8	-896.4	-178.2	-20.1
Normalised Operating Margin		-4608.4	-1407.9	-1005.6	-190.9	-22.0
BALANCE SHEET						
Fixed Assets		30.3	23.3	26.0	27.1	31.9
Intangible Assets		30.2	23.3	26.0	27.1	31.9
Tangible Assets		0.0	0.0	0.0	0.0	0.0
Investments & other		0.0	0.0	0.0	0.0	0.0
Current Assets		6.8	7.3	56.0	10.7	32.8
Stocks		0.0	0.0	0.0	0.0	0.0
Debtors		1.6	2.3	0.8	4.3	13.3
Cash & cash equivalents		5.2	4.4	54.6	3.0	9.1
Other		0.0	0.6	0.6	3.4	10.4
Current Liabilities		(9.3)	(7.8)	(10.4)	(40.3)	(90.2)
Creditors		(3.4)	(5.9)	(8.0)	(12.1)	(15.9)
Tax and social security		(5.5)	0.0	0.0	0.0	0.0
Short term borrowings		0.0	(0.3)	(0.3)	(25.0)	(70.0)
Other		(0.4)	(1.6)	(2.1)	(3.2)	(4.2)
Long Term Liabilities		(3.1)	(2.7)	(2.7)	(2.7)	(2.7)
Long term borrowings		0.0	0.0	0.0	0.0	0.0
Other long term liabilities		(3.1)	(2.7)	(2.7)	(2.7)	(2.7)
Net Assets		24.6	20.0	68.9	(5.2)	(28.2)
Minority interests		0.0	0.0	0.0	0.0	0.0
Shareholders' equity		24.6	20.0	68.9	(5.2)	(28.2)
CASH FLOW						
Op Cash Flow before WC and tax		(17.2)	(25.0)	(58.3)	(70.7)	(24.4)
Working capital		3.9	2.4	3.5	0.6	(5.1)
Exceptional & other		0.0	0.0	0.0	0.0	0.0
Tax		0.0	0.0	0.0	0.0	0.0
Net operating cash flow		(13.3)	(22.6)	(54.7)	(70.1)	(29.5)
Capex		(6.8)	(5.6)	(9.1)	(6.3)	(8.2)
Acquisitions/disposals		0.0	0.0	0.0	0.0	0.0
Net interest		0.0	0.0	0.0	0.1	(1.2)
Equity financing		21.3	29.4	128.1	0.0	0.0
Dividends		0.0	0.0	0.0	0.0	0.0
Other		0.0	(2.3)	(14.0)	0.0	0.0
Net Cash Flow		1.3	(1.1)	50.2	(76.3)	(38.8)
Opening net debt/(cash)		(3.9)	(5.2)	(4.1)	(54.3)	22.0
FX		0.0	0.0	0.0	0.0	0.0
Other non-cash movements		0.0	0.0	0.0	0.0	0.0
Closing net debt/(cash)		(5.2)	(4.1)	(54.3)	22.0	60.8

Source: TerraNet accounts, Edison Investment Group forecasts. Note: For illustrative purposes future funding requirement modelled as debt.

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