

TERN

SOFTWARE AND COMPUTER SERVICES

31 May 2023

TERN.L

4.25p

Market Cap: £16.5m

SHARE PRICE (p)



12m high/low 16.8p/3.5p

Source: LSE Data (priced as at prior close)

KEY DATA

Net (Debt)/Cash	£1.0m (at 31/12/22)
Enterprise value	£15.5m
Index/market	AIM
Next news	AGM, June
Shares in Issue (m)	388.6
Chairman	Ian Ritchie
Chief Executive	Albert E Sisto
CFO	Sarah Payne

COMPANY DESCRIPTION

Tern operates a hybrid venture capital model, providing access to disruptive IoT start-ups with proven technology.

www.ternplc.com

TERN IS A RESEARCH CLIENT OF PROGRESSIVE

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FY22 progress despite global tech sell-off

Tern has delivered further progress in FY22 against a challenging backdrop. KPIs demonstrate that repeat revenues are growing and headcount is increasing, supporting our view that the portfolio is gaining commercial traction and turning configuration work into recurring revenue. However, valuations across the global technology landscape have been challenged for several quarters due to interest rates, risk appetite and long-term value expectations. Therefore, despite the significant improvement in metrics across its portfolio companies, Tern has reported an £8.4m reduction in fair value, reversing the uplifts in value achieved in H1 22. While the reversal of the recent uplift in NAV is disappointing, we see significant value creation from Tern's hybrid VC model and organic growth potential. Tern's funding-to-exit model requires patience: we see recurring revenue growth attracting additional strategic interest and look forward to positive newsflow.

- **Tern's portfolio is at an inflexion point**, with aggregated annual recurring revenue (ARR) increasing 97% in FY22, coupled with 66% growth in employee numbers and a rise of 19% in ARR per employee. While we do not expect any near-term rebound in valuations, we believe that Tern remains well placed to help its portfolio through this difficult phase and potentially emerge stronger, with increased market share, as other early-stage technology companies are less capable of weathering the harsh economic climate.
- **A decrease in valuation metrics across the global technology sector** has led to a fair value reduction of £8.4m for Tern, offset by £1.7m of additional investment. Therefore, assets under management as at 31 December 2022 were £23.9m, a 22% decline on the previous year (£30.6m). Additionally, £3.1m (gross) was raised through three equity raises in August, October and December 2022, and £42,300 realised from sales of Tern's holding in Wyld Networks
- **Third-party investments reflect confidence in underlying businesses** and reduce the reliance on Tern for capital. However, it has been year of two halves, with valuation uplifts reversed in H2. The first Series B round was successfully completed in May 2022 for FundamentalVR, raising £7m at a 77% uplift. The recent follow-on investment resulted in a reversal of this uplift due to the change in sentiment regarding valuation metrics, which also impacted the rest of the portfolio including reductions for Device Authority (£3.2m), Konektio (£1.9m) and Wyld Networks (£3.2m).

FYE DEC (£M)	2018	2019	2020	2021	2022
Revenue	0.1	0.1	0.2	0.1	0.1
Adj EBITDA	0.0	0.0	0.0	0.0	0.0
Fully Adj PBT	-0.3	-0.8	0.8	4.6	-10.4
Fully Adj EPS (p)	-0.1	-0.3	0.3	1.3	-2.9
Net asset value	16.8	18.9	24.0	32.4	24.9
NAV/share (p)	7.7	7.5	8.3	9.2	6.4
PER (x)	N/A	N/A	15.4x	3.2x	N/A

Source: Company Information and Progressive Equity Research estimates.

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Please refer to important disclosures at the end of the document.

Financial highlights

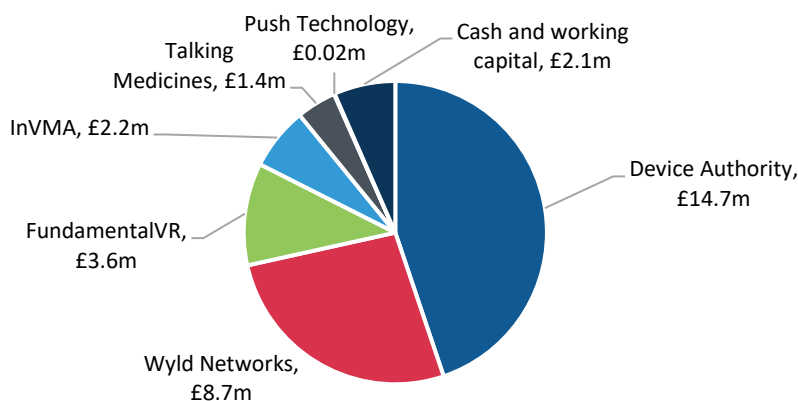
Tern reported a year of further significant progress across the portfolio, delivering growth in all key performance metrics. Aggregated annual recurring revenues (ARR) increased 97% in FY22, coupled with a 66% rise in employee numbers and 19% growth in ARR per employee.

However, the global sell-off in technology stocks eventually trickled down to the private technology sector in the second half of 2022, resulting in down valuations, with the trend continuing into 2023. This has led to a fair value reduction of Tern’s portfolio of £8.4m, offset by £1.7m of additional investment. Therefore, assets under management at the year-end were £23.9m, a 22% decline on FY21.

Total comprehensive loss for the year was £10.4m (FY21: profit of £4.6m), due to the net negative movement in fair value. Administration costs rose to £1.8m (FY21: £1.6m), including a £0.1m decrease in directors’ fees. Other costs of £0.4m include the aborted Pires deal costs.

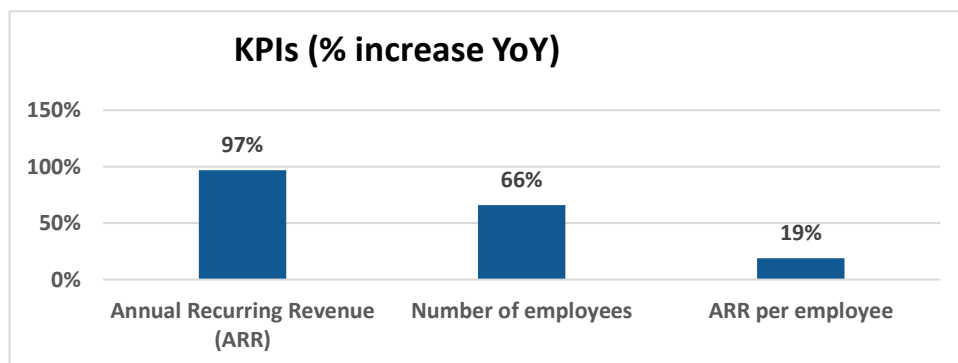
To enable Tern to support its portfolio, £3.1m (gross) was generated from equity raises in August, October and December 2022. Tern also realised £42,300 from its holding in Wyld. The year-end cash balance was £1.0m (FY21: £2.0m). NAV fell 30% to 6.4p (FY21: 9.2p) (calculated using the year-end number of ordinary shares in issue of 388,571,510).

Tern – NAV breakdown as at 31 December 2022



Source: Company data, Progressive Equity Research

Tern KPIs



Source: Company data, Progressive Equity Research

Operational highlights

The negative movement in fair value does not reflect the positive momentum throughout the portfolio. Device Authority is making rapid progress with multi-year contract wins following the launch of KeyScaler 7.0. Konektio is seeing strong growth for its AssetMinder platform and is structuring the business to increase its operational scale. Talking Medicines is expanding the subscription base for PatientMetRx and has been engaging with a number of global advertising agencies.

Tern's management is looking to take advantage of Wyld's success as a standalone company, following its IPO on NASDAQ First North in 2021. Wyld has built a significant order backlog since the commercial launch. Tern's management will look to crystallise upside at appropriate stages to provide capital for investment elsewhere.

Management has reiterated its strategy to pursue rapid, high-growth opportunities, supporting entrepreneurs by providing the necessary capital. Given the challenging economic backdrop, Tern is assisting portfolio companies to become sustainable opportunities, rather than seeking market dominance, while reducing burn rates and driving value-creating growth.

Overall, Tern remains committed to its long-term strategy to provide shareholders with access to returns as liquidity events are achieved, through full or partial exits at the appropriate time when shareholder value is maximised.

Tern investment strategy

Investment Sector

- Disruptive IoT tech
- In key new "Fourth wave" areas
- Artificial Intelligence
- VR/AR Immersive Tech /Metaverse
- Machine Learning
- Security (e.g. Cyber/Info)

Creating Value

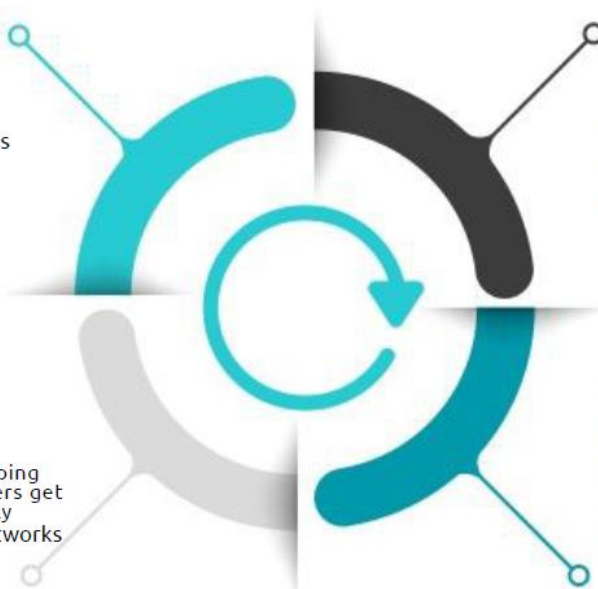
- Value Add through hands on approach
- Focused on helping and developing portfolio companies and Founders get to scaling industry metrics rapidly
- Leveraging our contacts and Networks

Investment Stage

- Initial investments at the Late Seed A round stage
- Lead deals at attractive valuations
- Bring in other leading VCs at scaling rounds at higher valuations and follow-on

Geography & Origination

- Focused on UK companies
- Experienced Leadership teams
- Tern team are based in London and Silicon Valley
- Data driven strategy used
- for origination across UK



Source: Company, Progressive Equity Research

Portfolio company highlights

Wyld Networks

Tern invested in Wyld Networks in June 2016 and held a 41.2% equity stake as at 31 December 2022. Wyld Networks started trading on NASDAQ First North in July 2021 following a successful IPO, which represents a phased exit from the business for Tern, with access to capital in the future. Tern realised £42.3k from sales of its holding in Wyld Networks in FY22.

Wyld Networks is a virtual satellite network operator that develops and delivers innovative wireless technology solutions that enable affordable connectivity for IoT devices and sensors anywhere in the world.

Following the commercial launch of its satellite IoT network in December 2022, Wyld has signed over 40 alliances and as at mid-May the purchase order backlog stands at a SEK 92m for its IoT module and data service, which is expected to begin to convert to revenue in 2023. This includes some large orders such as the recent SEK 12.6m four-year contract in the Middle East in the agriculture sector and a SEK 4m payment from the UK government for R&D activities.

As at the year-end, the valuation of Wyld Networks was £6.0m (FY21: £8.7m). The decrease was due to a reduction in market capitalisation of £3.0m, plus an exchange rate loss of £0.2m, offset by additional funding of £0.5m provided to exercise warrants in Wyld Networks.

Device Authority

Tern invested in Device Authority in September 2014, holding a 53.8% equity stake plus convertible loan of £0.4m and cashflow loan of £0.1m.

Device Authority is a global leader in Identity and Access Management (IAM), focused on automotive, medical and industrial sectors, enabling 'zero trust' security policies for the IoT. DA is making rapid progress in growing its revenue base through its modularised licence platform following the launch of KeyScaler 7.0, with contract wins in the UK, EU and US, as well as closing its first KeyScaler software as a service (KSaaS) and 'Edge' contracts. Recent wins have included a US\$1.2m five-year automotive supplier contract and US\$500k three-year contract with an energy provider.

In October 2022, Tern completed a US\$440k working capital funding in the form of unsecured convertible loan notes from Tern and other existing shareholders, including Venafi and Alsop Louie Partners. (Device Authority entered into a strategic partnership including a US\$1.25m investment from Venafi / Thoma Bravo in December 2021.)

As at the year-end, the valuation of Device Authority was £11.9m (FY21: £14.7m). The decrease was due to a net fair value reduction of £3.2m, including an exchange rate gain of £1.3m. This reduction was due to the changing sentiment surrounding technology valuations described earlier, and was offset by additional funding provided by Tern, of £0.4m via a convertible loan note. £0.1m of short-term loans is also outstanding.

Konektio (formerly InVMA)

Tern invested in Konektio in September 2017 and held a 36.8% equity stake, plus a convertible loan of £0.2m, as at 31 December 2022.

Konektio's AssetMinder is a modular, IoT SaaS platform, using a wide range of analytical tools and algorithms to connect whole factory floors and processes. Konektio is seeing strong growth for AssetMinder, releasing new modules in 2022, with good take up from new and existing customers. The business is entering an accelerated growth stage and has been restructured to expand its operational scale. We note Tern's hands-on management of the business with Mathew Scherba, a director of Tern, joining the Konektio executive team to aid development.

Post period-end, in April 2023, Konektio completed a small £0.3m equity fundraise with Tern investing £0.1m and the remainder coming from Konektio's existing institutional investors Mercia and Foresight (see our [note](#)). Konektio has also simplified its capital structure, with Tern converting £0.5m of loan notes into equity.

In May 2023, Konektio agreed a £2.5m equity fundraise, to be completed in two tranches: a first tranche of £1.2m (at approximately the same pre-money valuation as the April raise, with Konektio having increased its employee share option pool) and a second tranche of £1.3m due for completion in Q4 2023. Post the Konektio first tranche, Tern's shareholding has reduced to 28% (before dilution on exercise of any employee share options).

Tern has committed to invest a minimum of £0.28m in the second tranche, with an option to increase this to £0.4m. The price of the second tranche will be determined as at 30 September 2023 and will be capped at a pre-money valuation of £6.0m. Should Tern not invest the minimum of £0.28m in the second tranche, 75% of Tern's holding in Konektio will be transferred to a valueless class of Konektio deferred shares.

As at the year-end, the valuation of Konektio was £0.5m (FY21: £2.2m). The decrease was due to a fair value reduction of £1.9m with the pricing of the most recent equity fundraise in April 2023 taken into account, with £0.2m additional funding provided via a convertible loan note (CLN) to the company.

FundamentalVR

Tern invested in FundamentalVR in May 2018 and held a 16.6% equity stake as at 31 December 2022.

FundamentalVR is involved in immersive technology and haptics. Its Fundamental Surgery offering is the market-leading medical education and training platform, providing medical professionals with the opportunity to practice within a controllable space that is as close to real-life as possible.

FundamentalVR was the first of Tern's investee companies to achieve a Series B growth financing round in May 2022, supporting global deployment of its Fundamental Surgery platform. The first Series B round raised £7m at a 77% uplift.

As at the year-end, the valuation of FundamentalVR was £3.6m (FY21: £3.6m). The valuation increased due the conversion of an outstanding CLN of £0.6m and a fair value uplift based on the Series B funding in May 2022 described above. This fair value increase was then reversed with the most recent equity fundraise in April 2023, reflecting the change in sentiment regarding valuation metrics.

Talking Medicines

Tern invested in Talking Medicines in November 2020 and holds a 23.3% equity stake.

Talking Medicines' PatientMetRx is a social intelligence platform for the pharmaceutical industry that uses artificial intelligence (AI) and natural language processing (NLP) to provide insights through social data.

Talking Medicines is expanding the subscription base for PatientMetRx. During 2022 it redefined its market strategy to focus on larger advertising agencies that work on behalf of major pharma companies. Management believes this will lead to significant revenue growth in 2023.

As at the year-end, the valuation of Talking Medicines was £1.8m (FY21: £1.4m). The valuation has increased due to additional funding of £0.4m. The equity value remains unchanged taking into account the equity fundraise in January 2022.

Diffusiondata (formerly Push Technology)

Tern holds less than a 1% stake. Diffusiondata enhances the ability of organisations to communicate and distribute data in real-time. As at the year-end, the valuation was £0.02m (FY21: £0.02m).

Sure Valley Ventures UK Software Technology Fund

Tern holds less than a 1% stake. SVVUK is a relatively new UK venture capital fund, investing in software companies that are specialists in immersive technology and metaverse innovation, with a focus on augmented and virtual reality, artificial intelligence, the IoT and security. As at the year-end the valuation was £0.01m, with fair value provided by the SVVUK fund.

Growth drivers and value creation

Tern provides a unique proposition, creating value via access to disruptive start-ups not generally available to AIM investors. It operates a hybrid venture capital (VC) model, with all shareholders acting as effective Limited Partners. This business model change was actioned in February 2017 following the acquisition of Device Authority Inc. For more details, see our Spotlight note *A hybrid VC model to access the IoT opportunity*, 1 August 2022.

Although the latest down rounds can be seen as a setback for Tern, we believe that the market reaction reflects a lack of understanding about the model created by management and the group's long-term ability to create value from its portfolio.

Unlike in the traditional VC model, Tern provides more than just funding: it proactively supports the growth of its portfolio companies. In our view, Tern could be considered an 'evergreen' VC fund: open-ended, with no termination date, meaning capital can be raised, repaid or transferred on an ongoing basis. This model provides a very efficient use of capital, and Tern has an excellent track record of building value that attracts new investors at higher multiples. Evergreen funds have more flexibility and the ability to raise more capital, meaning that they can truly focus on long-term capital appreciation for investors.

Tern's management team has pivoted the company such that the business is squarely at the centre of the IoT opportunity, with a very focused investment management strategy. Although regular equity raises have the perception of being dilutive, the track record for Tern suggests that they have been accretive over time, with third parties supporting the placements. While we do not expect any near-term rebound in valuations, we believe that Tern remains well placed to help its portfolio through this phase of difficult macro conditions and potentially emerge stronger, with increased market share, as other early-stage technology companies are less capable of weathering the difficult economic climate.

Tern's model requires patience through difficult economic periods as exits are timed to maximise shareholder value. Against an extremely challenging macro backdrop, particularly for tech companies, Tern's underlying metrics are improving, driven by strong growth in annual recurring revenue. In our view, good things can come to those who wait.

Financial Summary: Tern

Year end: December (£m unless shown)

	2018	2019	2020	2021	2022
PROFIT & LOSS					
Revenue	0.1	0.1	0.2	0.1	0.1
Adj EBITDA	0.0	0.0	0.0	0.0	0.0
Adj EBIT	0.0	0.0	0.6	4.4	(10.5)
Reported PBT	(0.3)	(0.8)	0.8	4.6	(10.4)
Fully Adj PBT	(0.3)	(0.8)	0.8	4.6	(10.4)
NOPAT	(0.3)	(0.8)	0.8	4.6	(10.4)
Reported EPS (p)	(0.1)	(0.3)	0.3	1.3	(2.9)
Fully Adj EPS (p)	(0.1)	(0.3)	0.3	1.3	(2.9)
Dividend per share (p)	0.0	0.0	0.0	0.0	0.0
CASH FLOW & BALANCE SHEET					
Operating cash flow	(0.8)	(1.3)	(1.2)	(1.5)	(2.1)
Free Cash flow	(4.3)	(3.8)	(3.1)	(4.0)	(3.8)
FCF per share (p)	(2.0)	(1.5)	(1.0)	(1.2)	(1.1)
Acquisitions	0.0	0.0	0.0	0.0	0.0
Disposals	0.0	0.0	0.0	0.0	0.0
Shares issued	5.9	2.9	4.2	3.8	2.8
Net cash flow	1.6	(0.9)	1.1	(0.2)	(1.0)
Overdrafts / borrowings	0.0	0.0	0.0	0.0	0.0
Cash & equivalents	1.9	1.0	2.1	2.0	0.9
Net (Debt)/Cash	1.9	1.0	2.1	2.0	0.9
NAV AND RETURNS					
Net asset value	16.8	18.9	24.0	32.4	24.9
NAV/share (p)	7.7	7.5	8.3	9.2	6.4
Net Tangible Asset Value	0.0	0.0	0.0	0.0	0.0
NTAV/share (p)	0.0	0.0	0.0	0.0	0.0
Average equity	13.7	17.8	21.5	28.2	28.6
Post-tax ROE (%)	(2.3%)	(4.4%)	3.7%	16.2%	(36.5%)
METRICS					
Revenue growth	N/A	17.6%	21.5%	(57.9%)	3.5%
Adj EBITDA growth		N/A	N/A	N/A	N/A
Adj EBIT growth		N/A	N/A	638.0%	(338.9%)
Adj PBT growth		149.8%	(203.0%)	469.5%	(328.2%)
Adj EPS growth		119.2%	(189.2%)	382.8%	(319.0%)
Net asset value growth	N/A	12.9%	26.9%	35.1%	(23.3%)
NAV/share growth	N/A	(2.7%)	10.0%	11.6%	(30.6%)
VALUATION					
EV/Sales (x)	146.2	124.3	102.3	243.2	235.0
EV/EBITDA (x)	N/A	N/A	N/A	N/A	N/A
EV/NOPAT (x)	N/A	N/A	19.3	3.4	N/A
PER (x)	N/A	N/A	15.4	3.2	N/A
Dividend yield	N/A	N/A	N/A	N/A	N/A
FCF yield	(46.7%)	(35.8%)	(24.7%)	(27.6%)	(24.8%)

Source: Company information and Progressive Equity Research estimates

Disclaimers and Disclosures

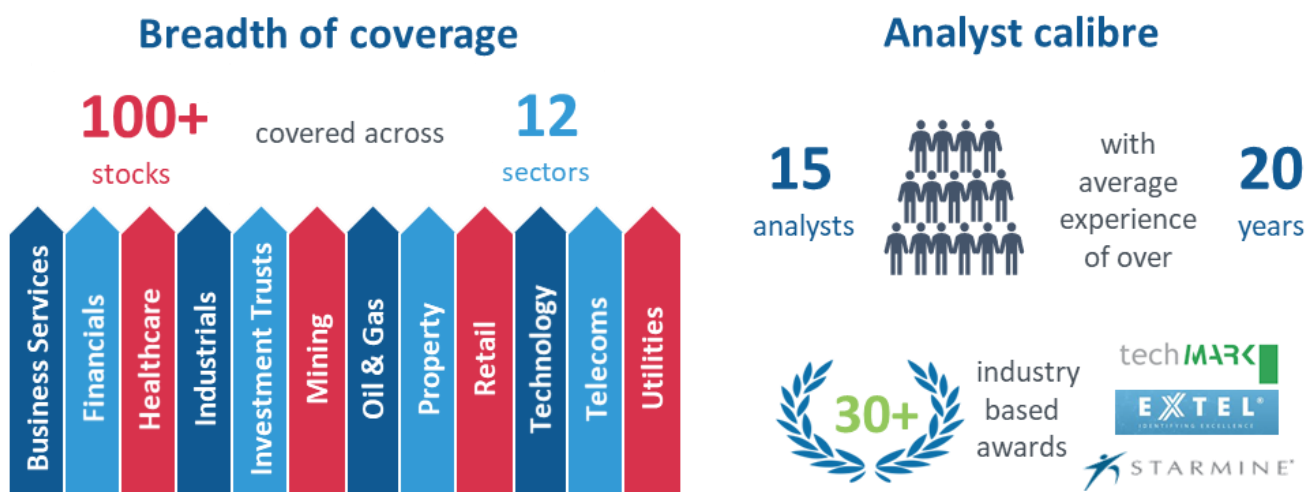
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