# TERN

## SOFTWARE AND COMPUTER SERVICES

**16 August 2023**

**TERN.L**

6.0p

Market Cap: £23.3m

**SHARE PRICE (p)**


| | |
|---|---|
| 12m high/low | 12.3p/3.5p |

*Source: LSE Data (priced as at prior close)*

| KEY DATA | |
|---|---|
| Net (debt)/cash | £0.7m *(at 30/06/23)* |
| Enterprise value | £22.6m |
| Index/market | AIM |
| Next news | Prelims, February |
| Shares in issue (m) | 388.6 |
| Chairman | Ian Ritchie |
| CEO | 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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# Further progress in H1 23

**Tern has delivered a solid set of first-half results against a challenging backdrop, with ARR up 43% year on year and other KPIs continuing to show an improvement. As flagged, valuations across the global technology landscape have been challenged due to risk appetite and long-term value expectations. Therefore, despite a significant improvement in metrics across Tern's portfolio, the valuation decreased to £21.8m (FY22: £23.9m). The portfolio is gaining commercial traction, highlighted by Wyld Networks' post-period agreement with SpaceX to explore areas of collaboration. During H1, Tern focused on supporting the growth and development of its existing portfolio, funded by cash realisations of its existing holding in Wyld Networks and a £0.5m loan. In a difficult environment for early-stage technology companies, we believe that Tern's 'hands on' funding-to-exit model can produce positive outcomes in the mid to long term.**

- **Restructuring.** Last week, Tern announced significant changes to its board and management structure, which, together with other measures, are expected to save 40% of central costs in FY24 vs FY22 (see our note). In our view, the new structure reflects the change in short-term emphasis to focus on existing portfolio companies through to near-term exit, while allowing a continued hands-on approach by experienced operators.

- **A decrease in valuation metrics across the global technology sector** has led to a further small reduction in the valuation of Tern's portfolio in H1 of £2.1m, reflecting £1.1m of additional investment, offset by £1.2m relating to the cash realisation on the sale of shares in Wyld and a £2m fair value loss. Therefore, assets under management at the year-end were £22.2m, an 11% decline from year-end (FY22: £24.9m).

- **KPIs are improving,** with aggregated annual recurring revenue (ARR) increasing 43% year on year in H1 23, coupled with 23% growth in employee numbers and a rise of 16% 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.

- **Tern's 'hands on' model has built value** and management is committed to generating returns through full or partial exits when shareholder value is maximised. Against a challenging macro backdrop, Tern's underlying metrics are improving. In our view, Tern's funding-to-exit model requires patience as it navigates economic difficulties. We see the strong recurring revenue growth attracting additional strategic interest and look forward to further positive newsflow on portfolio companies.

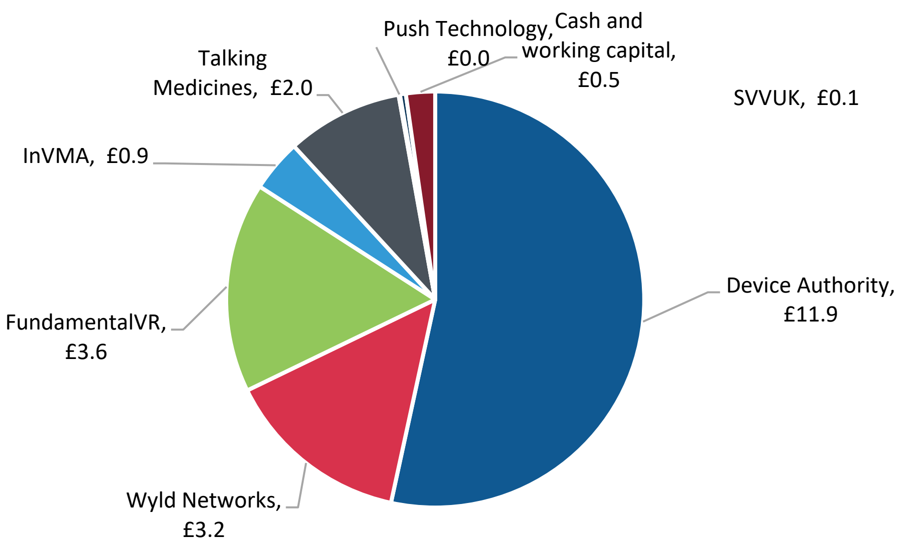
| FYE DEC (£M) | 2018 | 2019 | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|
| Revenue | 0.1 | 0.1 | 0.2 | 0.1 | 0.1 |
| Adj EBITDA | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Fully Adj PBT | -0.3 | -0.8 | 0.8 | 4.6 | -10.4 |
| Fully Adj EPS (p) | -0.1 | -0.3 | 0.3 | 1.3 | -2.9 |
| Net asset value | 16.8 | 18.9 | 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 | 21.7x | 4.5x | N/A |

*Source: Company Information and Progressive Equity Research estimates.*

## Financial highlights

Tern reported further significant progress in H1 across the portfolio, delivering growth in all key performance metrics. Aggregated annual recurring revenues (ARR) increased 43% in H1 23, coupled with a 23% rise in employee numbers and 16% growth in ARR per employee. The challenging backdrop for early-stage technology companies and global sell-off in technology stocks impacted Tern's portfolio valuation in H2 22, and this has continued into H1 23. The value of Tern's portfolio fell by £2.1m in H1 23, reflecting £1.1m of additional investment, offset by £1.2m relating to the cash realisation on the sale of shares in Wyld and a £2m fair value loss. Assets under management at the period-end were £22.2m, an 11% decline on the £24.9m reported at 31 December 2022, with NAV per share falling to 5.7p from 6.4p.

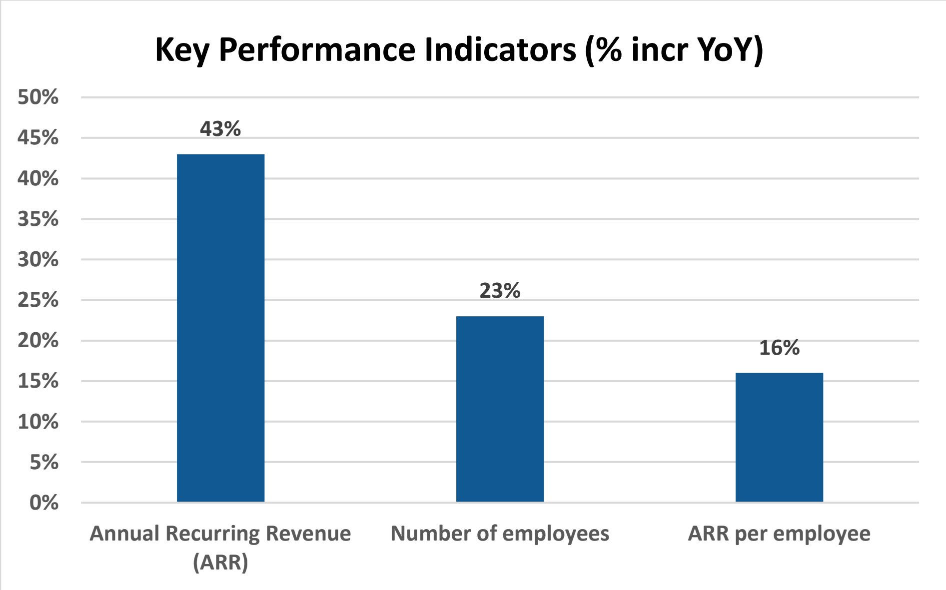
**Tern – NAV breakdown as at 30 June 2023 (£m)**




*Source: Company data, Progressive Equity Research*

Total comprehensive loss for H1 was £2.8m (H1 22: £2.4m loss), due to the fair value reduction. Operating costs reduced to £1.1m (H1 22: £1.2m), offset in part by revenue received following the secondment of Tern director, Matthew Scherba to Konektio. Audit fees and costs associated with the loan facility increased, but all other expenses remained flat. For H2 23, costs are expected to fall significantly following the announced board and management restructuring. The cash balance was £0.7m as at 30 June 2023 (H1 22: £0.3m). Tern negotiated a new funding facility in June 2023, with an investor to provide up to £3m (see our note), available for up to 36 months, with an initial £0.5m drawn down. Tern is currently unable to make further drawdowns until it has issued the required warrants under the terms of the loan facility.

**Tern KPIs, H1 23**




*Source: Company data, Progressive Equity Research*

## Portfolio highlights

**Device Authority** (53.8% holding, £11.9m NAV) – automates the provision of secure platforms for IoT devices, and has continued positive business momentum in H1 22. We understand that Device Authority has material growth in its monthly recurring revenues from its subscription base. Its modularised licence platform KSaaS (KeyScaler software as a service) is built on Microsoft's Azure Cloud and was awarded Microsoft's Rising Azure Technology 2023 Microsoft Partner of the Year.

The KeyScaler platform, focused on automotive, medical and industrial sectors enabling 'zero trust' security policies for the IoT, has been selected by several major enterprises, including a leading automotive business. We see further good demand driven by the recent White House Executive Order, which defines elements of the Software Bill of Materials (SBOM) to improve security. The fair value at £11.9m was flat on the year-end, and in H1 23 Tern has provided £0.3m of convertible loan notes to DA (£0.1m post period).

**FundamentalVR** (13% holding, reducing to 12.1% post-period, £3.6m NAV) – provides a software simulation environment allowing surgeons' accuracy to be measured objectively for the first time. Social distancing and the reduction in elective surgeries as a result of Covid have accelerated the adoption of FundamentalVR's solutions, and ARR continued to build in H1 23.

FundamentalVR recently attracted new investors to raise £7m in a Series B round at a much higher valuation, resulting in a 35% uplift to the year-end book value. This was followed by an additional £5m tranche of the Series B in early Q3 22. The fair value of Tern's shareholding remained flat on the year-end at £3.6m. The final tranche of third-party funding received by FundamentalVR post period end reduced Tern's equity ownership further, although the pricing of that tranche did not impact on valuation.

**Wyld Networks** (27% holding, £3.2m NAV) – was floated on the NASDAQ First North Growth Market in Stockholm in 2021. The IPO has also provided staged access to additional capital and a route to exit to maximise value for Tern shareholders.

Wyld's success following the commercial launch of its product in December 2022 continues apace. In mid-May 2023, it had a significant order backlog of SEK 92m ($8.7m). On 4 August, Wyld signed a potentially transformational deal with SpaceX to explore areas of collaboration, initially looking at remote connectivity in North, Central and South America.

SpaceX offers connectivity for broadband through Starlink (the largest satellite constellation using a low Earth orbit) and for IoT through Swarm. Wyld is already in partnership with Eutelsat Communications, TrakAssure and Senet. Wyld also plans to add 5G NB-IoT to its current LoRaWAN satellite IoT capability, which is estimated to increase Wyld's addressable market from $670m to $1.3bn by 2025.

As at 30 June 2023, the fair value of Tern's shareholding in Wyld Networks decreased to £3.2m (31 December 2022: £6.0m), primarily due to the disposal of shares in Wyld Networks (£1.2m) as well as a fair value decrease (£1.5m) driven by the quoted market price at the reporting date. The SpaceX deal has had a notable positive impact on Wyld's quoted market price post period.

**InVMA** (trading as Konektio, 28.3% holding, £0.9m NAV) – Konektio's Industrial IoT connected asset software as a service (SaaS) product, AssetMinder, is in ever-increasing demand from customers and it is continuing to build MRRs. AssetMinder assesses the effectiveness and efficiencies of entire operations, factory floors and processes, putting customers in control of their assets and therefore directly impacting productivity, efficiency and business outcomes.

In early 2023, Konektio released an energy monitoring and carbon tracking platform, AssetMinder Impact, to assist with savings across the most energy consuming manufacturing processes that use water, air, gas, electricity, and steam (WAGES). This release prompted a significant hire of a new Chief Technology Officer, Gareth McLaughlin.

In H1 23, Konektio raised £1.5m in Series A fund raisings from existing investors, with all outstanding convertible loan notes converted. Tern invested £0.2m and converted £0.5m of loan notes. A second tranche of £1.3m is due for completion in Q4 23, with Tern committing to a minimum of £0.28m, with an option to increase its investment up to £0.4m. If the minimum £0.28m is not fulfilled, 75% of Tern's holding in Konektio will be transferred to a valueless class of Konektio's deferred shares.

The fair value of Tern's shareholding increased to £0.9m as at 30 June 2023, compared with the year-end valuation of £0.5m.

**Talking Medicines** (23.8% holding, £2.0m NAV) – has developed a next-generation data platform, PatientMetRx, to deliver insights on patient experience for pharmaceutical drug brands. Talking Medicines has recently broken into the US market, which means, in our view, that it is too early to look for an exit as the company continues to build its US operation.

Its cloud-based SaaS service is driven by artificial intelligence models processing real-world data collection at a scale that is transformational versus traditional research. Already at the forefront of AI, Talking Medicines is well placed to take advantage of Large Language Models (LLMs) following the media attention given to the launch of Chat GPT by Open AI. Talking Medicines has launched Drug-GPT, which stands apart as a specialised 'Curated Large Language Model'.

The fair value of Tern's shareholding increased on the year-end valuation of £1.8m, due to additional investment from Tern of £0.2m in the form of a convertible loan note.

**Sure Valley Software Technology Fund** (5.9% holding, £0.1m NAV). In December 2022, Tern invested in the SVV fund, which looks to invest in private UK software companies in the metaverse, AI and cyber security sectors. Tern has committed up to £5m over the 10-year life.

SVV has investments in two companies so far, RETìníZE Limited, a creative tech company based in Belfast, and Jaid (t/a Opsmatix Limited), an innovative technology firm providing AI-powered human communication solutions.

**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 (FY22: £0.02m).

## 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. 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 may reflect 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 has pivoted the business to be 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.

## Financial Summary: Tern

**Year end: December (£m unless shown)**

| **PROFIT & LOSS** | **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 |
| 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** | **2018** | **2019** | **2020** | **2021** | **2022** |
| 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** | **2018** | **2019** | **2020** | **2021** | **2022** |
| 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** | **2018** | **2019** | **2020** | **2021** | **2022** |
| 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** | **2018** | **2019** | **2020** | **2021** | **2022** |
| EV/Sales (x) | 213.1 | 181.3 | 149.2 | 354.6 | 342.6 |
| EV/EBITDA (x) | N/A | N/A | N/A | N/A | N/A |
| EV/NOPAT (x) | N/A | N/A | 28.1 | 4.9 | N/A |
| PER (x) | N/A | N/A | 21.7 | 4.5 | N/A |
| Dividend yield | N/A | N/A | N/A | N/A | N/A |
| FCF yield | (33.1%) | (25.3%) | (17.5%) | (19.6%) | (17.6%) |

*Source: Company information and Progressive Equity Research estimates*

16 August 2023

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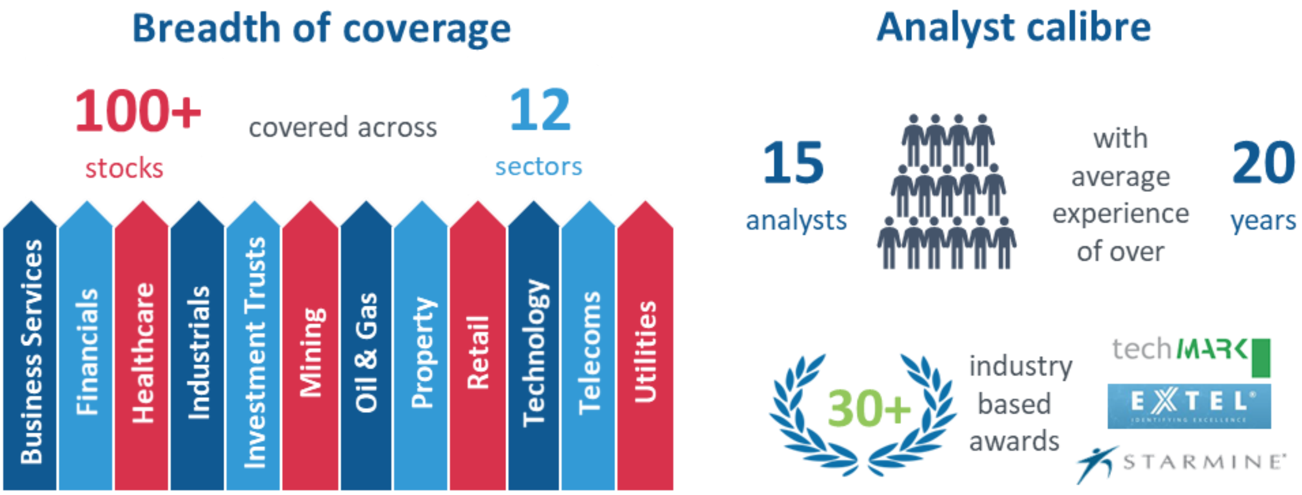


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