

5 August 2021

Technology



Source: Refinitiv

Market data

EPIC/TKR	CYAN.L
Price (p)	12.00
12m High (p)	14.50
12m Low (p)	1.25
Shares (m)	219.98
Mkt Cap (£m)	26.4
EV (£m)	24.3
Free Float*	70%
Country of listing	UK
Market	AIM

*As defined by AIM Rule 26

Description

CyanConnode is a leading global vendor of intelligent communications solutions, bringing together narrowband RF mesh and cellular technologies, and the Internet of Things (IoT), to create a highly scalable platform for transmission, collection and analysis of data. The company is headquartered in Cambridge, UK, with offices in India and Sweden. To date, it has spent in excess of \$50m on developing its technology platform, on which more than 1.5m endpoint nodes have been implemented globally. At the end of March 2020, total headcount stood at 48 employees, of which 10, or 21%, were women.

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CYANCONNODE

Major new contracts in India and Africa

CyanConnode has this week announced two major new orders, one in India, for 152,000 smart meter modules, and the other in Africa for 100,000 modules. Both are plus associated gateways, software licences and maintenance for full Advanced Metering Infrastructure (AMI). In India, the customer is a new one for CyanConnode, while the prime contractor is Schneider Electric (Schneider), one of the largest global manufacturers of infrastructure platforms. The details of the African contract remain confidential. 80%-90% of revenue for both contracts is expected to be recognised in the first two years, leading to upgrades to our FY'22 estimates.

- **Major AMI deployments:** Delivery of the modules for each contract will commence in 3Q'21. While the contract values are not disclosed, AMI encompasses a large element of software across the head-end system (HES) and analytics software, both of which are high-margin elements and recognisable on delivery.
- **India:** The end-customer utility is in Northern India, a new region for CyanConnode, whose strong relationships with the state-sponsored entities (EESL and Intellismart) and the main prime contractors bode well. We estimate that more than 80% of the planned rollout of 250m meters has yet to be placed under contract.
- **Schneider Electric:** Schneider entered the Indian market segment through the acquisition of Larsen & Toubro's electrical and automation business, which was completed in August 2020. Schneider should be comfortable selling large AMI platform deals, and the contract appears to be an example of this.
- **Africa:** The details of the contract and customer are undisclosed for reasons of commercial confidentiality. The power distribution networks in many African countries are in desperate need of efficiency improvements and reduced leakage. CyanConnode's highly resilient technologies are well suited to the region.
- **Investment summary:** Our updated revenue estimate for FY'22 (to end-March) of £9.3m is based largely on existing contracts, including these latest major wins. CyanConnode remains in discussions for new contracts in several existing and new markets, and we anticipate additional new contracts that will contribute to FY'22 financials and beyond. Our DCF-implied equity fair value is £83.0m, compared with the current market capitalisation of £26.4m.

Financial summary and valuation

Year-end Mar (£m)	Dec'18	Mar'20*	2021E	2022E	2023E
Revenue	4.47	2.45	6.20	9.28	18.83
Reported EBITDA	-5.85	-5.46	-1.92	-0.65	3.07
EBITDA margin	-131%	-223%	-31%	-7%	16%
Adjusted EBIT	-5.28	-5.69	-2.28	-0.93	2.82
Adjusted pre-tax profit	-5.27	-5.70	-2.49	-0.84	2.92
Net income	-4.34	-5.13	-1.89	-0.22	3.55
EPS (p)	-3.71	-2.96	-1.09	-0.10	1.62
EV/revenue (x)	5.4	9.9	3.9	2.6	1.3
EV/EBITDA (x)	-4.2	-4.5	-12.6	-37.1	7.9
P/E (x)	-3.2	-4.0	-11.0	-118.3	7.4

*15 months to Mar'20 (due to year-end change); Source: Hardman & Co Research

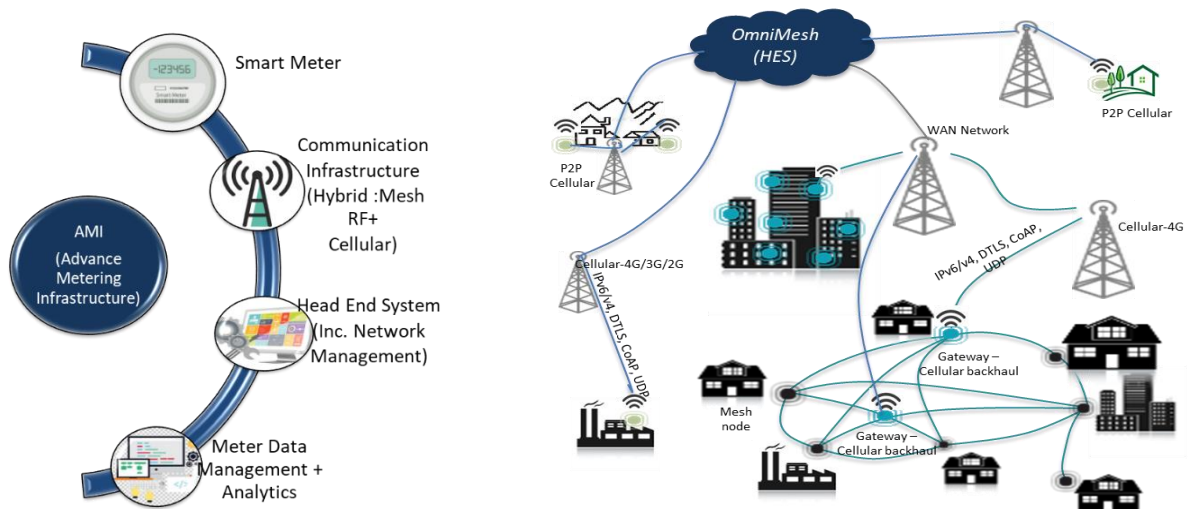
Advanced Meter Infrastructure (AMI)

Within its portfolio, CyanConnode has full capabilities for RF mesh technology and cellular 2G to 5G, including narrowband IoT, and powerline communications. All of these communications technologies can be connected to the same HES, which is also provided by CyanConnode. The HES is where the data are collected and then sent on to a data management system, which will be managed by the utility.

AMI is an integrated system of smart meters, communications networks and data management systems that enables two-way communication between utilities and customers. With AMI, not only can meters be read automatically, but instructions can be sent to the meter from a central point – which might be to disconnect (for example, if a bill has not been paid) or to update time-based pricing data to manage consumption. The information collected from smart meters can be processed in real time, and signals can be sent to manage demand. These systems are widely acknowledged to offer substantial potential benefits, many of which are central to the highly positive returns on investment associated with smart meter implementations.

CyanConnode offers a comprehensive platform that covers the AMI from the meter endpoint through to the Meter Data Management System (MDMS), which is procured and managed by the utility, and stores the huge quantities of data generated by the smart meter network.

CyanConnode's AMI and Omnimesh IoT networks



Source: Company data

Smart meters in Africa

As in many developing regions, the power infrastructure in Africa generally is creaking. Even in South Africa, the main utility is in relative disarray, leaving the country vulnerable to power shortages and repeated periods of downtime. From an economic development and foreign investment perspective, this situation is untenable across the continent, and governments are responding by starting to put in the place the building blocks for more modernised power generation and distribution infrastructures. Smart meters are widely acknowledged to be a key part of these initiatives given the successful case studies that have emerged around the world demonstrating reduced revenue losses and power theft, improved efficiency and more usage predictability.

As might be expected, there is limited coordination across countries and, consequently, there are few standards or legal frameworks specific to smart meters. However, these are starting to emerge – sophisticated and experienced technology providers able to showcase successful implementations are likely to find favour with decision-makers. In this respect, CyanConnode is well positioned with a technology portfolio ideally suited to handle both urban and rural environments with its combination of expertise in RH mesh and cellular networks.

CyanConnode has formed a number of partnerships to address various regions in the EMEA market and we expect more news flow on this front over the next 12 to 18 months. CyanConnode is also engaging directly with some end customers, as the latter seek to understand how to achieve large-scale rollouts. In our view, the contract win, just announced in Africa, is likely to be the first of many. To put matters into context, the total population of Africa is around 1.38bn people, similar to the total population of India. There are of course structural differences starting with the fact that the African population is across 54 different countries. However, the addressable market in Africa, in principle, should be similar, at 250m smart meters, if not more. Funding mechanisms will be a key consideration in Africa. We have written in the past about smart meters-as-a-service, where the upfront capex is funded by infrastructure funds and essentially rented to the end customer.

Revenue model

The table below sets out our revenue estimates for FY'22 and FY'23. Our revised revenue estimate for FY'22 of £9.3m represents a 6% uplift versus our previous estimate of £8.8m, resulting from the new contract announcements in India and Africa. We are not adjusting our FY'23 revenue estimate at this stage, but we are already anticipating a doubling of revenue in FY'23E, based on a sharp uptick in the number of modules shipped. The recent announcements from the company are consistent with our expectation of a growing pipeline over the next 12 months.

CyanConnode: revenue model									
Year-end Mar (£000)	1H'21	2H'21E	2021E	1H'22E	2H'22E	2022E	1H'23E	2H'23E	2023E
Modules shipped	92,000	320,500	412,500	210,000	390,000	600,000	540,000	780,000	1,320,000
Contract val. per endpoint (\$)	28.40	27.60	28.00	28.00	28.00	28.00	26.00	26.00	26.00
£/\$ exchange rate	1.35	1.43	1.44	1.39	1.39	1.39	1.40	1.40	1.40
Contract val. per endpoint (£)	20.9749	19.2563	19.0000	20.1439	20.1439	18.0000	18.5714	18.5714	18.5714
Total shipped contract value	1,930	6,172	8,101	4,230	7,856	12,086	10,029	14,486	24,514
Hardware proportion	60%	60%	60%	60%	60%	60%	60%	60%	60%
Hardware revenue recognised	1,158	3,703	4,861	2,538	4,714	7,252	6,017	8,691	14,709
Software proportion	11%	11%	11%	11%	11%	11%	11%	11%	11%
Total software revenue	212	679	891	465	864	1,329	1,103	1,593	2,697
Services and maintenance revenue proportion	29%	29%	29%	29%	29%	29%	29%	29%	29%
– recognised in the period	23%	18%	20%	20%	20%	20%	20%	20%	20%
Services revenue recognised	129	322	451	245	456	701	582	840	1,422
Total revenue for the period	1,499	4,704	6,203	3,249	6,033	9,282	7,702	11,125	18,827

Source: Hardman & Co Research

Valuation

Our approach to understanding the potential valuation of CyanConnode centres on a DCF analysis. Our assumptions are set out in their entirety in the table below, and are relatively conservative, particularly the WACC of 10.9% and the medium-term revenue profile, given the international pipeline of opportunities.

The analysis produces an implied fair enterprise value of £80.9m and an implied fair equity value of £83.0m (equating to £0.38 per share). These valuation outcomes are materially higher than the current enterprise value of £24.3m and market capitalisation of £26.4m.

CyanConnode – Hardman & Co DCF analysis

Key inputs

Terminal FCF growth rate	3.0%
Long-term sustainable EBIT margin	28.0%
Long-term tax rate on EBIT	20.0%
WACC	10.9%

Y/end March, £m	2021E	2022E	2023E	2024E	2025E	2026E	2027E	2028E	2029E	Terminal value
Revenues	6.2	9.3	18.8	24.5	31.1	38.9	46.6	52.2	54.8	
yoy growth	2.7%	49.6%	102.8%	30.0%	27.0%	25.0%	20.0%	12.0%	5.0%	
EBIT margin	-36.8%	-10.0%	15.0%	22.0%	23.5%	25.0%	26.0%	27.0%	28.0%	
EBIT	-2.3	-0.9	2.8	5.4	7.3	9.7	12.1	14.1	15.4	
Depreciation & amortisation	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.7	0.7	
Adj. EBITDA	-1.7	-0.4	3.4	6.0	7.9	10.3	12.8	14.8	16.0	
Tax rate	0.0%	0.0%	5.0%	10.0%	15.0%	20.0%	20.0%	20.0%	20.0%	
Tax on EBIT	0.0	0.0	-0.1	-0.5	-1.1	-1.9	-2.4	-2.8	-3.1	
Change in net working capital	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	
Cashflow from operations	-2.2	-0.9	2.7	4.9	6.3	7.9	9.8	11.4	12.5	
Capex	-0.2	-0.2	-0.3	-0.3	-0.4	-0.5	-0.6	-0.7	-0.9	
Unlevered free cashflow	-2.4	-1.1	2.5	4.6	5.9	7.4	9.2	10.7	11.6	146.9
Year	1	2	3	4	5	6	7	8	9	10
Discount factor	1.11	1.23	1.36	1.51	1.68	1.86	2.06	2.29	2.54	2.54
Present value	-2.1	-0.9	1.8	3.0	3.5	4.0	4.5	4.7	4.6	57.9

Note: based on medium-term assumptions from 2024E

Implied valuation metrics	£m
Sum of 9-year cashflow	23.1
Terminal value	57.9
Value of the firm	80.9
Net funds	2.1
Total equity value	83.0
No. of shares in issue (m)	220.0
Fair value share price (£)	0.38

Source: Hardman & Co Research estimates

Profit and loss

CyanConnode P&L								
Year-end Mar (£000)	12m Dec 2017	12m Dec 2018	6m Jun 2019	15m Mar 2020	1H'21	2021E	2022E	2023E
Revenue	1,171	4,465	1,014	2,451	1,499	6,203	9,282	18,827
Cost of sales	-674	-1,724	-537	-1,081	-668	-3,194	-5,105	-10,731
Gross profit	497	2,741	477	1,370	831	3,008	4,177	8,096
Gross margin	42%	61%	47%	56%	55%	49%	45%	43%
Operating expenses	-11,161	-8,589	-3,386	-6,827	-2,148	-4,930	-4,831	-5,025
EBITDA	-10,664	-5,848	-2,909	-5,457	-1,317	-1,922	-654	3,071
Share-based payments	-689	-445	-107	-267	-130	-200	-300	-320
Stock impairment	-55	-578	0	-4	0	0	0	0
Foreign exchange losses	-52	-16	-115	-267	-71	-71	0	0
Adjusted EBITDA	-9,868	-4,809	-2,687	-4,919	-1,116	-1,651	-354	3,391
EBITDA margin	-911%	-131%	-287%	-223%	-88%	-31%	-7%	16%
Depreciation & amortisation	-489	-472	-235	-772	-305	-630	-576	-570
EBIT	-11,153	-6,320	-3,144	-6,229	-1,622	-2,552	-1,230	2,501
Adjusted EBIT	-10,357	-5,281	-2,922	-5,691	-1,421	-2,281	-930	2,821
Adjusted EBIT margin	-884%	-118%	-288%	-232%	-95%	-37%	-10%	15%
Investment income	16	13	10	17	1	2	2	2
Net finance income	-6	-2	-2	-30	-102	-210	84	92
Adjusted PBT	-10,347	-5,270	-2,914	-5,704	-1,522	-2,489	-844	2,915
Taxation/tax credit	1,402	927	300	576	377	603	621	640
Effective tax rate	-14%	-18%	-10%	-10%	-25%	-24%	-74%	22%
Net income	-8,945	-4,343	-2,614	-5,128	-1,145	-1,885	-223	3,555
EPS (basic, p)	-10.18	-3.71	-1.51	-2.96	-0.66	-1.09	-0.10	1.62
EPS (diluted, p)	-10.18	-3.71	-1.51	-2.96	-0.66	-1.09	-0.10	1.62
Average shares in issue (basic, m)	95.740	116.976	172.931	173.048	173.548	173.548	219.984	219.984
Average shares in issue (dil., m)	95.740	116.976	172.931	173.048	173.548	173.548	219.984	219.984

Source: Hardman & Co Research

Balance sheet

CyanConnode balance sheet						
@31 Mar (£000)	12m Dec 2018	15m Mar 2020	1H'21	2021E	2022E	2023E
Non-current assets						
Intangible assets	5,048	4,558	4,365	4,170	3,736	3,255
Goodwill	1,930	1,930	1,930	1,930	1,930	1,930
Fixed asset investments	44	93	91	91	91	91
Property, plant and equipment	73	43	41	30	21	15
Right of use asset	0	274	196	94	0	0
Total non-current assets	7,095	6,898	6,623	6,315	5,778	5,290
Current assets						
Inventories	319	308	304	930	1,207	1,883
Trade and other receivables	4,827	3,676	3,863	1,799	1,856	2,824
Cash and cash equivalents	4,563	1,172	952	1,508	3,882	6,247
Total current assets	9,710	5,156	5,119	4,237	6,945	10,954
Total assets	16,805	12,054	11,742	10,552	12,723	16,244
Current liabilities						
Short-term borrowing	-1,994	-560	-785	-785	0	0
Trade and other payables	0	-1,491	-2,157	-1,489	-1,856	-1,883
Lease liability	0	-121	-131	-90	-50	-14
Total current liabilities	-1,994	-2,172	-3,073	-2,364	-1,906	-1,897
Net current assets	7,716	2,984	2,046	1,874	5,038	9,057
Non-current liabilities						
Lease liability	0	-153	-65	-65	-25	-1
Deferred tax liability	-690	-912	-853	-853	-853	-853
Total non-current liabilities	-690	-1,065	-918	-918	-878	-854
Total liabilities	-2,684	-3,237	-3,991	-3,282	-2,784	-2,751
Net assets	14,121	8,817	7,751	7,271	9,939	13,494
Equity						
Share capital	3,648	3,656	3,666	3,666	3,666	3,666
Share premium account	69,515	69,547	69,556	69,556	72,506	72,506
Own shares held	-3,253	-3,253	-3,253	-3,253	-3,253	-3,253
Share option reserve	1,761	2,028	2,158	2,158	2,158	2,158
Translation reserve	-76	-20	111	111	111	111
Retained losses	-57,474	-63,141	-64,487	-65,026	-65,250	-61,695
Total equity attributable to owners	14,121	8,817	7,751	7,271	9,938	13,493

Source: Hardman & Co Research

Cashflow

CyanConnode cashflow						
Year-end Mar (£000)	12m Dec 2018	15m Mar 2020	1H'21	2021E	2022E	2023E
Operating loss for the period	-6,320	-6,229	-1,622	-2,552	-1,230	2,501
Depreciation of property, plant and equipment	51	247	95	200	103	50
Amortisation of Intangible assets	421	526	210	430	473	520
Foreign exchange	55	59	71	71	0	0
Share-option payment expense	445	267	130	275	91	64
Op. cashflows pre-movements in work. cap.	-5,348	-5,131	-1,116	-1,576	-563	3,135
Decrease/(increase) in inventories	809	11	4	-622	-276	-676
Decrease/(increase) in receivables	-2,377	1,124	-79	1,877	-58	-968
Increase/(decrease) in payables	-253	-503	666	-2	368	26
Cash reduction from operating activities	-7,169	-4,499	-525	-323	-530	1,517
Income taxes or tax credit received	1,326	822	150	603	621	640
Net cash outflow from op. activities	-5,843	-3,677	-375	280	92	2,157
Investing activities						
Interest received	13	17	1	2	2	2
Purchases of property, plant and equipment	-41	-20	-11	-24	-49	-56
Capitalisation of software development	0	-36	-20	-42	-40	-39
(Purchase)/disposal of investments	4	-49	0	0	0	0
Net cash used in investing activities	-24	-88	-30	-64	-87	-93
Financing activities						
Interest paid	-2	-4	-24	-210	84	92
Capital repayments of lease liabilities	0	560	-33	-119	-80	-60
Cash inflow from borrowings	0	-197	225	225	0	0
Interest paid on lease liabilities	0	-26	-3	-6	-4	-1
Proceeds on issue of shares	5,467	40	20	20	2,950	0
Share issue costs	-428	0	0	0	0	0
Net cash from financing activities	5,037	373	185	120	2,866	-61
Net change in cash and cash equivalents	-830	-3,392	-220	336	2,871	2,003
Cash and cash equivalents at beg. of period	5,394	4,564	1,172	1,172	1,508	4,379
Cash and cash equivalents at end of period	4,564	1,172	952	1,508	4,379	6,382

Source: Hardman & Co Research

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