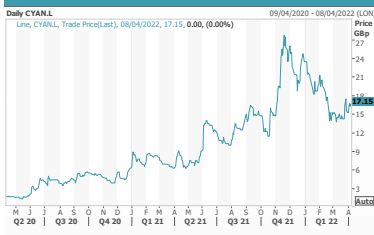




11 April 2022

Technology



Source: Refinitiv

Market data

EPIC/TKR	CYAN
Price (p)	17.2
12m high (p)	29.9
12m low (p)	1.55
Shares (m)	236.3
Mkt. cap (£m)	40.5
EV (£m)	37.5
Free float*	100%
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 2.6m endpoints have been delivered globally. At the end of March 2021, total headcount stood at 54 employees, of which 11, or 20%, were women.

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CYANCONNODE

New contract, fundraising and Indian developments

CyanConnode is awaiting news with respect to the first large tranche of smart meter contracts in India, for which it is an established supplier of intelligent communications modules. In the meantime, contract wins in other markets continue; for example, this week's announcement of a win in the Middle East and North Africa (MENA) region, which we expect has a multi-million pound value. The recent fundraising of £2.0m gross saw strong investor support – this was a growth-centric initiative as the new funds will be primarily used to fund inventory of components in short supply and/or have longer lead times. Our DCF-implied fair equity value is £91.4m compared with the current market capitalisation of £40.5m.

- ▶ **Major new contract win:** A new contract in the MENA region for electricity and water meters will see the deployment of CyanConnode's cellular communications hubs to connect up to 1m existing meters to central infrastructure. We expect this high-profile deployment to be a multi-million pound contract in total.
- ▶ **Indian opportunity remains firmly on track:** Benefiting from renewed momentum stemming from Government initiatives, over 40m meters are currently out for tender, with awards for most expected by year-end. The emphasis is on vendors with proven, end-to-end technologies, boxes that CyanConnode clearly ticks. CyanConnode India has deployed over 1.1m smart meters and is profitable.
- ▶ **State elections yield favourable outcome:** Uttar Pradesh has been a leader in smart meter rollouts from the outset. This week saw the re-election of the ruling BJP party in the state, which is currently tendering for close to 27m meters, making continuity critical. The BJP also won in three other significant state elections.
- ▶ **Successful fundraising to scale inventory and production:** CyanConnode recently raised £2.0m gross through a placing of 14.3m new shares at £0.14, a discount of only 1.8% to the previous close due to oversubscription. The news triggered a positive market response with stock up 16% in choppy markets.
- ▶ **Investment summary:** The coming 12 months will be a key period for CyanConnode as the 40m or so meters out for tender are awarded. The company is working with many bidders and its prospects of winning a solid share are strong. In the meantime, management is wisely scaling up key aspects of the business. Our DCF-implied fair equity value for CyanConnode is £91.4m (£0.39 per share), vs. the current market capitalisation of £40.5m.

Financial summary and valuation

Year-end Mar (£m)	Mar'20*	2021	2022E	2023E	2024E
Revenue	2.45	6.44	9.28	18.83	24.46
Reported EBITDA	-5.46	-2.18	-1.00	2.71	4.67
EBITDA margin	-223%	-34%	-11%	14%	19%
Adjusted EBIT	-5.69	-2.69	-1.28	2.46	4.50
Adjusted pre-tax profit	-5.70	-2.73	-1.26	2.48	4.53
Net income	-5.13	-2.06	-0.56	2.29	3.99
EPS (p)	-2.96	-1.18	-0.25	1.04	1.81
EV/revenue (x)	17.3	6.6	4.6	2.3	1.7
EV/EBITDA (x)	-7.8	-19.5	-42.4	15.7	9.1
P/E (x)	-6.7	-16.9	-78.8	19.3	11.0

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

Investment highlights

When considered cumulatively, the news flow relating to CyanConnode is quite positive. A financial trajectory consistent with the guidance set out for FY'22 and FY'23, contract wins in major new regions, and a successful fundraising intended to assist with the scaling up the supply chain and working capital in the face of major contract wins. This careful execution by management is welcome against a backdrop of global uncertainty and volatility as a consequence of the Covid pandemic and then the war in Ukraine. Overall, there is much to play for over a range of time periods, noting that, beyond the current focus on smart meters, the long-term opportunities for CyanConnode with respect to smart cities around the world are potentially immense.

An FY'22 trading update for the 12 months to end-March 2022 is expected before the end of April. We expect confirmation that the outturn for last year was at least in line with market expectations and guidance for FY'23 will be provided. The significant deal announced this week in the Middle East and Africa region should make a significant revenue contribution in FY'23 given that we infer the value to CyanConnode to be several million pounds, based on the number of aggregation hubs required to cover up to one million meter endpoints.

Contract awards for the majority of the c.40m meters out for tender in India are expected by the end of calendar 2022. As a vendor of end-to-end solutions with proven efficacy and resilience, we continue to expect CyanConnode to fare well despite the inevitably twists and turns associated with these types of immense procurement exercises. The largest constituent of the current tenders is Uttar Pradesh, the largest state in India, which we understand represents c.27m of the c.40m meters currently out for tender. The re-election of the ruling BJP party in the state is, in our view, positive for future momentum in smart meter rollouts.

India remains the focus for 2022/23

The star of the global smart meter show remains the Indian Programme, which is seeking to replace some 250m meters. Progress, to date, has been modest, but the Government is implementing a range of measures to accelerate contract awards and deployments. Some 40m meters are out for tender currently with further tenders pending. Among the cast list of suppliers, CyanConnode stands out as a vendor of intelligent connectivity modules that has a number of large-scale successful installations under its belt with a range of meter manufacturer partners. The partner roster continues to grow, as the EPCs join the fray as prime contractors.

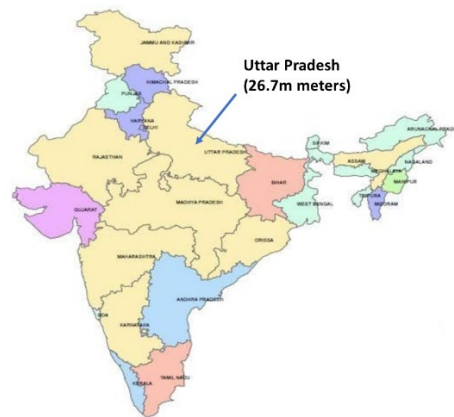
New financing models that seek to alleviate the short-term financial burden on utilities are coming to the fore, allowing utilities to lease smart metering infrastructure for several years before eventually taking ownership of these assets. These opex models are, in our view, a critical component of the efforts to accelerate progress given that the distribution companies (Discoms) are, in many cases, struggling financially due to the sheer scale of their financial losses and inefficiencies.

Amid this intensifying activity, the potential win rate for CyanConnode inevitably remains tricky to predict. These are complex projects, with a growing number of participants (most of which will be partners with CyanConnode rather than competitors to it) and many moving parts. Assuming a 15% win rate (which could prove to be an overly conservative assumption), the current tenders, in aggregate, have a potential intelligent module contract value (over five to 10 years) of well over \$100m. These tenders account for only 15% of the total programme. Under the revamped Government smart meter scheme and objectives, the first phase requires almost 100m smart meters to be installed and commissioned by December 2023.

Potentially positive developments in Uttar Pradesh

From the outset of the Indian Smart Meter Programme, Uttar Pradesh has been one of the more proactive states with respect to rollout of smart meters. It is the most populous state in India, with a population of more than 200m, and the fourth-largest state in terms of land area. The outcome of the elections in Uttar Pradesh in recent days is, we believe, positive for the smart meter programme in that state. The chief minister, Yogi Adityanath, is the first incumbent in the state history to be elected for a second consecutive term. We have seen disruptions from state elections in the past, so this is positive news and points to seamless continuation of the smart meter rollouts in Uttar Pradesh. Of the c.40m smart meter tenders out in the market today, our understanding is that around 27m are for the state of Uttar Pradesh. While there will be several separate blocks of contract awards within this overall tally, the extent to which these tenders are successfully completed will be an important determinant of the pace of progress of the current phase of the programme.

India: Uttar Pradesh is a key state in current smart meter tenders



Source: Hardman & Co Research

Important contract win in Middle East/Africa region

This week's announcement of a substantial contract win in a new region for CyanConnode confirms that activity levels remain buoyant across the smart meter industry globally. The contract is for both electricity and water meters and entails the deployment of CyanConnode's cellular communications platform to connect meters to central infrastructure. The hubs being deployed will handle up to 1m smart meters. Based on typical pricing, we expect this to be a multi-million-pound contract for CyanConnode cumulatively over the next two to three years. The hardware element will be paid upfront, while the maintenance element will be deferred over the lifetime of the contract. Details of the customer remain confidential. However, it is noteworthy that it is only hubs that are being deployed.

Validation of CyanConnode's cellular technologies

The new MENA deal is compelling from a technology perspective. The announcement notes that the data transmission technology being deployed is cellular. Traditional cellular options, such as 4G and LTE networks, consume too much power. They are also less suited to applications where only a small amount of data is transmitted infrequently; for example, meters for reading gas, electricity or water consumption. CyanConnode is an acknowledged leader in narrowband RF Mesh technologies and this contract is strong validation of the company's capabilities in narrowband cellular technologies. As we discussed in our previous research reports on CyanConnode,

the long-term opportunity in Machine to Machine (M2M) communications and IoT is immense, as these technologies enable utilities, enterprises and entire cities to manage their assets, operations and environment more optimally.

Rationale for recent fundraising is growth-centric

The Indian programme together with the additional contract wins that continue to come through in the Far East and MENA are creating a step change in CyanConnode's production requirements. This is happening at a time when supply chain continuity is a major challenge in the face of global silicon shortages. Finding additional suppliers is not straightforward as, in the absence of a longstanding customer relationship, they will seek to protect themselves by requesting significant upfront payments in the early stages. This is in contrast to the 45- to 90-day payment terms that may be extended by existing suppliers. The need to create depth and breadth in the supply chain is a cash-consumptive process and is a key driver of the recent fundraising. Another factor is the previous payment triggers built into the early smart meter contracts in India, based on a range of milestones, some of which are evidently beyond CyanConnode's control. Nonetheless, payments from Indian against receivables continue to be made. The company is amending terms of newer contracts to allow payments to be made based on time periods and specific dates, which will assist with predictability of cashflows.

Combined with the inventory build-up required to meet existing orders, there was a cash outflow in 2Q'22, resulting in a period-end net cash position of £1.1m (with a further £0.4m received shortly after the end of December 2021), compared with £1.7m at the end of September 2021. This is after cash collections of £5.9m in the period. Trade debtors related to Indian contracts at the end of 2Q'21 stood at £5.5m, of which at least £3m is expected to come in during 4Q. The mix of shipments is relevant here, as payments for gateways (typically one per 250 modules) are usually based on delivery and implementation milestones being achieved, whereas meter modules are invoiced as shipped. Gateways are a larger element towards the end of a phase of a contract, and this has been the case in the latest quarter: 3,100 gateways were delivered in the first nine months of FY'22, compared with only 200 in the same period last year. In the context of the new opex models, in general, there appears to be appreciation that, as a small technology vendor, CyanConnode cannot sustain a fully deferred revenue model at this juncture, resulting in agreement to pay a significant proportion upfront, at least the hardware element. Maintenance and support revenue streams are likely to be deferred across all delivery models.

On track to meet FY'22 estimates

Against market opportunities that offer substantial potential but have been characterised by delays and complexity, CyanConnode's conservative approach is enabling the company to meet its financial guidance. Revenue for the first nine months was £6.8m, double the outturn for the same period in FY'21.

For FY'22, the expected revenue increase, based on our unchanged estimates, is £9.3m. Our calculation includes only the hardware element of the modules, which would be paid for following delivery. The value of orders currently being deployed by CyanConnode in India is c.INR1.8bn (c.£19m).

CyanConnode: financial summary

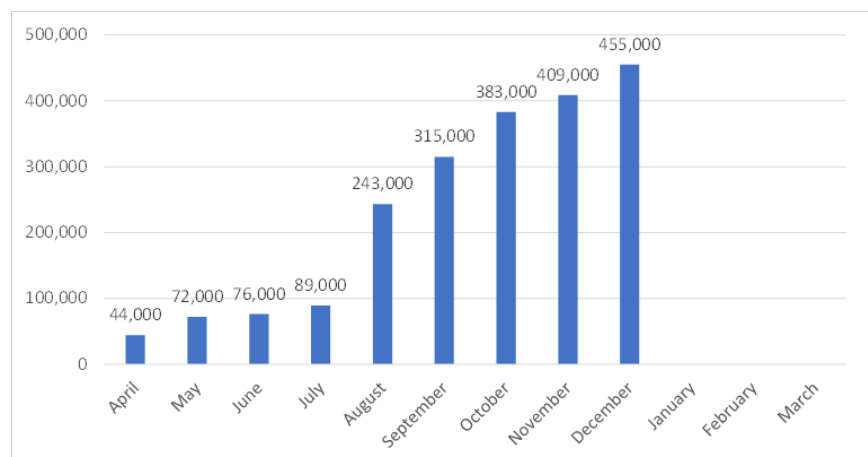
Year-end March (£m)	15M Mar 2020	2021	2022E	2023E	2024E
Revenue	2.45	6.44	9.28	18.83	24.46
<i>yoy growth</i>	-	163%	44%	103%	30%
EBITDA	-5.46	-2.18	-1.00	2.71	4.67
<i>EBITDA margin</i>	-223%	-34%	-11%	14%	19%
Adj. EBIT	-5.69	-2.69	-1.28	2.46	4.50
<i>Adj. EBIT margin</i>	-232%	-42%	-14%	13%	18%
Adj. Pre-tax profit	-5.70	-2.73	-1.26	2.48	4.53
<i>Adj. Pre-tax margin</i>	-233%	-42%	-14%	13%	19%
Net income	-5.13	-2.06	-0.56	2.29	3.99
<i>Net margin</i>	-209%	-32%	-6%	12%	16%
EPS (p)	-2.96	-1.18	-0.25	1.04	1.81

Source: Hardman & Co Research

Strong YoY growth in shipments

As set out in the charts below, the number of modules delivered in the first nine months of FY'22 was 455,000, which compares with 259,000 over the same period last year and 481,000 for the whole of FY'21.

CyanConnode: module shipments FY'22 YTD



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 £88.4m and an implied fair equity value of £91.4m (equating to £0.39 per share). These valuation outcomes are materially higher than the current enterprise value of £37.5m and market capitalisation of £40.5m.

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	2022E	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E	Terminal value
Revenue	9.3	18.8	24.5	31.1	38.8	46.6	52.2	54.8	57.5	
yoy growth	44.2%	102.8%	29.9%	27.0%	25.0%	20.0%	12.0%	5.0%	5.0%	
EBIT margin	-13.8%	13.1%	22.0%	23.5%	25.0%	26.0%	27.0%	28.0%	30.0%	
EBIT	-1.3	2.5	4.5	7.3	9.7	12.1	14.1	15.3	17.3	
Depreciation & amortisation	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.7	0.7	
Adj. EBITDA	-0.7	3.0	5.1	7.9	10.3	12.7	14.7	16.0	17.9	
Tax rate	0.0%	8.0%	12.0%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%	
Tax on EBIT	0.0	-0.2	-0.5	-1.5	-1.9	-2.4	-2.8	-3.1	-3.5	
Change in net working capital	-0.5	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7	
Cashflow from operations	-1.2	2.1	3.8	5.7	7.7	9.6	11.2	12.2	13.8	
Capex	-0.2	-0.2	-0.3	-0.3	-0.4	-0.5	-0.6	-0.7	-0.9	
Unlevered free cashflow	-1.4	1.9	3.5	5.4	7.3	9.1	10.6	11.5	12.9	145.8
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	-1.3	1.5	2.6	3.6	4.3	4.9	5.1	5.0	5.1	57.5

Note: based on medium-term assumptions from 2024E

Implied valuation metrics	£m
Sum of nine-year cashflow	30.9
Terminal value	57.5
Value of the firm	88.4
Net funds	3.0
Total equity value	91.4
No. of shares in issue (m)	236.3
Fair value share price (£)	0.39

Source: Hardman & Co Research estimates

Profit and loss

CyanConnode: profit and loss summary							
Year-end Mar (£000)	12M Dec 2017	12M Dec 2018	15M Mar 2020	2021	2022E	2023E	2024E
Revenue	1,171	4,465	2,451	6,437	9,282	18,827	24,461
Cost of sales	-674	-1,724	-1,081	-3,334	-5,105	-10,731	-14,187
Gross profit	497	2,741	1,370	3,103	4,177	8,096	10,274
Gross margin	42%	61%	56%	49%	45%	43%	42%
Operating expenses	-11,161	-8,589	-6,827	-5,284	-5,178	-5,385	-5,601
EBITDA	-10,664	-5,848	-5,457	-2,181	-1,001	2,710	4,673
Share-based payments	-689	-445	-267	-80	-300	-320	-400
Stock impairment	-55	-578	-4	-108	0	0	0
Foreign exchange losses	-52	-16	-267	15	0	0	0
Adjusted EBITDA	-9,868	-4,809	-4,919	-2,008	-701	3,030	5,073
EBITDA margin	-911%	-131%	-223%	-34%	-11%	14%	19%
Depreciation & amortisation	-489	-472	-772	-627	-576	-570	-570
EBIT	-11,153	-6,320	-6,229	-2,808	-1,577	2,140	4,103
Adjusted EBIT	-10,357	-5,281	-5,691	-2,685	-1,277	2,460	4,503
Adjusted EBIT margin	-884%	-118%	-232%	-42%	-14%	13%	18%
Investment income	16	13	17	1	2	2	3
Net finance income	-6	-2	-30	-50	20	22	26
Adjusted PBT	-10,347	-5,270	-5,704	-2,734	-1,255	2,484	4,532
Taxation/tax credit	1,402	927	576	677	697	-199	-544
Effective tax rate	-14%	-18%	-10%	-25%	-56%	8%	12%
Net income	-8,945	-4,343	-5,128	-2,057	-558	2,285	3,988
EPS (basic, p)	-10.18	-3.71	-2.96	-1.18	-0.24	0.97	1.69
EPS (diluted, p)	-10.18	-3.71	-2.96	-1.18	-0.24	0.97	1.69
Average shares in issue (basic, m)	95.740	116.976	173.048	174.755	232.228	236.309	236.309
Average shares in issue (dil., m)	95.740	116.976	173.048	174.755	232.228	236.309	236.309

Source: Hardman & Co Research

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