

## TERN SOFTWARE AND COMPUTER SERVICES

11 January 2024

### TERN.L

3.25p

Market Cap: £12.6m

#### SHARE PRICE (p)



12m high/low

8.8p/3.1p

Source: LSE Data (priced as at prior close)

#### KEY DATA

Net (debt)/cash £0.7m (at 30/06/23)

Enterprise value £11.9m

Index/market AIM

Next news Prelims, February

Shares in issue (m) 388.6

Chairman Ian Ritchie

CEO Albert E Sisto

CFO Colin Nunn

#### COMPANY DESCRIPTION

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

[www.ternplc.com](http://www.ternplc.com)

TERN IS A RESEARCH CLIENT OF PROGRESSIVE

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### Supporting investee secured for DA

Tern recently took part in an interview with DirectorsTalk following the announcement in late December that portfolio company Device Authority (DA) had received a US\$7m strategic investment from Ten Eleven, a global leader in cyber security with a strong foothold in automotive and medical devices. The next step to accelerate growth for DA's KeyScaler is to expand the sales footprint, particularly in the US. Having Ten Eleven as a partner marks a significant milestone for DA in this respect, attracting 'intelligent growth funding' from a partner with substantial experience and reach across the US, complementary to the Tern structure. In our view, pressure to realise cash through an exit is unfounded given the timeframe required to deliver maximum value to shareholders by preparing a business for harvest. Tern remains focused on the route of value creation and ultimately exit at the appropriate time.

- Strategic investment in Device Authority from Ten Eleven.** DA will secure US\$7m from Ten Eleven via a Series B type fundraising in two tranches (US\$3.7m already agreed and US\$3.3m contingent on NASI approval) and US\$0.3m from Alsop Louie Capital 3 via conversion of short-term loans. While the valuation is disappointing, at \$7.4m (£5.9m), a 49.5% discount compared to the June 23 book value of £11.9m, this reflects the landscape for tech businesses across the board, and we believe this new capital validates the Tern in-price. Although Tern's holding in DA equity will fall from 53.8% to 29.5%, attracting 'smart money' in the form of Ten Eleven aligns with DA's scaling objectives to 'land and expand' in the US.
- Tern offers UK investors a unique proposition.** Acting as an AIM-listed hybrid VC, Tern provides its shareholders with a diversified way to gain exposure to a range of IoT-related assets. New independent third-party partners have been secured, de-risking the business, and we expect the continued monthly recurring revenue (MRR) growth to drive additional strategic interest this year, as businesses enter the next phase of growth.
- Third-party investments reflect confidence in the underlying businesses,** which are gaining commercial traction and becoming technology leaders, with configuration work translating into repeat licencing and SaaS models. As flagged, valuations across global technology have been challenged due to risk appetite and long-term value expectations. However, third-party investments remain critical proof-points that the Tern's 'hand on' model is delivering, and management is committed to generating returns through full or partial exits when shareholder value is maximised.

| 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  | 11.8x | 2.4x | N/A   |

Source: Company Information and Progressive Equity Research estimates.

This publication should not be seen as an inducement under MiFID II regulations.

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

A hybrid VC model invested in sectors poised for exponential growth

## The Tern model

Tern PLC is an AIM-listed provider of venture capital to exciting IoT innovators, creating value through a hybrid VC model via access to disruptive start-ups not generally available to AIM investors. This model gives all shareholders the opportunity to act as Limited Partners (LPs), akin to the capital call model in a traditional VC fund.

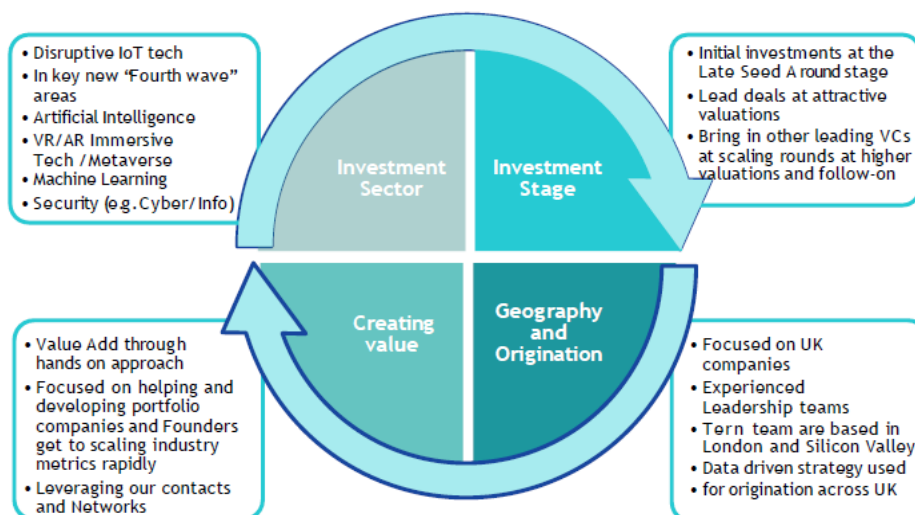
Tern is positioned at the forefront of IoT, Cyber Security, Big Data, Digital Assets, Immersive Technologies and thereby Artificial Intelligence (AI), where we see multiple opportunities in the existing portfolio, in sectors poised for exponential growth. We continue to look for significant value creation from Tern’s hybrid VC model, with management seeking well-timed exits that maximise value ‘when the market conditions are right’.

Unlike in the traditional VC model, Tern provides more than just funding; it proactively supports the growth of its portfolio companies. Organic delivery has been strong, with significant commercial traction and growing monthly recurring revenues (MRR), a key metric in establishing value for a trade sale or IPO.

Investments are therefore growing rapidly, with a need for further capital. 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, with third-party investors strengthening Tern’s position.

### Tern Investment Strategy

## Tern Investment Strategy



Source: Company, Progressive Equity Research

Tern can be considered an ‘evergreen’ VC fund, with continuous access to returns for LPs, having recently restructured its management and operations to behave more like an asset manager, with a Board and Investment Committee alongside an executive team that manages the existing assets and markets the portfolio in terms of further raises and eventual full or partial disposal. 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.

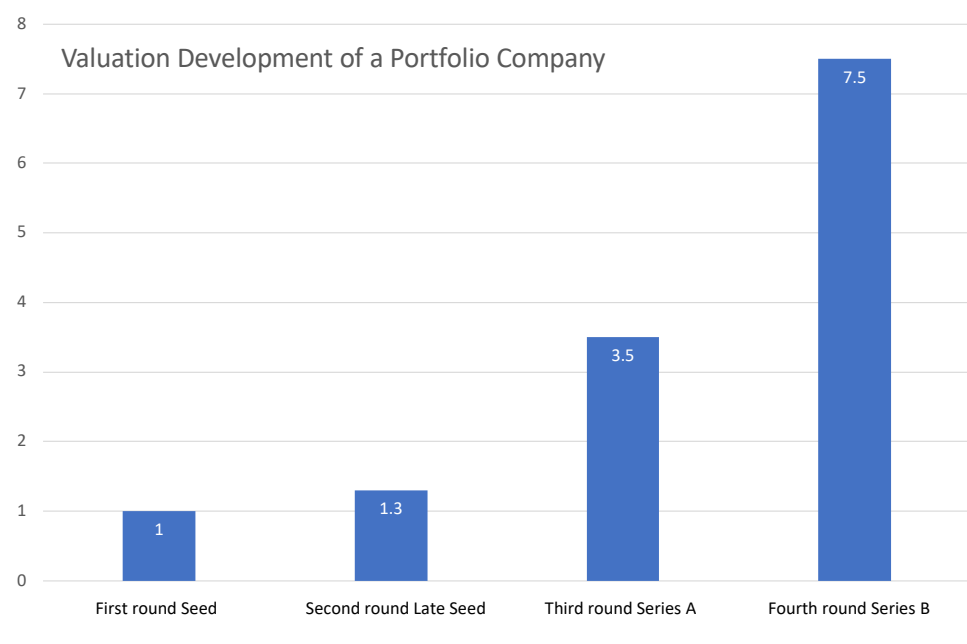
*An early-stage investor positioned for larger returns on exit*

## Timing and anticipation

The chart below demonstrates Tern’s funding strategy for its companies since 2017. Tern is providing the necessary capital and management of that capital. As the early-stage investor, while not wanting to go beyond Series B, Tern still requires capital for growth. Tern’s seed and late seed, 'A' to 'B' round investment approach positions it well for larger returns on exit or acquisition after growth rounds ‘C’ and beyond.

Tern has also co-invested with leading private equity and VC investors, providing third-party validation of value and independent financing. For example, through the recent strategic investment from Ten Eleven and the IPO of Wyld, Tern has achieved a public market valuation. In the most recent funding rounds, the Tern investment proportion has been relatively small, demonstrating that capital requirements are reducing as the businesses become attractive to third-party investors.

### Example: equity valuation relative to when first invested



Source: Company, Progressive Equity Research

## New structure in place

Tern recently implemented a new structure for its management and Board. The result is an organisation shaped more like a ‘traditional’ asset manager, with an overseeing Board of Directors (comprising a mixture of non-executive and independent directors) and a management team tasked with the active day-to-day execution of the Board’s strategy and marketing the portfolio of existing assets. This marketing will target additional fundraising rounds, and eventually a full or partial disposal (as has been the case with Wyld Networks).

The group has been able to reduce costs through this process, with people costs down 50%. However, a significant fixed cost base is unavoidable, over and above salaries, including legal costs for structuring financial support and safeguarding shareholders, alongside the ongoing costs of being AIM listed.

## Recent events and opportunity around IoT, data and AI

Individual companies are gaining commercial traction, with configuration work turning to repeat licencing as businesses move to SaaS models. Tern is positioned at the confluence of IoT, data and thereby Artificial Intelligence (AI), where we see multiple opportunities in the existing portfolio. The Tern portfolio has been built up around Internet of Things (IoT) – generally connected devices or inter-related operations and assets. Data will become an even more valuable resource over time, in our view. IoT devices, assets and platforms create, store and analyse data already – and AI will provide an opportunity to achieve more.

- **Positive business momentum for Device Authority**, which monitors functional data from a large number of installed industrial machinery and devices. DA is making rapid progress in growing its revenue base through its modularised licence platform KeyScaler, and in 2023 launched KeyScaler software as a service (KSaaS), which has gained a growing customer base. DA has recently launched a preview of KeyScaler AI.
- **Shipping of Wyld Connect Terminals started in October 2023**. Wyld manages huge amounts of data around the operation and performance of its advanced networks and mesh technologies. It has signed over 60 alliances and built a SEK 92m purchase order backlog for its IoT module and data service.
- **FundamentalVR has continued to build ARR during 2023** with its telemetry from virtual (practice/training) medical procedures, performed by clinicians using realistic simulations to learn and test functionality. The company has a healthy pipeline of customers and new client opportunities looking to deploy Fundamental Surgery, the surgical training platform that utilises its patented HapticVR technology.
- **Talking Medicines is becoming a jewel in the crown**, gaining traction using its curated AI model to source patient feedback. It garners information from the internet (social media) about the ways in which real-life consumers are interacting with and discussing medications. The business is expanding the subscription base for PatientMetRx, its SaaS on-demand product, with strong interest from the Big Pharmaceutical players.
- **No further investment in Konektio**. In one of the first major decisions executed under the new structure, Tern has elected not to make further investments in Konektio. We understand that Konektio still relies on a relatively significant hardware element to its revenue base, and Tern had been aiming to deliver a more SaaS-heavy model. Tern will continue to monitor its investment, with some form of disposal expected.

## Conclusion

We remain optimistic about the outlook for Tern. Efforts to date have propelled the four key portfolio companies, mentioned above, to become technology leaders, albeit with relatively limited funding. All four businesses are on a positive trajectory, with significant momentum. We see huge potential in the next phase of growth as portfolio companies work with investment partners to achieve additional recognition and scale.

The strategic importance of expanding sales operations is key to success, especially when competing with companies often backed by significant investment capital. Although Tern will where possible participate in fundraises to avoid dilution, its early entry at seed and seed plus allows Tern to retain a more substantial share. Tern's investment proportion has been relatively small in the most recent rounds, demonstrating that the capital requirements are reducing as the businesses become attractive to third-party investors.

We recognise that Tern's commitment extends beyond financial support; negotiating the best deals for shareholders during engagements with new investors, with the end goal to facilitate successful exits for all shareholders in a timely and prudent manner.

**Financial Summary: Tern**

Year end: December (£m unless shown)

|                                      | 2018    | 2019    | 2020     | 2021    | 2022     |
|--------------------------------------|---------|---------|----------|---------|----------|
| <b>PROFIT &amp; LOSS</b>             |         |         |          |         |          |
| 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      |
| <b>CASH FLOW &amp; BALANCE SHEET</b> |         |         |          |         |          |
| 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      |
| <b>NAV AND RETURNS</b>               |         |         |          |         |          |
| 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%)  |
| <b>METRICS</b>                       |         |         |          |         |          |
| 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%)  |
| <b>VALUATION</b>                     |         |         |          |         |          |
| EV/Sales (x)                         | 112.4   | 95.6    | 78.7     | 187.0   | 180.7    |
| EV/EBITDA (x)                        | N/A     | N/A     | N/A      | N/A     | N/A      |
| EV/NOPAT (x)                         | N/A     | N/A     | 14.8     | 2.6     | N/A      |
| PER (x)                              | N/A     | N/A     | 11.8     | 2.4     | N/A      |
| Dividend yield                       | N/A     | N/A     | N/A      | N/A     | N/A      |
| FCF yield                            | (61.0%) | (46.8%) | (32.3%)  | (36.1%) | (32.5%)  |

Source: Company information and Progressive Equity Research estimates

**Disclaimers and Disclosures**

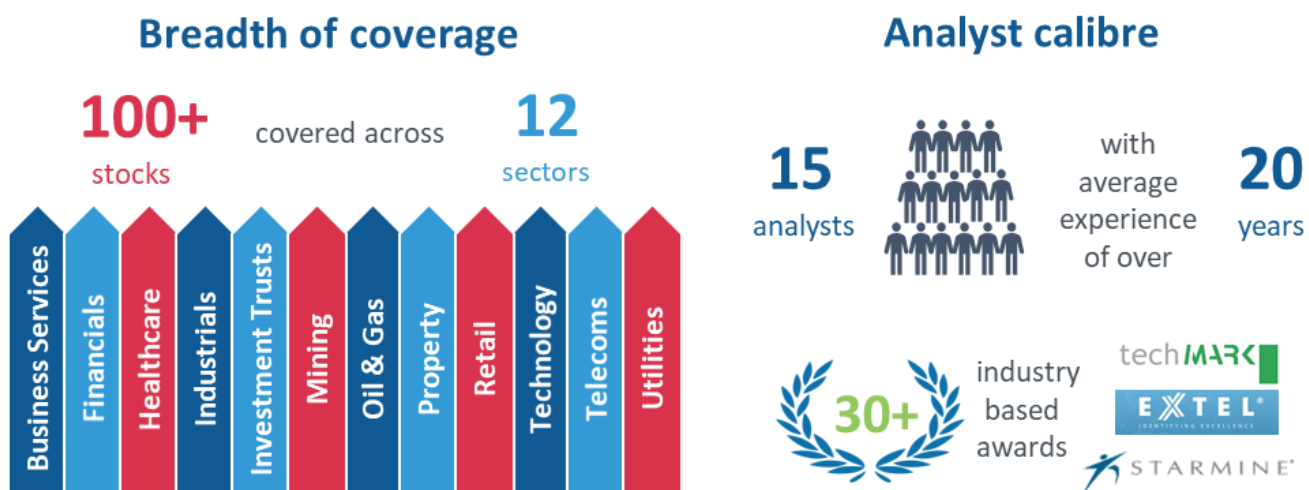
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