Sensera Limited

Major funding boost

Share Price: A$0.073

Valuation range: A$0.40-0.42

ASX: SE1

Sector: Semiconductors & Semiconductor Equipment

25 November 2019

New funding package to help unlock potential

Sensera Limited (ASX:SE1) raised substantial capital, totalling A$9.4m, in October 2019. The funding package includes A$6.4m in a secured debt facility and an equity infusion of A$3m via a private placement.

Concurrently, the company launched a share purchase plan (SPP). In our view, this inflow of funds will support SE1 in realising its growth potential.

All cashed up to execute its growth strategy

The proceeds from the funding package will help unshackle SE1 from the binds of limited working capital. Though the company has been consistently signing up new clients, it has been experiencing delays in fulfilling contracts because of constrained working capital leading to delays in booking revenue.

However, we believe this funding package will better position SE1 to leverage incremental sales opportunities from major partnerships such as the recently signed partnership with Meglab, which is a strong testimonial to the relevance of SE1's products in the mining sector.

Valuation range of A$0.40–0.42 per share

Lower sales of higher margin products, coupled with delays in revenue realisation in 1QFY20, has prompted us to bring down our valuation range for SE1. We now assume the company to be EBITDA positive in 2022 vs. the earlier expectation of 2020. Consequently, we now value SE1 at A$0.40 to A$0.42 per share (was A$0.50 to A$0.58) using DCF-based valuation.

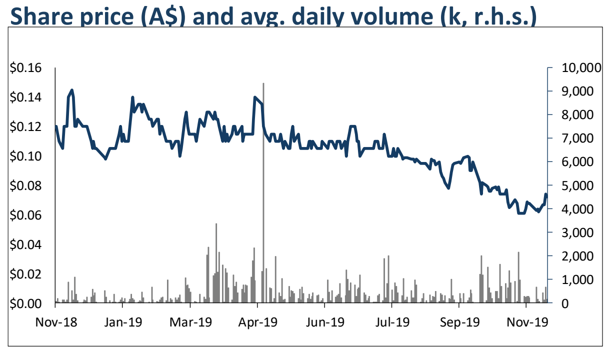
Year to June (USD)	2018A	2019A	2020f	2021f	2022f
Sales (m)	6.4	10.2	14.9	19.4	23.6
EBITDA (m)	-6.6	-9.3	-2.3	-0.2	2.2
Net Profit (m)	-6.8	-9.5	-2.9	-1.1	1.5
EBITDA Margin	NM	-91.0%	-15.6%	-1.1%	9.2%
Net Margin	NM	-93.7%	-19.3%	-5.9%	6.5%
RoA	-69.6%	-66.2%	-15.4%	-4.5%	4.8%
EPS	-4.51c	-4.03c	-0.91c	-0.36c	0.48c
EV/Sales	2.8x	2.1x	0.9x	0.6x	0.3x
EV/EBITDA	-2.7x	-2.3x	-5.7x	-54.0x	3.7x
P/E	NA	NA	NA	NA	10.1x

Source: Company, Pitt Street Research

Market Cap. (A$ m)	23
# shares outstanding (m)	315.5
# shares fully diluted	353.8
Market Cap Ful. Dil. (A$ m)	25.8
Free Float	71.7%
52-week high/low (A$)	0.16 / 0.06
Avg. 12M daily volume ('1000)	545
Website	www.sensera.com

Source: Company, Pitt Street Research

Share price (A$) and avg. daily volume (k, r.h.s.)



Source: Thomson, Pitt Street Research

Valuation metrics	
Fair valuation (A$)	0.40-0.42
WACC	9.4%
Assumed terminal growth rate	2.0%

Source: Pitt Street Research

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Please note Pitt Street Research and/or its directors hold stock in Sensera per the date of this report.

Analyst: Marc Kennis

Tel: +61 (0)4 3483 8134

marc.kennis@pittstreetresearch.com

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Funding package underpins future growth

The funding will help SE1 build inventory to meet customer demand most of whom are transitioning to the commercial production phase

SE1 entered 2QFY20 with a substantial A$9.4m funding package in order to support its working capital requirements. The company signed a binding term sheet with Pure Asset Management and Altcor Capital for a A$6.4m secured debt facility. The facility has a term of four years, with an interest rate of 11.75% p.a. payable quarterly. It also includes 35.6 million warrants with an exercise price of A$0.18 and an expiry of four years. The company plans on using A$3m from this facility to pay down the existing Timelio facility. In January 2019, SE1 had signed an agreement with Timelio Pty Ltd for an A$3m invoice facility, secured by its working capital assets. In addition to this debt facility, SE1 successfully completed a A$3m private placement at an issue price of A$0.08 per share.

Additionally, SE1 also raised A$110k through a non-underwritten SPP by issuing 1.4m shares at the price of A$0.08 per share. Though the proceeds fell short of management's expectation, we expect this amount to support the company in building cash reserves for meeting its working capital requirements (Figure 1).

Figure 1: Sources and uses of funds

Sources of funds	(In A$m)
Debt Facility	6.4
Private Placement	3.0
Share Purchase Plan	0.1
Total	**9.5**
Uses of funds	**(In A$m)**
Pay down of Timelio Financing	3.0
Working Capital	6.5
Total	**9.5**

Source: Company, Pitt Street Research

The substantial increase in working capital will provide much-needed support for SE1 to build its inventory levels. This will aid SE1 in fulfilling customer orders on time. Further, with most of its customers transitioning towards commercial production, SE1 will need substantial funding in the future to meet their growing demand. In our view, the long-term nature of the debt facility provides certain assurances about the company's ability to continue to serve its commitments. Moreover, we believe a sustainable inventory level will allow SE1 to take advantage of new client opportunities as and when they arise.

Meglab partnership to provide incremental sales

Integration with Meglab's mine management system to unlock incremental sales potential

In 1QFY20, the company signed an agreement with Meglab, a Canada-based provider of mining technologies, with operations in 15 countries. Under the agreement, Meglab will integrate Nanotron's location-aware Internet of Things (IoT) technology with Imagine – its mine management system. The plan is to use Nanotron's swarm bee modules to feed the system with real-time data on the location of miners and equipment. This will allow Imagine to enhance safety in mines by providing smart ventilation automation, lamp assignment, mine evacuation support, etc.

We expect SE1 to leverage this collaboration and enhanced its brand value to secure future clients and partnerships in the Mining segment.

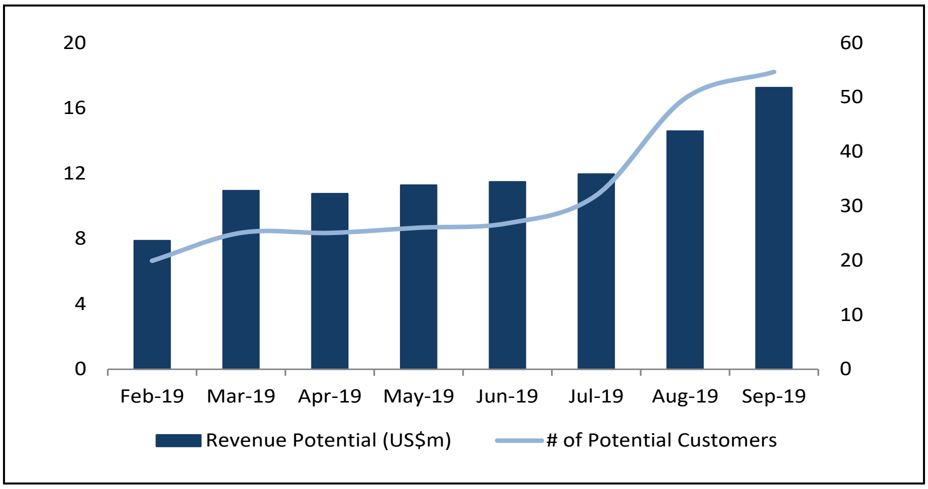
Strong top-line growth in 1QFY20 but costs higher than anticipated

SE1 reported revenues of A$3.6m in 1QFY20, an impressive growth of 2.2x YoY. However, revenue was ~5% lower vis-a-vis 4QFY19, with insufficient working capital being the primary reason. Even though the company has been consistently innovating and signing new clients, the lack of working capital has strained its inventory levels and ability to fulfil order backlog.

Recent funding package to alleviate working capital pressure

Notably, the company has a long cost-to-revenue cycle of 18–24 months, and as such high levels of work-in-progress and inventory. However, the recent funding package is expected to alleviate the pressure. Moreover, SE1 has a strong sales pipeline facilitated by the expansion of its sales team, which we believe should help advance sales opportunities (Figure 2).

Figure 2: Sales opportunity pipeline



Source: Company

Operating costs to remain elevated in the short to medium term

While SE1's revenue grew 60% YoY in FY2019, its EDITDA margin continued to be negative, despite management guidance to obtain 1-2 months of profitability in 4QFY19. This was driven by a 36% YoY growth in operating expenses to US$13.4m in FY2019. In 2HFY19, the company expanded its sales team, leading to a jump in the sales and marketing costs – from 6.5% (as a % of sales) in FY2018 to 13.4% in FY2019. This increase in cost, coupled with R&D expenses remaining high, overshadowed the strong top-line growth. We believe the operating costs will remain elevated in the short to medium term as SE1 builds out its business and makes further investments.

Lower valuation as break-even takes longer

In order to model the delay that SE1 is experiencing in achieving operating-level break-even, we have made certain changes in our assumption:

– Marketing expenses: SE1's selling and marketing expenses (as a % of sales) shot-up in 2HFY19 to 17.1% (vs. 6.8% in 1HFY19 and 6.5% in FY18). We believe that SE1 is most likely to carry this cost in the near-to-medium term (as against only in near term) as it makes significant investment to build its brand value using collaboration and partnerships.

– R&D expenses: R&D expenses continue to remain high (2HFY19: 15.8%; 1HFY19: 8.5%). We believe that SE1 will continue to invest in the technical specifications of its sensors to remain of the curve. They have migrated to using partners in non-key areas in order to see a reduction in this spending in FY20.

– Gross margins: Driven by an increase in costs and a skewed chip level product mix, the gross margin declined from 52% in FY2018 to 41% in FY2019 (36.4% in 2HFY19). Though management expects the gross margin to return to historical levels in FY2020, we cautiously believe that higher contribution from low-margin product mix could delay this. High volume chip level contracts are due to be completed at the end of Q2FY20.

Additionally, we believe that the management would continue to utilise the credit facility to build business scale instead of paying it down early. As a result of these changed assumptions, we believe the company will achieve positive EBITDA only in FY2022, as opposed to the previously estimated FY2020 (Figure 3).

Figure 3: Change in forecasted financials

(In USD million)	Change in estimates (Annual)					
	FY 2020		FY 2021		FY 2022	
	Old	New	Old	New	Old	New
Revenue	16.1	14.9	21.1	19.4	26.0	23.6
Operating expenses	(8.9)	(9.1)	(9.6)	(9.0)	(10.0)	(9.0)
Adjusted EBITDA	0.3	(2.3)	2.7	(0.0)	5.2	2.2

Source: Pitt Street Research

Valuation range re-calibrated to A$0.40-A$0.42

We have retained the basic assumptions for valuation as used in our initiation report (dated 11 June 2019). However, following the recent delay in revenue realisation, the long conversion cycle and the higher cost levels (both R&D and employee costs), we believe it will take longer than previously expected for SE1 to clock operational break-even.

In our view, as the company manages its inventory levels – fuelled by recent funding proceeds – it should witness improvements in margins in the medium term. We now assume that SE1 will be EBITDA positive in 2022, compared with the earlier estimation of 2020. Consequently, we have lowered our valuation range from A$0.50 base case/A$0.58 optimistic case (June 2019) to A$0.40 -A$0.42 (Figure 4 and 5).

Figure 4: DCF in A$ using various WACCs

Sensitivity Analysis									
WACC	9.38%								
Terminal Growth Rate	2.00%	Change in WACC							
Implied Price (AUD cents)	40	*6.4%*	*7.4%*	*8.4%*	*9.4%*	*10.4%*	*11.4%*	*12.4%*	*13.4%*
Change in Terminal Growth Rate	*1.25%*	72.8	56.5	45.0	36.5	30.1	25.1	21.1	17.9
	1.50%	76.4	58.8	46.5	37.6	30.9	25.7	21.6	18.2
	1.75%	80.4	61.3	48.2	38.8	31.7	26.3	22.0	18.6
	2.00%	84.8	64.0	50.0	**40.0**	32.6	27.0	22.5	19.0
	3.00%	109.2	78.1	58.9	46.0	36.9	30.1	24.8	20.8
	3.50%	127.7	87.9	64.7	49.8	39.4	31.9	26.2	21.8
	4.00%	154.0	100.5	71.9	54.3	42.4	34.0	27.7	22.9

Source: Pitt Street Research

Figure 5: Revised valuation for SE1

Base Case Valuation (USD)	
Present value of FCF	7,239,445
Present value of Terminal FCF	76,967,836
Enterprise Value	**84,207,280**
Net debt (cash)	(2,192,718)
Equity value	86,399,998
Share outstanding (for 2020, million)	315.5
Implied price (USD cents)	27.4
Implied price (AUD cents)	**40.0**
Current price (AUD cents)	7.2
Upside (%)	454.9%

Bull Case Valuation (USD)	
Present value of FCF	7,558,521
Present value of Terminal FCF	80,976,708
Enterprise Value	**88,535,229**
Net debt (cash)	(2,192,718)
Equity value	90,727,947
Share outstanding (for 2020, million)	315.5
Implied price (USD cents)	28.8
Implied price (AUD cents)	**42.0**
Current price (AUD cents)	7.2
Upside (%)	482.7%

Source: Pitt Street Research

Risks

There are four main risks associated with SE1's investment thesis:

1. Execution risk: The contracting results of FY19 and Q1FY20 from management commentary pose a threat to its ability to rationalise costs. As a result, future bottom-line growth will be underpinned by the management's ability to streamline operating expenses.
2. Future funding: Due to a delay in order completions, as well as higher operating and fixed costs, the company's margins have been impacted. In order to achieve economies of scales, SE1 will have to raise substantial funding. We believe the recent funding package provides some relief to its working capital needs and indicates SE1's ability to successfully raise funds.
3. Risk of cannibalisation: Introduction of the Blink communications protocol, which can be applied to any DW1000-based tag, poses the threat of cannibalisation of sales of Nanotron's own anchors.
4. Shortening of supply chain: The current structure of Sensera involves the company selling its products and technologies to OEMs, which in turn sell them to mainstream manufacturers. However, as these manufacturers are large enough to move these processes in-house, such as Walmart's creation of AI-based Eden technology, there is a threat of the company being left out of the market.

Please see www.pittstreetresearch.com for our initiating coverage on SE1.

Analyst certification

Marc Kennis, lead analyst on this report, has been covering the Semiconductor sector as an analyst since 1997.

- Marc obtained an MSc. in Economics from Tilburg University, The Netherlands, in 1996 and a Post Grad. in investment analysis in 2001.
- Since 1996, he has worked for a variety of brokers and banks in The Netherlands, including ING and Rabobank, where his main focus has been on the Technology sector, including the Semiconductor sector.
- After moving to Sydney in 2014, he worked for several Sydney-based brokers before setting up TMT Analytics Pty Ltd, an issuer-sponsored equities research firm.
- In July 2016, with Stuart Roberts, Marc co-founded Pitt Street Research Pty Ltd, which provides issuer-sponsored research on ASX-listed companies across the entire market, including Technology companies.

Profit & Loss (US$m)	2017A	2018A	2019A	2020F	2021F	2022F	2023F
Sales Revenue	**1.2**	**6.4**	**10.2**	**14.9**	**19.4**	**23.6**	**28.2**
Operating expenses	-5.0	-9.9	-13.4	-9.1	-9.2	-9.0	-9.7
Adjusted EBITDA	**-5.3**	**-6.6**	**-9.3**	**-2.3**	**-0.2**	**2.2**	**3.9**
Depn & Amort	-0.1	-0.3	-0.1	-0.1	-0.4	-0.7	-0.9
Adjusted EBIT	**-5.3**	**-6.9**	**-9.4**	**-2.5**	**-0.6**	**1.5**	**3.0**
Net Interest	0.0	0.0	-0.1	-0.5	-0.4	-0.4	-0.4
Profit before tax (before exceptionals)	**-5.3**	**-6.8**	**-9.5**	**-2.9**	**-0.9**	**1.2**	**3.9**
Tax expense	0.0	0.0	0.0	0.0	-0.2	0.3	0.7
NPAT	**-5.3**	**-6.8**	**-9.5**	**-2.9**	**-1.1**	**1.5**	**3.4**

Cash Flow (US$m)	2017A	2018A	2019A	2020F	2021F	2022F	2023F
Profit after tax	-5.3	-6.8	-9.5	-2.9	-1.1	1.5	3.4
Depreciation	-0.1	-0.3	-0.1	-0.1	-0.4	-0.7	-0.9
Change in trade and other receivables	0.2	-0.9	-1.0	-0.3	-0.6	-0.6	-0.1
Change in trade payables	0.1	-3.2	0.6	1.5	-0.3	-0.3	0.4
Other operating activities	0.6	5.0	2.0	3.1	6.6	5.7	3.9
Operating cashflow	**-4.5**	**-6.1**	**-8.2**	**1.4**	**4.1**	**5.6**	**6.7**
Capex (- asset sales)	-0.9	-1.3	-0.4	-1.5	-1.8	-2.2	-5.1
Other investing activities	0.0	-3.1	-2.8	0.0	0.0	0.0	0.0
Investing cashflow	**-0.9**	**-4.4**	**-3.2**	**-1.5**	**-1.8**	**-2.2**	**-5.1**
Equity raised (repurchased)	9.9	8.9	8.5	2.1	0.0	0.0	0.0
Other financing activities	-0.8	-0.6	1.9	2.3	-0.4	-0.4	-0.4
Net change in cash	3.7	-2.1	-1.0	4.3	2.0	3.1	1.3
Cash at End Period	4.0	2.0	0.8	5.1	7.1	10.2	11.5
Net Debt (Cash)	-4.0	-2.0	1.6	-2.2	-4.2	-7.3	-8.6

Balance Sheet (US$m)	2017A	2018A	2019A	2020F	2021F	2022F	2023F
Cash	4.0	2.0	0.8	5.1	7.1	10.2	11.5
Total Assets	5.4	14.0	14.8	22.5	28.2	35.2	42.7
Total Debt	0.0	0.0	2.5	2.9	2.9	2.9	2.9
Total Liabilities	0.4	5.7	7.7	6.7	7.1	7.4	7.0
Shareholders' Funds	5.0	8.3	7.1	15.8	21.2	27.8	35.6

Ratios (US$m)	2017A	2018A	2019A	2020F	2021F	2022F	2023F
Net Debt/Equity (%)	-80.8%	-24.4%	23.0%	-13.9%	-19.8%	-26.2%	-24.1%
Interest Cover (x)	NM	607.4	82.8	-5.1	-1.7	4.2	8.5
Return on Equity (%)	NM	NM	NM	NM	NM	6.2%	10.9%

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