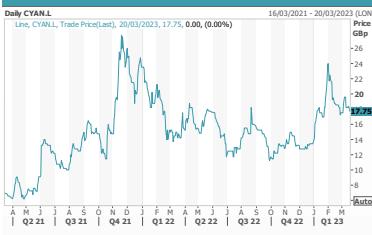




21 March 2023

## Technology



Source: Refinitiv

## Market data

EPIC/TKR	CYAN
Price (p)	17.75
12m high (p)	29.9
12m low (p)	1.55
Shares (m)	267.2
Mkt. cap (£m)	47.4
EV (£m)	40.9
Free float*	100%
Country/Currency	UK/GBP
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 2.7m endpoints have been delivered globally. At the end of March 2022, total headcount stood at 60 employees, of which 11, or 18%, were women.

## Company information

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## CYANCONNODE

## Acceleration, and revenue uplift for FY24 and beyond

CyanConnode is currently involved in Indian tenders for more than 100m meter endpoints, and its partners have already secured L1 preferred bidder status for c.30m incremental meters. In addition to the 2.3m orders won in the fiscal year to date, CyanConnode has entered into a framework agreement with a partner to supply hardware and software for 3m endpoints for future contract awards under the Indian smart meter programme. Our revised forecasts represent an initial step towards reflecting the prospective upside in financial performance. Our updated DCF analysis suggests an implied fair equity value of £96.8m.

- **Phase 1 of the Indian programme is well-advanced:** Of the total smart meter rollout of 250m meters, 100m were identified as higher priority. CyanConnode's latest update confirms that tenders for c.100m meters are currently in process, compared with c.62m in November 2022.
- **Acceleration:** The win rate in FY23 to date has been 38%, including the order for c.1m nodes announced in January 2023. CyanConnode's partners have achieved L1 status for c.30m meter endpoints. Even a 20% overall win rate would imply revenue far beyond our revised estimates.
- **Silicon Labs highlights partnership:** Silicon Labs is a major US vendor in the semiconductor market, and it recently highlighted its partnership with CyanConnode, which is using the FG25 module and leading the market regarding meeting Indian technical requirements for RF, such as Wi-Sun.
- **Recent fundraising creates working capital cushion:** The January 2023 oversubscribed raise brought in £5.25m gross proceeds at £0.17 per share. The funds are largely for expansion of inventory and production capacity, necessitated by an accelerating pace of contract awards.
- **Investment summary:** From the outset, CyanConnode has positioned itself as a neutral technology vendor able to partner with any meter manufacturer or prime contractor. This approach has yielded an array of partnerships, which are now paying off in terms of breadth of exposure to current tenders across India. Our updated DCF-implied fair equity value for CyanConnode is £96.8m (£0.36 per share).

## Financial summary and valuation

Year-end Mar (£m)	2021	2022	2023E	2024E
Revenue	6.44	9.56	12.23	17.18
Reported EBITDA	-2.18	-0.04	-0.49	0.52
EBITDA margin	-34%	0%	-4%	3%
Adjusted EBIT	-2.81	-0.29	-0.54	0.57
Adjusted pre-tax profit	-2.73	-0.45	-0.72	0.38
Net income	-2.06	-0.87	-0.44	0.38
EPS (p)	-1.18	-0.42	-0.18	0.14
EV/revenue (x)	6.4	4.3	3.3	2.4
EV/EBITDA (x)	-18.8	-1077.0	-83.0	78.8

Source: Company data, Hardman &amp; Co Research

## Investment highlights

The total budgeted outlay for the smart meter element of the Indian programme is INR1.5 lakh crores, i.e. INR1.5tr, or around £15.8bn. A similar amount has been allocated to enabling activities such as expansion of distribution capacity and training. These are immense sums, creating a highly compelling opportunity for CyanConnode. The company is executing strongly against this opportunity – the win rate from contracts tendered since April 2022 is cited to have been c.38% in volume, and the overall win rate, including installed meters, is c.25%. CyanConnode is currently bidding for contracts worth over £1bn in value. CyanConnode's partners have recently been named as Level 1 status for more than 25m modules.

The waiting period for Indian smart meter contracts is over, with announcements coming through at a regular pace. CyanConnode is maintaining strong market share, having formed relationships with several of the leading prime contractors that are bidding for contracts. The company's most recent update noted that, during the past 10 months, orders for 2.3m modules have been achieved. As at March 2023, the order book for India stood at 3.6m nodes, of which 1.3m have been shipped. Of these, 1.1m have been implemented and are under maintenance contracts. These recent order metrics compare with 1.3m of total endpoint orders over the previous decade.

This step change in performance is a function of the acceleration in progress in the smart meter programme in India, for which CyanConnode's management has spent many years preparing at a granular level. The flow of contracts and the framework agreement with a major prime contractor indicate that the company's efforts are starting to pay off. Most of the current order book of 2.3m meters is expected to be installed during the next two years. Assuming that the framework contract converts into orders, combined with high activity levels in a number of markets outside of India, we believe that our upgraded forecasts for FY24 (which see our revenue estimate up by 20% compared with our previous forecast, and the adjusted EBITDA estimate more than doubling) and beyond are very well underpinned.

### *New framework agreement*

On 6 February 2023, CyanConnode announced a major strategic framework agreement with an undisclosed partner. Under this agreement, CyanConnode will supply, essentially, a full platform, comprising Omnimesh RF modules, Advanced Metering Infrastructure (AMI), standards-based hardware, Omnimesh head-end software and associated components, perpetual software licences, design, installation, implementation, integration, training, and support and maintenance contracts for 3m smart meters. A comprehensive supply agreement such as this implies an enhanced per meter contract value over the 10-year typical lifetime of the contracts.

The rationale for a framework agreement such as this is, presumably, being ready for anticipated contract awards. We know that several of CyanConnode's partners are in relatively advanced stages of negotiation for specific tenders amounting to several million units each. The framework agreement with one such partner, with key terms in place, will allow for a seamless progression, with CyanConnode able to commence placing orders for components, etc., knowing that it is a preferred supplier for a portion of the contract awards. Cumulative market shares are unknown, and the prime contractor will need to ensure that it maintains its own supply chain diversification, but the reality is that relatively few technology providers have proven deployments in India that tangibly meet the stringent service level

agreements (SLAs) of the Indian programme. This is, in our view, the driving factor of the strong market share that CyanConnode has delivered to date.

### *Large order announced in January 2023*

In January 2023, CyanConnode announced one of the largest single orders in the company's history, and the first with a new partner, Montecarlo. The order is for 984,000 modules, together with Advanced Metering Infrastructure, standards-based hardware, Omnimesh head-end software, software licences, and a support and maintenance contract. This contract follows the order with Genus for 1m endpoints, which was announced in August 2022 and which is the company's largest order to date.

The profile of revenue from the latest contract is typical of the new generation of contracts under the Indian smart meter programme, combining upfront recognition of the hardware modules and subsequent recurring revenue. 60% of the contract will be recognised during the installation phase (the initial 24 to 27 months). The remaining 40% of the contract will be paid for in equal monthly instalments over the support and maintenance contract period of eight years.

### *Growing recognition from major suppliers*

The flow of contract awards is creating an imperative to scale the business. Alongside the existing supply chain in India (Syrma), Genus will be producing modules on a third-party basis for its own meter requirements for the August 2022 order, and potentially beyond.

Notably, CyanConnode's tangibly growing presence in the Indian smart meter market is attracting the attention of its major suppliers. Silicon Labs, a US-headquartered company, with over \$1bn in revenue and a market capitalisation of \$5.5bn, recently publicised its relationship with CyanConnode. The extract below from the press release focuses on the use of the FG25 module, which notes Silicon Labs' excitement regarding CyanConnode's traction in India and elsewhere.

## Silicon Labs highlights CyanConnode's use of FG25 module

### **CyanConnode and the FG25 Sub-GHz SoC are Ready to Take on India's Smart Metering Challenge**

In Silicon Labs' [FG25 sub-GHz wireless SoC](#), CyanConnode has found a solution that meets its requirements for performance, cost, and supportability. And as metering solutions evolve, the meters themselves get more complex, and the expectations for what they are able to provide utility customers is increasing. The FG25 will scale with customer demand and expanding networks. Silicon Labs has worked closely with the Wi-SUN Alliance, became a member in 2016, and led the way in delivering Wi-SUN-certified solutions for the smart energy and smart city markets.

The FG25 integrates a sub-GHz radio transceiver, microcontroller, and memory, making it a compact and cost-effective solution with advanced security features including 128-bit AES encryption. These features, coupled with the development tools and software available with the certified Wi-SUN SDK, makes it an ideal choice for smart utility projects, where security and energy usage data have a direct impact on revenue. CyanConnode's use of the FG25 module enables the company to offer its customers a highly reliable and secure solution, and with Silicon Labs' history of chip innovation and working with wireless standards, CyanConnode can deliver high-quality products that meet the stringent requirements of its customers now and in the future.

Silicon Labs is excited to have the FG25 be part of CyanConnode's commitment to providing innovative and secure smart metering solutions in India and around the world.

*Source: Company data*

CyanConnode's adoption of Silicon Labs' flagship SoC and Wi-SUN will ensure that CyanConnode is the first to meet the technical requirement set by the Government of India as defined by BIS LITD28 standards for Smart Meter RF Communication systems.

### *Strong progress beyond India*

In addition to the surge in performance in India, activity levels in the MENA region remain strong. Partners based in the Middle East are also taking CyanConnode into new markets in Africa and Costa Rica. Thailand has been a solid contributor to CyanConnode's annual performance for a few years, and its installed base there continues to grow. When considered in conjunction with India, we believe our upgraded estimates are well-supported by activity levels across a number of markets, and, therefore, low-risk.

### *Evolving go-to-market models*

CyanConnode is considering approaches by third parties that are seeking to manufacture modules using CyanConnode's technology designs, in return for royalty payments. These would represent particularly high-margin revenue streams for the company, additive to the current core business, and consistent with multiple opportunities available to scale the presence of the Omnimesh platform on an indirect basis. The decision to allow Genus to manufacture modules on behalf of CyanConnode comprises a similar initiative in terms of being intended to scale the revenue base.

### *Adani news flow should not affect CyanConnode*

In early February 2023, the Uttar Pradesh power utility, Madhyanchal Vidyut Vitran Nigam (MVVNL), disclosed that it had cancelled Adani Group's bid to win a contract to supply c.7.5m smart meters. The reasons for the decision to cancel the Adani consortium bids were not disclosed. The decision may or may not be related to the wider documented controversy surrounding the Adani Group.

CyanConnode will not be adversely affected by these developments, as it was not directly supplying Adani for integration into meters; rather, Adani was acting as a reseller of CyanConnode products to the utilities. Other bidding parties for these Uttar Pradesh contracts include Larsen & Toubro (part of Schneider Electric) and Intellismart, which are also partners of CyanConnode.

The broader point to be made here is that the performance or outcome of any individual partner should not exert any particular impact on CyanConnode's progress in the Indian programme. CyanConnode is working with a range of prime contractors, including meter manufacturers and large EPCs, and, quite often, it is a designated supplier for multiple partners in the same regional tenders. We believe this diversification and neutral stance will continue to leave the company well-positioned.

### *CyanConnode has no banking arrangements involving Silicon Valley Bank*

Given the very recent news flow on Silicon Valley Bank, as confirmed by the company's announcement on 13 March 2023, CyanConnode does not have any banking arrangements involving the bank.

### *CyanConnode's presence across India building nicely*

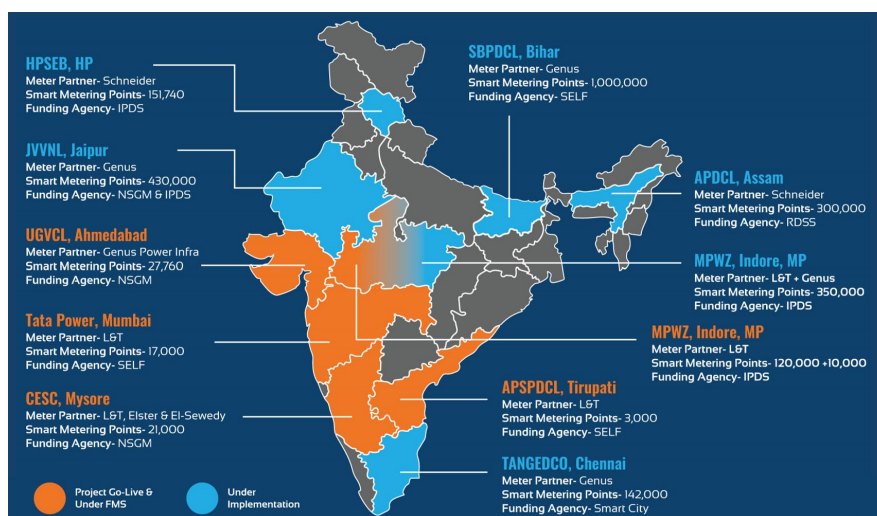
CyanConnode's breadth of presence across India is demonstrable by reference to the regional implementation metrics. It is worth recapping on data that we have published previously. As at November 2022, the company had delivered all of the meters installed to date in the following states:

- ▶ Himachal Pradesh: 147,104
- ▶ Tamilnadu: 124,945
- ▶ Karnataka: 20,916
- ▶ Gujarat: 23,760

- ▶ Madhya Pradesh: 243,313
- ▶ Rajasthan: 555,958

In addition, CyanConnode received an order earlier this financial year for 300,000 meter endpoints in Assam, which are yet to be fully deployed. This order is via Intellismart, and represents the latter's first win under the RDSS for a total of 620,000 meters to be deployed for the Assam Power Distribution Company Limited. Today, over 1.1m meter endpoints have been installed across 10 states in India, while the Indian order book stands at 2.6m endpoints.

### Current status of CyanConnode's smart meter deployments in India



Source: Company data

### Updated estimates reflect underlying momentum

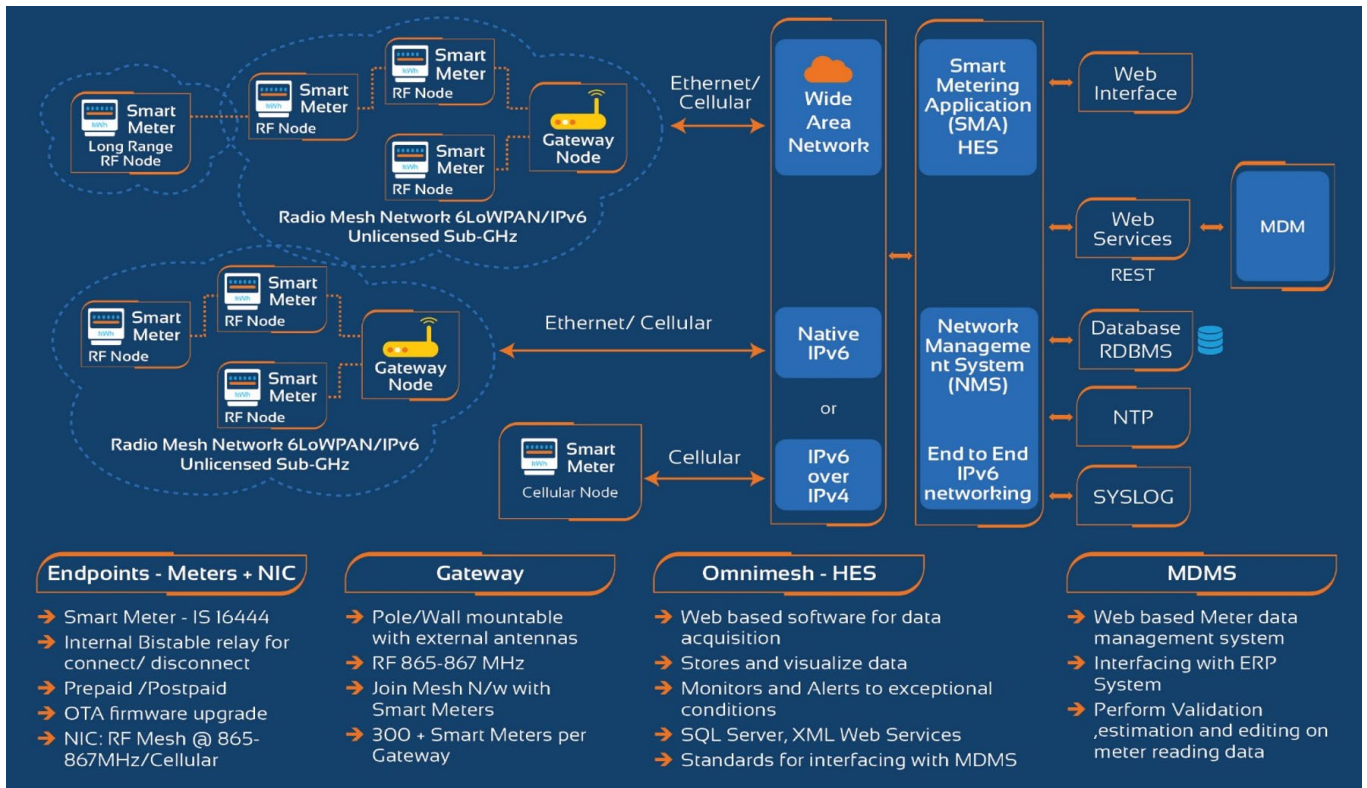
Even assuming a highly conservative per meter contract value, every one million in meter orders, on the basis of the revenue recognition model for the most recent contract, would equate to revenue over a two-year installation period of at least £7.2m.

Our previous revenue estimate for FY24, ending March, was £15.8m. Our understanding is more than the entirety of this revenue number is accounted for by contracts that have already been won by CyanConnode with an agreed delivery schedule. This revenue coverage has persuaded us that the revenue forecasts should be upgraded for FY24 and beyond. Accordingly, we have upgraded our FY24 revenue estimate by 20%, from £15.8m to £17.2m.

### End-to-end technology platform

The stringent SLAs demanded by the Indian programme are well-served by CyanConnode's end-to-end platform, spanning meter endpoints, gateways and head-end software. The comms modules offer RF and cellular functionality on the same meter, significantly enhancing ease of deployment.

## CyanConnode: end-to-end technology platform



Source: Company data

# Profit and loss

## CyanConnode: Hardman & Co profit and loss

Year-end March (£000)	12M Dec 2017	12M Dec 2018	15M Mar 2020	2021	2022	2023E	2024E
<b>Revenue</b>	<b>1,171</b>	<b>4,465</b>	<b>2,451</b>	<b>6,437</b>	<b>9,562</b>	<b>12,227</b>	<b>17,183</b>
Cost of sales	-674	-1,724	-1,081	-3,334	-4,554	-6,970	-10,138
<b>Gross profit</b>	<b>497</b>	<b>2,741</b>	<b>1,370</b>	<b>3,103</b>	<b>5,008</b>	<b>5,258</b>	<b>7,045</b>
<i>Gross margin</i>	42%	61%	56%	49%	45%	43%	41%
Operating expenses	-11,161	-8,589	-6,827	-5,284	-5,046	-5,751	-6,526
<b>EBITDA</b>	<b>-10,664</b>	<b>-5,848</b>	<b>-5,457</b>	<b>-2,181</b>	<b>-38</b>	<b>-493</b>	<b>519</b>
Share-based payments	-689	-445	-267	-80	-363	-320	-400
Stock impairment	-55	-578	-4	-108	0	0	0
Foreign exchange losses	-52	-16	-267	15	0	0	0
<b>Adj. EBITDA</b>	<b>-9,868</b>	<b>-4,809</b>	<b>-4,919</b>	<b>-2,008</b>	<b>325</b>	<b>-173</b>	<b>919</b>
<i>EBITDA margin (%)</i>	-911%	-131%	-223%	-34%	0%	-4%	3%
Depreciation & amortisation	-489	-472	-772	-627	-616	-370	-350
<b>Adj. EBIT</b>	<b>-10,357</b>	<b>-5,281</b>	<b>-5,691</b>	<b>-2,808</b>	<b>-291</b>	<b>-543</b>	<b>569</b>
<b>EBIT</b>	<b>-11,153</b>	<b>-6,320</b>	<b>-6,229</b>	<b>-2,685</b>	<b>-1,017</b>	<b>-1,183</b>	<b>-231</b>
<i>Adj. EBIT margin (%)</i>	-884%	-118%	-232%	-42%	-3%	-4%	3%
Investment income	16	13	17	1	0	2	3
Net finance income	-6	-2	-30	-50	-161	-177	-195
<b>PBT</b>	<b>-10,347</b>	<b>-5,270</b>	<b>-5,704</b>	<b>-2,734</b>	<b>-452</b>	<b>-718</b>	<b>377</b>
Taxation / tax credit	1,402	927	576	677	307	280	0
<i>Effective tax rate (%)</i>	-14%	-18%	-10%	-25%	-68%	-39%	0%
<b>Net income</b>	<b>-8,945</b>	<b>-4,343</b>	<b>-5,128</b>	<b>-2,058</b>	<b>-871</b>	<b>-438</b>	<b>377</b>
EPS (basic, p)	-10.18	-3.71	-2.96	-1.18	-0.42	-0.18	0.14
EPS (diluted, p)	-10.18	-3.71	-2.96	-1.18	-0.42	-0.18	0.14
Average shares in issue basic (m)	95.740	116.976	173.048	174.755	205.173	241.456	267.191
Average shares in issue dil. (m)	95.740	116.976	173.048	174.755	205.173	241.456	267.191

Source: Company data, Hardman & Co Research estimates

## 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, including a WACC of 10% and the medium-term revenue profile, which reflects the international pipeline of opportunities.

The analysis produces an implied fair enterprise value of £90.3m and an implied fair equity value of £96.8m (equating to £0.36 per share). These valuation outcomes are materially higher than the current enterprise value of £40.9m and market capitalisation of £47.4m.

### CyanConnode: Hardman & Co DCF analysis

#### Key inputs

Terminal FCF growth rate	3.0%
Long-term sustainable EBIT margin	25.0%
Long-term tax rate on EBIT	18.0%
<b>WACC</b>	<b>10.0%</b>

Y/end March, £m	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E	2031E	Terminal value
<b>Revenue</b>	<b>12.2</b>	<b>17.2</b>	<b>23.4</b>	<b>30.4</b>	<b>38.6</b>	<b>48.2</b>	<b>58.8</b>	<b>67.7</b>	<b>73.1</b>	
<i>yoy growth</i>	27.9%	40.5%	36.0%	30.0%	27.0%	25.0%	22.0%	15.0%	8.0%	
<b>EBIT margin</b>	<b>-4.4%</b>	<b>3.3%</b>	<b>10.0%</b>	<b>12.0%</b>	<b>15.0%</b>	<b>19.0%</b>	<b>22.0%</b>	<b>23.0%</b>	<b>25.0%</b>	
<b>EBIT</b>	<b>-0.5</b>	<b>0.6</b>	<b>2.3</b>	<b>3.6</b>	<b>5.8</b>	<b>9.2</b>	<b>12.9</b>	<b>15.6</b>	<b>18.3</b>	
Depreciation & amortisation	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	
<b>Adj. EBITDA</b>	<b>-0.2</b>	<b>0.9</b>	<b>2.7</b>	<b>4.0</b>	<b>6.2</b>	<b>9.6</b>	<b>13.3</b>	<b>16.0</b>	<b>18.7</b>	
Tax rate	0.0%	0.0%	5.0%	10.0%	12.0%	14.0%	16.0%	18.0%	18.0%	
Tax on EBIT	0.0	0.0	-0.1	-0.4	-0.7	-1.3	-2.1	-2.8	-3.3	
Change in net working capital	-0.1	-0.1	-0.1	-0.2	-0.2	-0.2	-0.3	-0.4	-0.4	
<b>Cashflow from operations</b>	<b>-0.3</b>	<b>0.8</b>	<b>2.4</b>	<b>3.5</b>	<b>5.3</b>	<b>8.0</b>	<b>11.0</b>	<b>12.8</b>	<b>15.0</b>	
Capex	-0.3	-0.3	-0.4	-0.4	-0.4	-0.5	-0.5	-0.6	-0.4	
<b>Unlevered free cashflow</b>	<b>-0.6</b>	<b>0.5</b>	<b>2.1</b>	<b>3.1</b>	<b>4.8</b>	<b>7.5</b>	<b>10.4</b>	<b>12.2</b>	<b>14.6</b>	<b>149.3</b>
Year	1	2	3	4	5	6	7	8	9	10
Discount factor	1.10	1.21	1.33	1.46	1.61	1.77	1.95	2.14	2.36	2.36
<b>Present value</b>	<b>-0.5</b>	<b>0.4</b>	<b>1.6</b>	<b>2.1</b>	<b>3.0</b>	<b>4.3</b>	<b>5.4</b>	<b>5.7</b>	<b>5.2</b>	<b>63.3</b>

Note: based on medium-term assumptions from 2025E

<b>Implied valuation metrics</b>	<b>£m</b>
Sum of nine-year cashflow	27.0
Terminal value	63.3
Value of the firm	90.3
Net funds	6.5
<b>Total equity value</b>	<b>96.8</b>
No. of shares in issue (m)	267.2
<b>Fair value share price (£)</b>	<b>0.36</b>

Source: Hardman & Co Research estimates



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## Status of Hardman & Co's research under MiFID II

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In particular, Article 12(3) of the Directive states: 'The following benefits shall qualify as acceptable minor non-monetary benefits only if they are: (b) 'written material from a third party that is commissioned and paid for by a corporate issuer or potential issuer to promote a new issuance by the company, or where the third party firm is contractually engaged and paid by the issuer to produce such material on an ongoing basis, provided that the relationship is clearly disclosed in the material and that the material is made available at the same time to any investment firms wishing to receive it or to the general public...'

The fact that Hardman & Co is commissioned to write the research is disclosed in the disclaimer, and the research is widely available.

The full detail is on page 26 of the full directive, which can be accessed here: <https://ec.europa.eu/transparency/regdoc/rep/3/2016/EN/3-2016-2031-EN-F1-1.PDF>.

In addition, it should be noted that MiFID II's main aim is to ensure transparency in the relationship between fund managers and brokers/suppliers, and eliminate what is termed 'inducement', whereby free research is provided to fund managers to encourage them to deal with the broker. Hardman & Co is not inducing the reader of our research to trade through us, since we do not deal in any security or legal entity.

