

TERN PLC

SOFTWARE AND COMPUTER SERVICES

1 August 2022

TERN.L

12.5p

Market Cap: £44m

SHARE PRICE (p)



12m high/low

23.3p/9.9p

Source: LSE Data (priced as at prior close)

KEY DATA

Net (Debt)/Cash	£2.0m (at 31/12/21)
Enterprise value	£42m
Index/market	AIM
Next news	Interims Sep 2022
Shares in Issue (m)	352.1
Chairman	Ian Ritchie
Chief Executive	Albert E Sisto
Finance Director	Sarah Payne

COMPANY DESCRIPTION

Tern predominantly invests in software companies, with proven technology, based in the UK but with global ambition.

www.ternplc.com

TERN PLC IS A RESEARCH CLIENT OF PROGRESSIVE

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A hybrid VC model to access the IoT opportunity

Tern recently issued a strategy update following the termination of its proposed acquisition of Pires Investments plc. While the termination was disappointing given the complementary portfolio potential from Pires, we believe that focus should shift to Tern's hybrid VC model and the value and organic growth potential from its own network of companies. 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. Coupled with delays due to Covid, we believe this would make an immediate exit premature. The group has delivered consistent valuation uplifts, with 35% year-on-year total net asset growth achieved in FY21. Tern remains focused on the route of value creation and ultimately exit at the appropriate time, and has the model to succeed in this.

- **Tern provides a unique proposition**, creating value via access to disruptive start-ups not generally available to AIM investors. It operates a hybrid Venture Capital (VC) model, focusing on proven VC success factors of Timing, Team, Business Model and Funding, with all shareholders as effective Limited Partners. This business model change was actioned in February 2017 following the acquisition of Device Authority Inc.
- **Tern's portfolio has achieved significant uplifts in value** in the last 18 months, despite the pandemic. Given most investments are still at an early stage in terms of a traditional VC model, we expect exit timing to be medium term rather than immediate.
- **Accelerated need for contactless due to the pandemic.** The expected adoption rate of IoT technologies has been delayed due to Covid. However, all of Tern's companies are benefitting from the acceleration of business digital transformation. FVR is at the forefront, having recently closed a 'round B' funding that included significant additional third-party capital with minimal participation from Tern. The remaining portfolio companies are likely poised to do the same.

Tern offers UK investors a unique proposition. Acting as an AIM-listed hybrid VC, the business provides its shareholders with a diversified way to gain exposure to a broad range of IoT-related assets. 2021 marked a year of record performance and growth, and a second year of profitability. New independent third-party partners have been secured, de-risking the business, and we expect the continued MRR growth to drive additional strategic interest this year. We look forward to further positive newsflow on the progress of Tern's network of companies during 2022.

TERN'S NETWORK OF COMPANIES



**DEVICE
AUTHORITY**

FUNDAMENTALVR



Wyld Networks

KONEKTIO



Talking Medicines

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

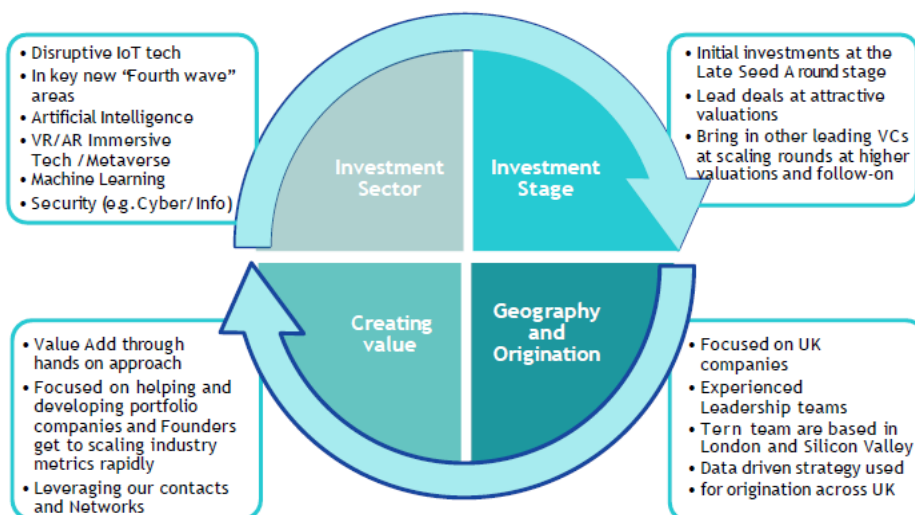
Tern PLC is an AIM-listed provider of venture capital to exciting IoT innovators, creating value through a hybrid VC model via access to disruptive start-ups not generally available to AIM investors. This model gives all shareholders the opportunity to act as Limited Partners (LPs), akin to the capital call model in a traditional VC fund. Tern has invested in sectors poised for exponential growth, including AI, Machine Learning, IoT, Cyber Security, Big Data, Digital Assets and Immersive Technologies.

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 uplifts in the values of portfolio companies, 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.

For the full year to the end of December 2021, Tern reported 35% growth in total net assets to £32.4m (2020: £24.0m), with NAV per share increasing 26% to 9.2p (2020: 7.3p). The main valuation driver was a £4.7m uplift in the value of Tern’s investment in Wyld Networks to £8.7m, following the successful IPO. This in essence represents an exit of Wyld Networks, now with access to public market capital in the future. Tern invested £2.5m across its network in the period, to support two value-enhancing syndicated equity raises (plus additional post period). The £4m equity raise in July 2021 significantly strengthened Tern’s balance sheet, with £2.0m cash held at the year-end.

Tern Investment Strategy

Tern Investment Strategy



Source: Company, Progressive Equity Research

Can be considered an 'evergreen' VC fund, with continuous access to returns for LPs

In our view, Tern could be considered an 'evergreen' VC fund: open-ended, with no termination date, meaning capital can be raised, repaid or transferred on an ongoing basis. This model provides a very efficient use of capital, and Tern has an excellent track record of building value that attracts new investors at higher multiples. The model means that Tern’s LPs (shareholders) have continuous access to returns as the group exits one

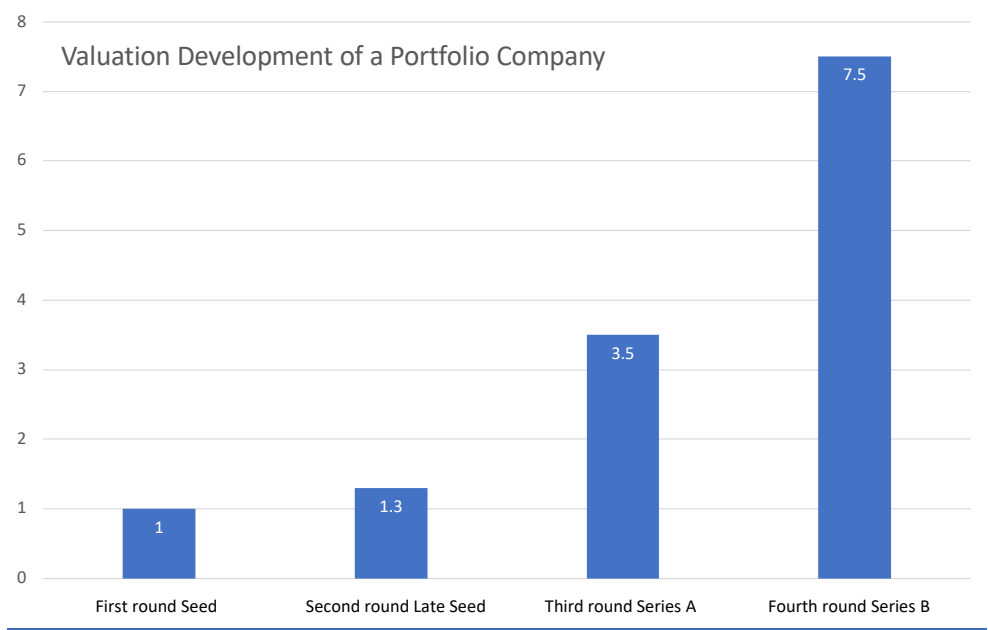
An early-stage investor positioned for larger returns on exit

investment and enters another; an example being Wyld as Tern has moved from VC investor to instructional investor status. 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.

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, Device Authority has benefitted from a strategic investment from Venafi in 2021 (whose major investor is Thoma Bravo), and with the IPO of Wyld, Tern has achieved a public market valuation for Wyld Networks.

Example: equity valuation relative to when first invested



Source: Company, Progressive Equity Research

The Covid pandemic changed the dynamics in almost every segment of the market. Tern built out early investments anticipating the rapid adoption of IoT in the 2020-2023 timeframe, which has been delayed by the pandemic. However, labour shortages and the need for contactless interaction have driven the rapid acceleration of a business digital transformation, of which Tern has been a major beneficiary. All of Tern’s portfolio companies are benefitting from this acceleration, with Fundamental VR at the forefront having recently closed a B round of funding with new growth-oriented VC firms. Tern’s other portfolio companies are poised to follow the same path. In the most recent funding rounds the Tern investment proportion has been relatively small, demonstrating that the capital requirements are reducing as the businesses become attractive to third-party investors.

Pires deal rationale

The Pires deal would have been an inorganic step-change in growth for Tern, alongside expected organic growth from the portfolio, or a layering of portfolios that can be accomplished by VCs (having Fund 1 followed by Fund 2 4-6 years later). The current Tern portfolio companies have either concluded an A round of funding or are expected to, and some can therefore be expected to conclude a B round (except for FVR, which has completed its B round).

Pires has a 20% investment in the €25m SVV1 fund, which has reached Harvest mode. Pires also has additional direct investments in companies moving to a B round. Tern's management believed that its hands-on approach and experience would have been able to accelerate harvest times and value, resulting in cash inflows to Tern.

The potential dilution appears to have been a stumbling block for existing shareholders. However, we believe this ignores the potential of acquiring a business worth c.£10-11m that has not had a third-party mark to market validation recently.

In its strategy update, Tern acknowledged the wish of some shareholders to see the business model crystallise value for shareholders through the exit of an existing holding before further companies are added to the network of companies. In response, management stressed its belief that all of the companies in Tern's network are capable of further value-enhancing growth. As mentioned, while understanding shareholder concerns, we believe that Tern has an efficient model and that maximum value for shareholders will come in the medium term after businesses have been prepared for harvest.

Recent events in the Tern portfolio

Device Authority (53.8%, with a book value of US\$19.8m, approximately £14.8m, as at December 2021) – automates the provision of secure platforms for IoT devices, and has seen good progress, particularly in the US following the \$1.25m strategic investment from Venafi (owned by Thoma Bravo) in December 2021. This is part of a broader US\$2.91m funding package for Device Authority, which includes a follow-on US\$1.25m investment from Tern alongside \$0.41m from existing Device Authority shareholders as part of a Series A round. We understand that Device Authority, has material growth in its monthly recurring revenues from its subscription base and its modularised licence platform, KeyScaler®.

FundamentalVR (20%, £6.3m NAV as at May 2022) – provides a software simulation environment, allowing surgeons' accuracy to be measured objectively for the first time. Social distancing and the reduction in elective surgeries as a result of Covid have accelerated the adoption of FundamentalVR's solutions. As a result, FundamentalVR recently attracted new investors to raise £7m in a Series B round at a much higher valuation, resulting in a 77% uplift to the year-end book value of £3.4m.

Talking Medicines (23.8%, £1.79m NAV as at January 2022) – has just broken into the US market at exactly the right time, meaning, in our view, that it is too early to look for an exit as it has excellent prospects. It raised a total of £1.59m (£0.40m from Tern) in January in a late seed round to support its planned expansion in the US, representing an uplift of approximately 62% on the amount invested by Tern since November 2020. Boston-based life science investor Mark Bamforth invested alongside Tern.

InVMA (36.8%, £2.2m NAV as at December 2021) – is now trading as Konektio following its £2.2m late-seed investment round in December 2021, led by fund managers Foresight and Mercia, at a 44% uplift. Konektio’s Industrial IoT connected asset software as a service (SaaS) product, AssetMinder, is in ever-increasing demand from customers and it is continuing to build MRRs.

Wyld Networks (58.7%, £8.7m NAV, as at the year ended December 2021) – has a wireless mesh technology to allow low-power networks to be formed. Wyld was floated on the NASDAQ First North Growth Market in Stockholm in 2021, with Tern retaining a majority stake. Tern is looking to leverage this into a larger return as the satellite business gathers pace and the lock-up period has ended. The IPO has also provided a route to exit to maximise value for Tern shareholders. The valuation of Wyld has increased to £8.7m (2020: £4.0m) due to its market-leading positions, additional funding and fair value uplift.

Investment in new SVV fund, which will focus on investing in private UK software companies in the Metaverse, Artificial Intelligence and Cyber Security sectors. First close of the fund amounted to £85m, with an initial investment from Tern of c.£90,000. This was used to fund the first investment made in RETinIZE Limited, an award-winning creative-tech company, successfully raising £2m. The seed round was led by the SVV2 Software Fund, which invested £1m.

Tern, as has Pires, scaled back its need for additional human resources – in Tern’s case to curate deals – by lessening its early return ratio on investments by using SVV and paying it venture management fees. This is the core difference in operating costs between Tern and Pires, with Pires shareholders almost solely dependent on SVV for a share of any returns.

Conclusion

Although the termination of the Pires acquisition can be seen as a setback for Tern, we believe that the market reaction reflects a lack of understanding about the model created by management and the group’s long-term ability to create value from its portfolio.

Tern operates an efficient hybrid VC model that gives shareholders an opportunity to act as Limited Partners (LPs). It could be considered an ‘evergreen’ VC fund, with a very efficient use of capital model and an excellent track record of building value that attracts new investors at higher multiples, as well as providing continuous returns for its LPs.

The management team has pivoted the company such that the business is squarely at the centre of the IoT opportunity, with a very focused investment management strategy. Tern anticipated the growing importance of IoT, particularly in the Healthcare/Life Sciences and Industrial segments, and has been successful in building a complementary portfolio.

Tern’s model requires capital calls (placements) to increase AUM, NAV/Share and its investment percentage position in a business. Although regular equity raises have the perception of being dilutive, the track record for Tern suggests that they actually have been accretive over time, with third parties supporting the placements and incremental value being created.

In our view, Tern continues to offer UK investors a unique proposition, providing its shareholders/LPs with a diversified way to gain exposure to a broad range of IoT-related assets. In 2021, the group achieved a year of record performance and a second year of profitability, and its portfolio companies appear well-positioned for further growth and value creation. In looking forward to more positive newsflow on the progress of Tern’s network of companies in coming months, we are hopeful that the market’s understanding of the group’s unique model will develop, creating further value for its shareholders/LPs.

Diversified access to the IoT opportunity through a unique business model

Disclaimers and Disclosures

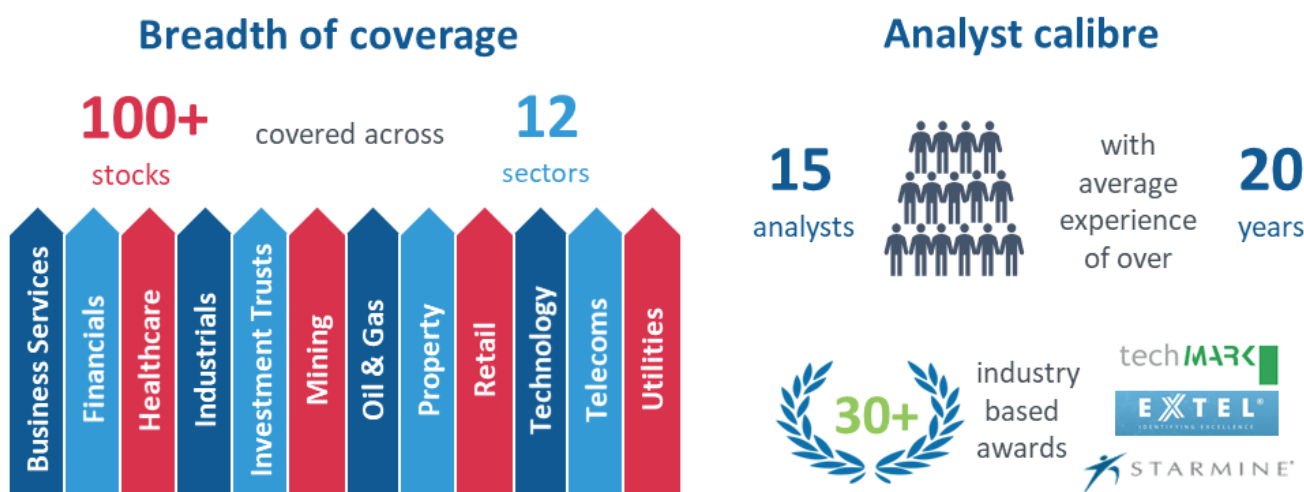
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