

27 February 2017

ASX ANNOUNCEMENT

Senetas Corporation Limited Half-Year Results Announcement For the six months to 31 December 2016

Senetas profit in line with market guidance

Senetas Corporation Limited (ASX: SEN), a leading global developer and manufacturer of multi-certified, defence-grade data encryption solutions, is pleased to announce its results for the six months ended 31 December 2016 (HY17).

HY17 highlights:

- Operating revenue up 8% to \$9.34 million (HY16: \$8.67 million);
- Net profit before tax down 31% to \$1.27 million (HY16: \$1.85 million);
- Net profit after tax down 45% to \$0.86 million (HY16: \$1.59 million);
- Gross profit margin was 73%, and pre-tax profit margin at 14%;
- Strong balance sheet
 - No debt;
 - Cash on hand at 31 December 2016 of \$19.72 million (30 June 2016: \$20.85 million); and
 - Net assets up 5% to \$19.45 million
- Certification for the new 100Gbps encryptor is on track and a second customer has commenced testing. Other major R&D projects are also progressing well including the virtual encryptor and the custom algorithm project

Commenting on the Company's results, Senetas CEO Andrew Wilson said, "As previously announced to the market, a number of Senetas' largest customers have been undergoing network upgrades which slowed demand for our products during HY17. Senetas' results in the first half reflect the impact of those disrupted customer ordering patterns although we are pleased to have delivered revenue growth and positive returns in what was a tough sales period.

"Whilst product sales revenue was lower, our annuity maintenance revenue grew 22% and made up 45% of total revenue for the period. The growth in maintenance revenue reflects strong sales growth in prior periods. Gross margin fell to 73% (2015:83%) primarily due to a larger inventory



NATO Classification
Restricted - Green

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transfer to our sales partner Gemalto in HY17; this was partly offset by the increase in recurring maintenance revenues.

“Whilst the company had 20% year on year growth in revenue for calendar year 2016, and similar growth for calendar 2015, we are disappointed with the HY17 sales performance and believe that it can be substantially improved.

“We advised in our FY16 results announcement that we were working closely with Gemalto to improve sales in the US Federal Government business and we are pleased with the results so far. However, we believe that substantial further work still needs to be done across the board with respect to sales (direct and through the channel) and marketing to fully realise the true growth potential of the Senetas product set across both geographic and vertical markets.

“The additional inventory orders placed by Gemalto during HY17 are a sign of confidence that they expect higher levels of sales to resume in the near term; however, we will continue to work with them to support ongoing improvements to client engagement and to achieve a stronger growth trajectory in future periods.

“Senetas’ financial position remains extremely sound, with net assets continuing to grow during the period, no debt, and cash on hand of almost \$20 million.”

Research and Development

A highly innovative and responsive R&D capability remains the company’s core focus and will be the major driver of growth prospects and increased profitability going forward.

The key focus during the half has been progressing certification for the 100Gbps encryptor and making changes in response to demands from end customers who have been testing the encryptor in their network environment.

Mr Wilson said: “With our 100Gbps product progressing through certification and currently being tested by two corporate customers this new product is expected to drive significant sales in future periods. Our engineers and technical staff continue to show exceptional ability to develop world leading technologies that will see increasing demand as network security and privacy concerns continue to gain attention.

“Senetas’ custom encryption algorithm product (“CEAP”) is also progressing and currently moving through the export approval process. The next steps towards future sales are customer testing and local certification. Subject to the timing of export approval and certification it is expected that the CEAP will become available for sale around the end of the 2017 calendar year.

“The virtual encryption technology being developed by Senetas also offers great potential for us to service remote clients who need secure networks but do not want a hardware solution. Pleasingly two customers have recently completed successful trials of the virtual encryptors. The product is now available for sale and is currently included in tender proposals for end users. The success of these tender proposals will determine the timing for initial sales. These sales are expected to be small compared to HSE hardware sales but can open the door to new markets and provide a recurring source of revenue that will grow over time as new customers are brought onboard.”



Senetas is continuing to work actively with its customers, master distribution partner (Gemalto) and technology partners in order to identify new product/service opportunities that will create significant ongoing revenue growth for Senetas in the future.

Senetas continues to expect that R&D expenditure during FY17 will be similar to FY16.

Acquisitions

During December 2016 Senetas purchased a 6% equity stake in Smart Antenna Technologies Ltd (SAT), a pioneering international smart antenna technology company based in the UK. This investment is complementary to Senetas' core competencies, was funded from cash reserves and provides Senetas with board observer status.

In February 2017 Senetas signed an agreement to acquire SureDrop on an earnout basis with no upfront capital outlay. This product delivers simple file sync and share capability that is delivered with the security and resilience of a bespoke on-premise solution. The product has progressed through development stages and the data encryption, key management and file fragmentation security features are based on the same best-in-class technologies used in Senetas' multi-certified high-speed encryptors. This solution will be offered on a user subscription basis. The SureDrop product is in the early stages of release to the market and is not currently revenue producing. It is currently being trialed by customers in partnership with a large Australian telecommunications company.

Mr Wilson said: "Both of these acquisitions reflect Senetas' stated strategy of exploring shareholder value enhancing opportunities that are complementary to Senetas' core competencies and have the potential to add significant value to Senetas in the longer term."

Balance Sheet and Cash Flow

Senetas' balance sheet continues to strengthen and provides significant capacity to support both organic growth and investment. Net assets increased 5% to \$19.45 million and the cash balance at 31 December 2016 was \$19.72 million.

Net operating cash outflows were \$0.14 million in HY17. Good growth in receipts from customers was more than offset by increased payments to suppliers as a result of the very strong sales in June 2016 and higher inventory transfers to Gemalto during the half. Net investing cash outflows of \$0.99 million primarily reflect the acquisition of a 6% stake in SAT in December 2016.

Tax Expense

The effective tax rate for HY17 was 31.7%. The effective tax rate is up from 14.1% in HY16 which benefited from the use of carried forward tax losses that have now been fully utilised.

Outlook

Commenting on the Company's growth outlook, Mr Wilson said:



“Whilst sales in the first half of FY17 were impacted by the network upgrades currently underway at Senetas’ largest customers, we continue to expect the sales disruption to be temporary and will reverse as those network upgrades are completed.

“The precise timing for completion of the network upgrades is uncertain; however, current expectations are for FY17 net profit before tax to be between \$5m and \$6m, and net profit after tax between \$3.4m and \$4.2m. A return to more normal customer ordering patterns earlier or later than anticipated will impact our current expectations for FY17 profit.

“With initial sales of the new 100Gbps encryptor and virtual encryptor currently expected to commence late in the financial year, and further out, sales from other technologies such as the custom algorithm product and SureDrop, Senetas has a strong pipeline of growth opportunities ahead over the medium term.”

END

Investor and analyst conference call

The Company will be holding an investor and analyst conference call at 11.00AM AEDT today.

Dial in details: Participants can dial +61 2 9007 8048 or 1800 908 299 (toll free) to join the call. When prompted, please enter Conference ID: 123145

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