

Q2 FY23 – APPENDIX 4C DECEMBER QUARTERLY REPORT AND OPERATIONAL UPDATE

Tesseract Limited (ASX:TNT) (Tesseract, the Group or Company) is pleased to provide its quarterly cash report and business update of its activities and achievements for the quarter ended 31 December 2022.

	Turnover	% change (vs. PCP)	EBITDA	% change (vs. PCP)
YTD Q2 FY23	\$85.1m	+35%	\$5.0m	+9%
Q2 FY23	\$45.5m	+31%	\$2.6m	+6%
Other activities and KPIs				
	<i>Positive operating cash flow of \$2.5m for the second quarter</i>	<i>ARR (annual recurring revenue) now 50% of turnover up from 44% in prior year</i>	<i>Growth in new Incident Response service offering in the market</i>	<i>Further \$1m investment in Innovation Partner - Daltrey</i>

* Turnover includes gross (billed) revenue from consulting and advisory services, plus turnover from product sales

* Q1 earnings results are unaudited. Operating EBITDA (excludes one-off acquisition costs and statutory AASB16 adjustments)

HIGHLIGHTS

Tesseract is pleased to announce continued growth through the second quarter of the FY23 financial year.

- Successful delivery of Q2 and first half turnover growth against prior year comparative results. Turnover and earnings are continuing to exhibit the regular seasonality profile.
- In the backdrop of the current market environment, and the recent high-profile breaches in the Australian market, Tesseract has recorded significant growth in its sales pipeline over the last three months across all Divisions.
- Tesseract's significant investment in starting and growing a new premium Incident Response service has been pleasing in securing five major retainer contracts since launching in June 2022. This new organic initiative however has necessitated a substantial increase to operating costs in the first half.
- The Group's security operations centre (SOC) is not yet at the scale we have targeted, but the transformation and improvement is ongoing (*as discussed on page 4*). The refreshed offering has recently been successful in signing a number of new enterprise clients as a result of the increased Cyber threats occurring in the second half of 2022.
- Annual Recurring Revenue (ARR) has now increased to 50% of annual Group turnover
- Continued recruitment of key cyber talent with a further 19 employees joining the Group during the half – taking total current Tesseract workforce to 478.

As noted in previous quarterly releases, earnings within the business are highly seasonal (with operating EBITDA in H1/H2 reported at c. 27% / 73% respectively for each of the last two years). The Group also expects similar seasonality within the current year.

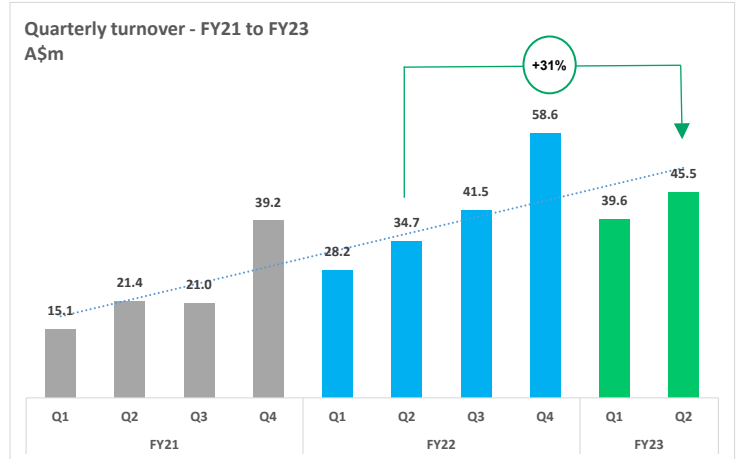


FINANCIAL UPDATE – SECOND QUARTER FY23

Continued growth in turnover and earnings

The Group reported continued growth in the underlying business for the second quarter of FY23, with year-on-year growth for the quarter of 31% against the second quarter of last year.

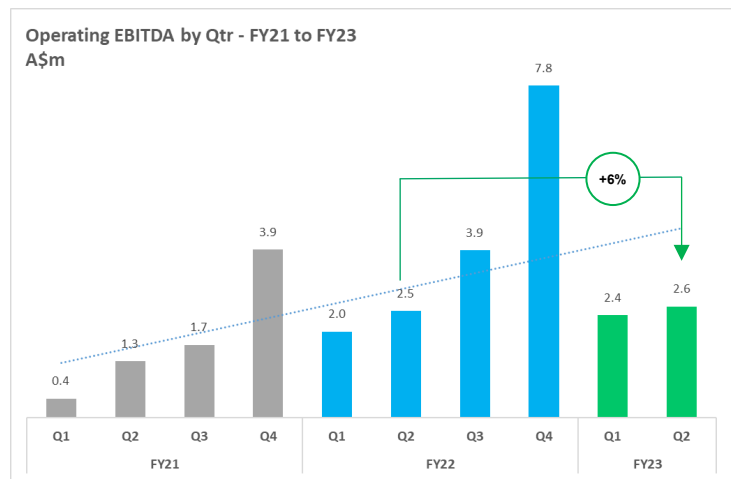
The Q2 turnover result of **\$45.5m** as expected, continues to exhibit growth in line with the normal annual seasonality profile of the business as shown in the adjacent chart.



Operating EBITDA also reported modest growth against the second quarter of last year – at +6% on PCP.

The Operating EBITDA result of **\$2.6m** for the second quarter came through slightly lower than budgeted at 5.8% EBITDA margin, reflecting restructuring/integration costs alongside investment/growth in resourcing and operational structure.

Tesseract is continuing to invest in, and expand, its service offering to its clients through its new Incident Response service offering and its Security Operations Centre (SOC) business. The SOC division is currently performing below the Group's target Operating EBITDA metric as it focuses on refreshing the offering in this area.



Figures 1 & 2 – Turnover and Operating EBITDA on quarterly basis for current period and previous year

Operating and overall cashflow

The Group recorded an operating cash inflow of \$2.5m in the second quarter FY23, as a result of positive movement in net working capital for the quarter – despite an increase in unbilled Work in Progress (WIP) of \$4.4m in the first half of FY23.

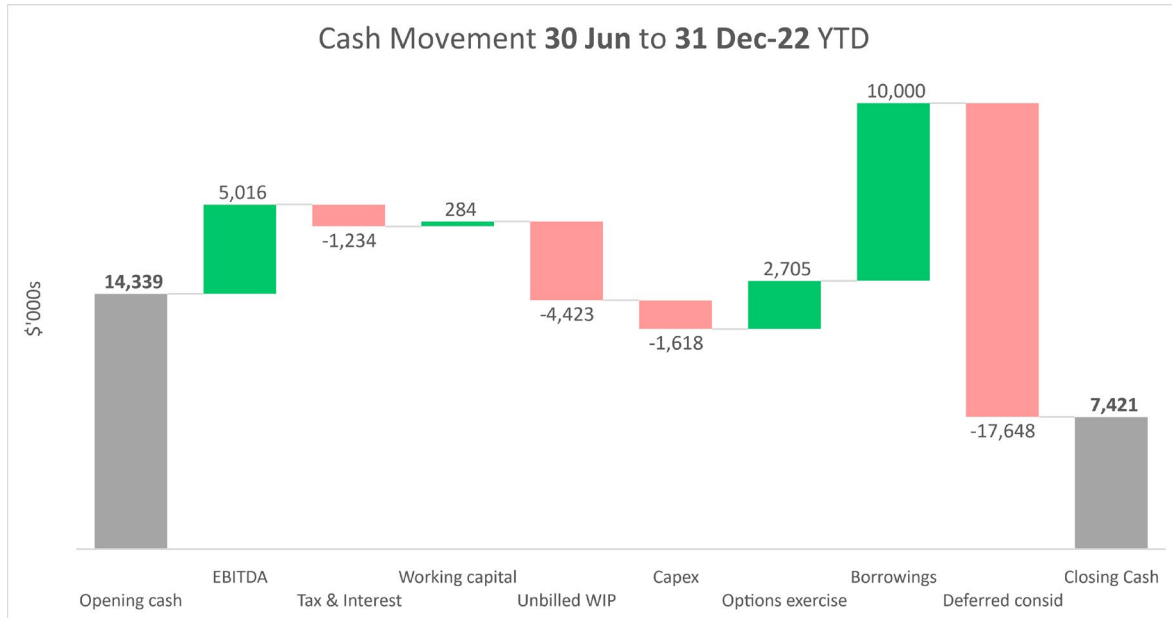
As shown in the cashflow chart over the page, WIP and working capital movements over the year have a material impact on the quarterly operating cash flow results. Looking at the full year performance however, the cash conversion and operating cash remains strong and the Group has facilities in place to manage working capital fluctuations.

Further to operating cash flows, the first half of FY23 saw pay down of \$16.6m of deferred consideration and earnout liabilities relating to acquisitions made in FY21 and FY22. The business also invested \$1m in innovation partner Daltrey and \$1.6m in software / IP development projects



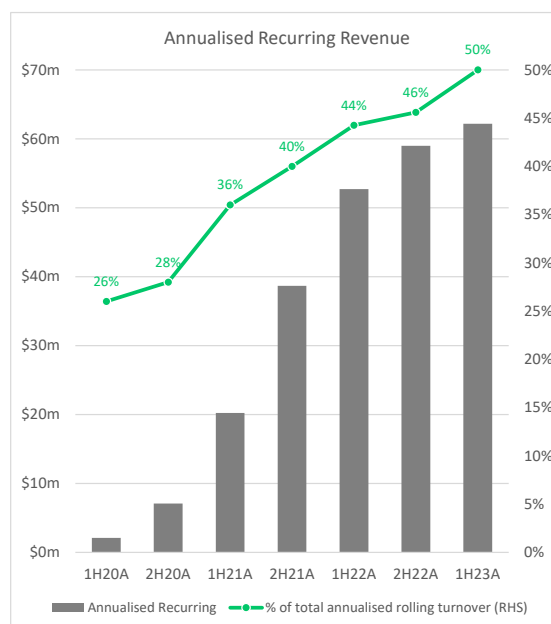
during the half. These payments were partially funded by conversion of \$2.7m of existing share options at current market pricing, partially funded by drawing down on the CBA facility, and partially funded from operating cash.

Refer to chart below for a breakdown of the cash flows for the Group since the start of FY23 financial year.



Continued Annual Recurring Revenue (ARR) Growth

Consistent with previous reports, the Group’s recurring revenue as a proportion of total annual sales continues to grow and is tracked as a key performance measure within the business (alongside total contracted revenue).



Margin progression

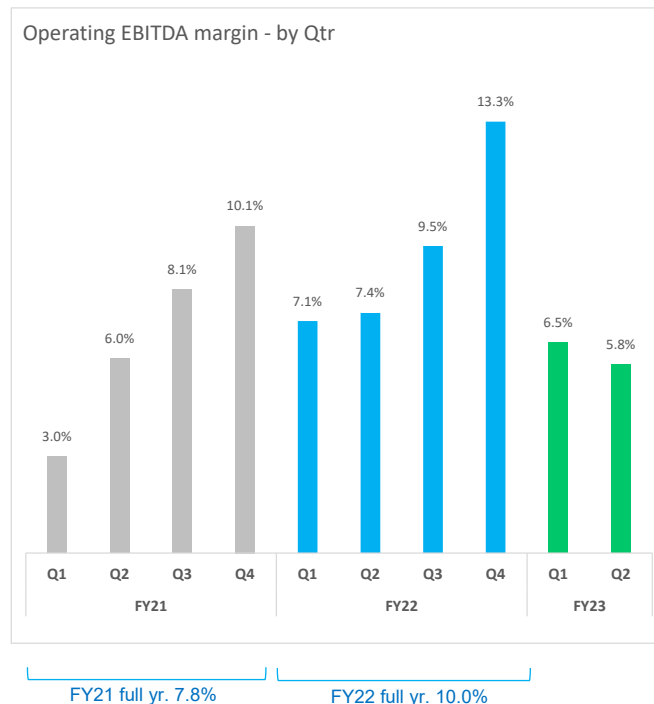
Tesseract has reported growth in EBITDA margin over the last two years through improved pricing and margin controls. The EBITDA margin exhibits seasonality, broadly consistent with the revenue seasonality of the business.

The Operating EBITDA margins in Q1 and Q2 of the current financial year have reduced from the prior comparative periods.

The Group’s investment in building and growing a new Incident Response service offering in the market is showing promise as the business has secured five significant retainer contracts and assisted clients with a number of incidents since it commenced operations in June-22. The cost incurred in building a credible IR offering has had some impact on the overall Group margins in the current year, but Management believe that this service offering will become a material part of the Group’s client offering and financial results.

This margin reduction also reflects some one-off costs associated with some underscale network and infrastructure management services, plus investment in key resources to take advantage of the growing Cyber market and the transformation needed to deliver the Security Operations Centre (SOC) offering. This refreshed offering has recently been successful in signing a number of new key enterprise and mid-market clients as a result of the increase in Cyber threats occurring in the second half of 2022.

Management expects the Security Operations Centre (SOC) to be back to delivering on its financial targets by Q4 FY23.



RECRUITMENT OF KEY TALENT AND HEADCOUNT GROWTH

As at the date of this report, the Group has grown to a headcount of 478, having recruited an additional 19 employees (net) in the first half of FY23.

The business remains focused on recruiting and retaining key talent to continue to provide an outstanding level of customer service to our clients, whilst continuing to grow our coverage in all aspects of the Cyber 360 delivery to the market.

Our senior leadership team continue to be a key differentiator in attracting talent to Tesseract, with several recent senior hires joining from key industry players.

ALC ACQUISITION

As announced on 30 January, Tesseract reached agreement to acquire the business of ALC Group, a prominent Australian Cybersecurity training business.

ALC will be integrated into the Tesseract Academy business division. The acquisition of structured course delivery models and content will support Tesseract Academy's strategic objective of addressing a talent shortage in the Cyber market, with Tesseract academy plans to rollout programmes which bring new talent into the industry at the entry level and supporting them with both training and placement opportunities to gain relevant and necessary experience.

ALC provides certified training courses and administers the associated exams across 10 accreditation bodies which will form a core part of Tesseract Academy's offering going forward.

ALC Group has a strong operating record, with unaudited FY22 turnover of \$7.4m, delivering \$1.4m EBITDA, and ALC will be immediately earnings, cash flow and EPS accretive to the TNT Group.

FURTHER INNOVATION INVESTMENT IN DALTREY

In mid-October 2022, the Group increased its investment in Daltrey Pty Ltd, a leading sovereign biometric security company. Tesseract's initial investment into Daltrey of \$1.7m was announced in July 2021, and since that date, the Daltrey business has continued the development of its technology to reach production stage and has commenced sales and rollout of the technology into a number of government and enterprise clients.

Daltrey's biometric authentication capability materially increases an organisation's security posture by getting rid of the most attacked vulnerability – passwords. It has been implemented by Federal Government, critical national infrastructure providers and publicly listed companies to help protect their teams' critical assets.

Tesseract invested a further \$1m into the Daltrey business, alongside other third party investors to drive Daltrey's continued growth. This investment was supported by a valuation which saw an uplift in the valuation of Tesseract's initial investment in TNT's FY22 audited accounts.



ABOUT TESSERENT

Our mission is to be the sovereign cybersecurity provider of choice for the protection of Australia and New Zealand's digital assets.

Tesseract provides full service, enterprise-grade cybersecurity and networking solutions targeted at midmarket, enterprise and government customers across Australia and New Zealand. The Company's Cyber 360 strategy delivers integrated solutions covering identification, protection and 24/7 monitoring against cybersecurity threats. With more than 450 security engineers, Tesseract has the capability to support organisations to defend their digital assets against increasing risks and cyber-attacks.

Tesseract has been transformed via the integration of several high-quality cybersecurity businesses making it Australia's largest listed dedicated cybersecurity firm.

Learn more at www.tesseract.com

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Authorised by the Disclosure Team under Tesseract's Continuous Disclosure policy



Appendix 4C

Quarterly cash flow report for entities subject to Listing Rule 4.7B

Name of entity

Tesserent Limited

ABN

13 605 672 928

Quarter ended ("current quarter")

31 December 2022

Consolidated statement of cash flows	Current quarter \$A'000	Year to date (12 months) \$A'000
1. Cash flows from operating activities		
1.1 Receipts from customers	42,922	94,758
1.2 Payments for		
(a) research and development		
(b) product manufacturing and operating costs	(22,224)	(55,998)
(c) advertising and marketing	(118)	(338)
(d) leased assets		
(e) staff costs	(16,968)	(35,447)
(f) administration and corporate costs	(329)	(1,213)
1.3 Dividends received (see note 3)		
1.4 Interest received		
1.5 Interest and other costs of finance paid	(671)	(1,130)
1.6 Income taxes paid	(91)	(238)
1.7 Government grants and tax incentives		
1.8 Other (provide details if material)	3	(8)
1.9 Net cash from / (used in) operating activities	2,524	386
2. Cash flows from investing activities		
2.1 Payments to acquire or for:		
(a) entities		
(b) businesses		
(c) property, plant and equipment	(166)	(1,009)
(d) investments	(1,000)	(1,000)

Consolidated statement of cash flows	Current quarter \$A'000	Year to date (12 months) \$A'000
(e) intellectual property		
(f) other non-current assets	(311)	(708)
2.2 Proceeds from disposal of:		
(a) entities		
(b) businesses		
(c) property, plant and equipment		
(d) investments		
(e) intellectual property		
(f) other non-current assets		
2.3 Cash flows from loans to other entities		
2.4 Dividends received (see note 3)		
2.5 Other – deferred settlement payments M&A	(11,047)	(16,648)
2.6 Net cash from / (used in) investing activities	(12,524)	(19,365)

3. Cash flows from financing activities		
3.1 Proceeds from issues of equity securities (excluding convertible debt securities)		
3.2 Proceeds from issue of convertible debt securities		
3.3 Proceeds from exercise of options and warrant shares	20	2,705
3.4 Transaction costs related to issues of equity securities or convertible debt securities		
3.5 Proceeds from borrowings	8,000	10,000
3.6 Repayment of borrowings	(246)	(810)
3.7 Transaction costs related to loans and borrowings		
3.8 Dividends paid		
3.9 a Other – Interest paid		
3.9 b Other – (provide details if material)		
3.10 Net cash from / (used in) financing activities	7,774	11,895

Consolidated statement of cash flows		Current quarter \$A'000	Year to date (12 months) \$A'000
4.	Net increase / (decrease) in cash and cash equivalents for the period		
4.1	Cash and cash equivalents at beginning of period	9,481	14,339
4.2	Net cash from / (used in) operating activities (item 1.9 above)	2,524	386
4.3	Net cash from / (used in) investing activities (item 2.6 above)	(12,524)	(19,365)
4.4	Net cash from / (used in) financing activities (item 3.10 above)	7,774	11,895
4.5	Effect of movement in exchange rates on cash held	-	-
4.6	Cash and cash equivalents at end of period	7,255	7,255

5.	Reconciliation of cash and cash equivalents at the end of the quarter (as shown in the consolidated statement of cash flows) to the related items in the accounts	Current quarter \$A'000	Previous quarter \$A'000
5.1	Bank balances	7,255	9,481
5.2	Call deposits		
5.3	Bank overdrafts		
5.4	Other (provide details)		
5.5	Cash and cash equivalents at end of quarter (should equal item 4.6 above)	7,255	9,481

6.	Payments to related parties of the entity and their associates	Current quarter \$A'000
6.1	Aggregate amount of payments to related parties and their associates included in item 1	-
6.2	Aggregate amount of payments to related parties and their associates included in item 2	-
<i>Note: if any amounts are shown in items 6.1 or 6.2, your quarterly activity report must include a description of, and an explanation for, such payments.</i>		

7. Financing facilities	Total facility amount at quarter end \$A'000	Amount drawn at quarter end \$A'000
<i>Note: the term "facility" includes all forms of financing arrangements available to the entity. Add notes as necessary for an understanding of the sources of finance available to the entity.</i>		
7.1 Loan facilities	59,000	46,011
7.2 Credit standby arrangements		
7.3 Other (please specify)		
7.4 Total financing facilities	59,000	46,011
7.5 Unused financing facilities available at quarter end		12,989
7.6 Include in the box below a description of each facility above, including the lender, interest rate, maturity date and whether it is secured or unsecured. If any additional financing facilities have been entered into or are proposed to be entered into after quarter end, include a note providing details of those facilities as well.		
<p><i>Market Rate Loan and ancillary facilities provided by the Commonwealth Bank of Australia (CBA)</i></p> <ul style="list-style-type: none"> - <i>Market Rate Loan Facility of up to \$55m to be used to fund cash consideration payments on existing and future acquisitions; and</i> - <i>Ancillary facilities of \$4m – to cover Bank Guarantees, FX and corporate cards for the Group.</i> 		

8. Estimated cash available for future operating activities	\$A'000
8.1 Net cash from / (used in) operating activities (item 1.9)	2,524
8.2 Cash and cash equivalents at quarter end (item 4.6)	7,255
8.3 Unused finance facilities available at quarter end (item 7.5)	12,989
8.4 Total available funding (item 8.2 + item 8.3)	20,245
8.5 Estimated quarters of funding available (item 8.4 divided by item 8.1)	N/A
<i>Note: if the entity has reported positive net operating cash flows in item 1.9, answer item 8.5 as "N/A". Otherwise, a figure for the estimated quarters of funding available must be included in item 8.5.</i>	
8.6 If item 8.5 is less than 2 quarters, please provide answers to the following questions:	
8.6.1 Does the entity expect that it will continue to have the current level of net operating cash flows for the time being and, if not, why not?	
Answer: N/A	
8.6.2 Has the entity taken any steps, or does it propose to take any steps, to raise further cash to fund its operations and, if so, what are those steps and how likely does it believe that they will be successful?	
Answer: N/A	

8.6.3 Does the entity expect to be able to continue its operations and to meet its business objectives and, if so, on what basis?

Answer: N/A

Note: where item 8.5 is less than 2 quarters, all of questions 8.6.1, 8.6.2 and 8.6.3 above must be answered.

Compliance statement

- 1 This statement has been prepared in accordance with accounting standards and policies which comply with Listing Rule 19.11A.
- 2 This statement gives a true and fair view of the matters disclosed.

Date: 31 January 2023

Authorised by: The Disclosure Team

(Name of body or officer authorising release – see note 4)

Notes

1. This quarterly cash flow report and the accompanying activity report provide a basis for informing the market about the entity's activities for the past quarter, how they have been financed and the effect this has had on its cash position. An entity that wishes to disclose additional information over and above the minimum required under the Listing Rules is encouraged to do so.
2. If this quarterly cash flow report has been prepared in accordance with Australian Accounting Standards, the definitions in, and provisions of, *AASB 107: Statement of Cash Flows* apply to this report. If this quarterly cash flow report has been prepared in accordance with other accounting standards agreed by ASX pursuant to Listing Rule 19.11A, the corresponding equivalent standard applies to this report.
3. Dividends received may be classified either as cash flows from operating activities or cash flows from investing activities, depending on the accounting policy of the entity.
4. If this report has been authorised for release to the market by your board of directors, you can insert here: "By the board". If it has been authorised for release to the market by a committee of your board of directors, you can insert here: "By the [name of board committee – eg Audit and Risk Committee]". If it has been authorised for release to the market by a disclosure committee, you can insert here: "By the Disclosure Committee".
5. If this report has been authorised for release to the market by your board of directors and you wish to hold yourself out as complying with recommendation 4.2 of the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations*, the board should have received a declaration from its CEO and CFO that, in their opinion, the financial records of the entity have been properly maintained, that this report complies with the appropriate accounting standards and gives a true and fair view of the cash flows of the entity, and that their opinion has been formed on the basis of a sound system of risk management and internal control which is operating effectively.