

28 August 2017

ASX ANNOUNCEMENT

Senetas Corporation Limited Full-Year Results Announcement For the year to 30 June 2017

FY2017 investment in new products to deliver increased sales and expand Senetas' addressable market

Senetas Corporation Ltd (ASX: SEN) (Senetas / the Company), a leading global developer and manufacturer of multi-certified, defence-grade data encryption solutions, is pleased to announce its results for the year ended 30 June 2017 (FY2017).

Whilst FY2017 was disappointing from an earnings perspective (as previously forecast) it has nevertheless represented a break-out year for Senetas. The Company's cash flow and balance sheet has allowed it to make considered investments in its capability and product portfolio. The investments in hardware encryption products, software encryption products, and complementary security tools provide a foundation for strong future revenue and earnings growth.

FY2017 FINANCIAL HIGHLIGHTS:

Operating revenue down 7% to \$17.59 million (FY2016: \$18.92 million) as a result of the disruption to major customer ordering patterns. As expected, the impacts were temporary and those customers' recommenced orders prior to the end of FY2017.

Strong growth in maintenance revenue – now 46% of total revenue following strong encryptor sales growth in prior periods.

Significant progress on developing the pipeline of new product and new market opportunities that will drive growth for Senetas in FY2018 and beyond.

- Net profit before tax \$5.26 million, within previously announced guidance range (FY2016: \$7.02 million)
- Gross profit margin 79%, and pre-tax profit margin 30%
- Strong cash reserves and balance sheet with no debt
- The Company's excellent R&D program focused on developing new technologies such as the 100GB encryptor, custom algorithm solutions and virtualised encryption software will enable the Company to address new market opportunities that will drive growth for Senetas and shareholders in FY2018 and beyond



NATO Classification
Restricted - Green



OPERATIONAL HIGHLIGHTS:

Development of the 100GB encryptor, custom algorithm products, and version 1 of Senetas' virtual software encryption product were completed during FY2017:

- The 100GB hardware encryptor received FIPS certification and has undergone successful testing with customers
- Custom algorithm prototypes have been exported for testing and certification
- The software based virtual encryptor (CV1000) has undergone successful testing and further development continues working closely with customers to address their needs for robust encryption
- Senetas has also developed a product specific virtual encryptor to integrate with an optical network provider's technology which will cover Layer 2, 3 and 4 markets (including the Internet), without compromising network performance. Senetas has received significant interest in the Company's core capabilities in the field of encryption
- SureDrop beta testing currently underway with initial group of customers
- Senetas' crypto agile technology architecture becoming increasingly important in an extremely high-risk cyber security environment

Commenting on the Company's performance in FY2017, Senetas CEO Andrew Wilson said, "Whilst the sales disruption in FY2017 was unfortunate, the business made significant progress during the year on developing the pipeline of new product and new market opportunities that will drive growth for Senetas in FY2018 and beyond.

"As announced in February 2017, the normal ordering patterns of some of our largest customers were disrupted as they undertook reviews and upgrades to their existing networks, however, as expected the impacts of the disruption have been temporary and those customers recommenced ordering before the end of FY2017. We expect no ongoing impacts in FY2018.

"While orders for new products were delayed during the year, maintenance revenue was a stabilising factor. Maintenance revenue increased by 16% to account for 46% of total operating revenue. This revenue stream helps us support our customers post sale, ensures that any issues are proactively addressed and improves our alignment with our partner organisations. As more encryptors are sold and remain in operation the revenue stream will provide a level of earnings predictability and reliability.

"During the year we have continued to invest in our relationship with Gemalto and are working closely with them to improve sales of our product to government and corporate customers. Our products are a key component of the Gemalto product suite and Senetas staff continue to be actively engaged in supporting the sales process.

"The enhancement of our hardware encryption products, through the 100GB product and custom algorithm offering has seen a very positive response from both Gemalto and our end customers. These market leading products continue our commitment to security without compromise, and were developed in direct response to customer requests to better secure their ultra-high-speed Layer 2 networks.

"Further we have seen recently that Senetas' crypto agile technology is becoming more important from a cyber security standpoint given the introduction of quantum computing in the near future. Any business that bases its security on encryption that is embedded in silicon and multipurpose hardware devices will rue the day when its encryption algorithms have been cracked and they cannot replace them in real time. Senetas has always had an architecture that allows for such an eventuality.

"This investment in the future has been enabled through Senetas' strong financial position, with net assets up 16% during the period, with no debt, and cash on hand of more than \$20 million."



R&D And New Product Development

Senetas' 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.

FY2017 marked the commercialisation of development on the 100G encryptor, the custom algorithm products, and version 1 of Senetas' virtual encryption product. Total R&D expenditure moderated during the year due to lower external contractor costs as the 100G and custom algorithm developments wound down.

Hardware Encryption Solutions

100G encryptor

Mr Wilson said: "Our 100Gbps encryptor received FIPS certification in April 2017 and has now successfully completed customer trials with 2 large multinationals. We are expecting our first sales of this product in FY2018. The product was developed to satisfy the increasing needs of our largest corporate customers who have been looking to upgrade their network speed and infrastructure from 10Gbps to 100Gbps. This transition to faster networks will be a natural progression for many organisations that handle and move a lot of sensitive information and Senetas is well positioned to capitalise on this opportunity.

"Interest in the 100G encryptor is increasing, with potential customers including cloud service providers, global telecommunications companies, large government agencies and other large corporates. Encouragingly, a number of the interested parties have not previously been customers of Senetas."

Custom algorithm products

Mr Wilson added "Our custom encryption algorithm product development has been completed and prototypes have been exported for testing and certification. This product allows customers to select their own encryption algorithm, thereby giving security control to our clients. Whilst the certification process may take up to 2 years to complete, sales can commence once customer testing is complete. This is a new and potentially very large market for Senetas and there are currently no competing products that match our product capabilities."

Software Encryption Solutions

Virtualised encryption

Trials of Senetas' first software based virtual encryption technology were successfully undertaken in the first half of FY2017 and customers have now included the solution in tender proposals to end users.

Software based virtualised encryption is an emerging technology, and Senetas' developers are continuing to work with customers to further develop the scale and use cases for the product (version 2), including larger scale opportunities (+10,000 users) with 'zero-touch' deployment. Sales of version 1 are expected in FY2018 although sales volume is not expected to be significant until version 2 is released. Senetas expects version 2 to be completed before the end of FY2018 and for it to potentially open up a significant revenue opportunity for Senetas in FY2019 and beyond.



Hybrid networks

A number of Senetas customers run hybrid Layer 2 and Layer 3 networks and have made enquiries of Senetas to provide an integrated solution with capabilities across both networks. To better serve existing and potential customers Senetas' engineers are investigating the possibility of re-engineering encryptors – both hardware and virtual – to enable this capability. Achieving this has the potential to substantially expand the addressable market for Senetas products.

Mr Wilson said: “We are also working to further develop Senetas' software virtual encryptor to operate across Layer 3 and 4 markets, which make up over 70% of all networks. Importantly, it will allow our existing Layer 2 clients to now secure even more of their network traffic. While development of this product is still at a relatively early stage, we expect the capability, when ready, to increase the addressable market for our encryption solutions.”

Security Tools

SureDrop

SureDrop was acquired by Senetas in February 2017 and is now market ready. The product is being trialled by customers in partnership with a large Australian telecommunications company and it is expected to be revenue producing in the second half of FY2018. As the revenue model is based on user subscription it will add another source of recurring revenues.

European Certification

Senetas has commenced obtaining an additional certification in the European market which the Company expects will open up additional sales opportunities in markets where Senetas currently cannot compete. The expected cost for undertaking the European certification will be \$0.40m - \$0.50m in FY2018 with the process expected to be completed prior to June 2018. Once obtained, the certification will allow sales to customers in relevant markets from FY2019. Certification in multiple jurisdictions is a measure of the quality and technical advancement of our devices. It is also a key criteria for government contracts and many corporates that deal with government agencies.

Expected FY2018 R&D Expenditure

R&D expenditure in FY2018 is expected to increase by approximately \$0.80m. The expense increase is associated with costs of a new European certification and increased engineering staff working on virtualised encryption software.

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 16% to \$21.48 million and the cash balance at 30 June 2017 was \$20.09 million.

Net operating cash flow was \$1.70 million in FY2017 which was lower than FY2016 reflecting lower sales.

The Board periodically reviews its capital management policy and in so doing takes into account a variety of factors including R&D and other investment opportunities, financial returns, risk and liquidity considerations which might impact Senetas' business.

As a rapidly growing R&D technology company, the Board continues to implement a conservative capital management policy in order to conserve capital for continued investment in attractive R&D product development, as well as to ensure that Senetas is well positioned to take advantage of other compelling investment opportunities.



OUTLOOK

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

“With the sales disruption in FY2017 now behind us and a strong pipeline of new product and new market opportunities ahead of us we expect an improvement in financial performance in FY2018.

“Continued growth in data flows across Layer 2 networks, the desire to customise security parameters, and need for software based encryption solutions for Layer 3 and 4 networks all provide growth opportunities for the Senetas product range. The technical milestones delivered in FY2017, combined with the commercial opportunities for these products gives the Board confidence for our future financial performance and for generating growth for our shareholders.

“The 100G encryptor, custom encryption and virtual encryption products are all expected to generate sales for the first time in FY2018, and longer-term opportunities from large scale virtual encryption deployments, Layer 3 compatibility, and new opportunities in Europe with further certifications will drive ongoing growth in FY2019 and beyond.”

NON-CORE ASSETS

Senetas holds minority interests in three unlisted technology companies. The goal with these companies is to leverage Senetas' experience, and maximise the value of those investments.

On 15 December 2016 Senetas announced it had invested \$0.86m for a 6% interest in Smart Antenna Technologies Ltd, and on 11 May 2017 that it had acquired a minority investment in Deep Radiology Inc. The investments in the two global technology assets provide Senetas with access to learn and participate in the evolution of these businesses that are at the forefront of antenna technology for mobile devices and artificial intelligence (deep learning) for (initially) medical applications and developing exciting products that present important opportunities for joint technology collaboration.

EON Realty Inc.

Senetas acquired a minority interest in EON Reality Inc. in 2000 but its value was subsequently written down and currently has a carrying value of zero on Senetas' balance sheet. EON Reality Inc. is a world leader in augmented and virtual reality based knowledge transfer for industry and education – an area that is gaining increased attention and interest.

As noted in Senetas' historic financial statements, the board has determined that no value should be ascribed to the investment until a liquidity event such as a capital raising, merger or IPO could provide the board with an independent value of the investment. For further information about Senetas' current interest in EON Reality Inc. investors are referred to the Company's annual report which will be released to the market by 29 September 2017.

In May 2017 EON Reality Inc. formed an IPO committee to facilitate a public listing on NASDAQ. At this stage, the timing of an IPO and the potential value of Senetas' investment in EON Reality Inc. remain unclear, however, a process is currently underway to appoint advisors to support the IPO and Senetas will provide regular updates on the status of this investment as information becomes available.

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: 601119

To bypass the operator and gain immediate access to the event participants can preregister:
<https://services.choruscall.com.au/diamondpass/Senetas-601119-invite.html>

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