

## Corporate

 Current price **1.05p**

 Sector **TMT**

 Code **STAR.L**

 AIM **AIM**

### Share Performance



Source: Thomson Reuters, Allenby Capital

### Share Data

 Market Cap (£m) **3.6**

 Shares in issue (m) **345.3**

52 weeks	High	Low
	<b>1.85p</b>	<b>1.1p</b>

 Financial year end **31 December**

Source: Company Data, Allenby Capital

### Key Shareholders

 Avi Hartmann (CEO) **7.0%**

 Uri Hartmann (CTO) **6.8%**

 Doron Kedem **6.8%**

Source: Company Data, Allenby Capital

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## Starcom plc (STAR.L)

*Maiden adj. EBITDA profit; positive outlook*

Starcom delivered FY19 results comfortably in line with forecasts. Revenue increased 14% to \$6.8m, gross margin was stable at 41% (FY18: 40%) and there was a \$0.3m positive swing in adj. EBITDA that resulted in the company's maiden profit. Management is upbeat on the prospects for Lokies, its intelligent reporting padlock, following the successful launch in April 2019. The company is also demonstrating good traction with the higher margin versions of Helios as well as the other newer generation products, Tetis and Kylos. Starcom has a proven product portfolio of advanced wireless solutions for the remote tracking, monitoring and protection of assets and people. It has also demonstrated the ability to develop innovative products that combine multiple communications techniques for specific applications. Meanwhile the number of connected devices continues to grow rapidly with the rise of the Internet of Things. Forecasts that were upgraded with the pre-close in February remain unchanged.

— **Financial performance** - Revenue increased 14% to \$6.8m. There was a significant improvement in H2 trading with revenue up 28% to \$3.7m, whereas H1 had been flat. Hardware revenue accounted for the bulk of the increase with Software as a Service (SaaS) revenue, excluding one-time income, +10% at \$2.0m. The contribution from the low margin legacy vehicle tracking Helios product also continues to fall. This ongoing shift in product mix resulted in gross margin increasing 70bps to 41.0% (41.3% in H2) whereas total operating expenditure increased 5% to \$3.4m. The combination of increased revenue, margin appreciation and measure cost expansion resulted in the positive swing in adj. EBITDA to \$0.3m.

— **Outlook** - Given the strength of Starcom's product portfolio, the scope for increased deployment in the existing client base and a substantial sales pipeline, management expects the revenue growth rate will increase this year as more companies look to monitor and secure assets more intelligently. Core sources of revenue are expected to be Lokies, Kylos (CubeMonk), Helios (Zero Motorcycles), the IoT module (CropX) and Tetis (WIMC Solutions). The ongoing shift in the business towards the higher margin latest generation products and growth in SaaS should boost gross margins further. Meanwhile management plans to expand its sales and marketing operations as well as maintaining investment in R&D. As a result, although we expect gross profit to increase \$0.7m, there is only a \$0.15m increase in FY20 adj. EBITDA.

Year End:	2017A	2018A	2019A	2020E	2021E
(\$'000)					
REVENUE	5,440	5,994	6,817	8,498	9,807
ADJ. EBITDA	(193)	(7)	296	451	925
ADJ. PBT	(756)	(144)	(233)	171	645
ADJ. EPS (p)	(0.31)	(0.07)	(0.05)	0.04	0.15
NET CASH/(DEBT)	(644)	(435)	(163)	(431)	(344)
EV/EBITDA (x)	NEG	NEG	12.8	9.0	4.3
PER (x)	NEG	NEG	NEG	20.3	5.4

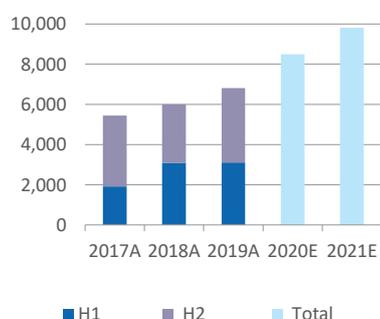
Allenby Capital acts as Nomad &amp; Joint Broker to Starcom plc (STAR.L). FX rate E\$: 1.29.

Please refer to the last page of this communication for all required disclosures and risk warnings.

## Investment summary

As flagged in February's pre-close update, Starcom delivered FY19 results comfortably in line with forecasts. Revenue increased 14% to \$6.8m, gross margin was stable at 41% (FY18: 40%) and there was a \$0.3m positive swing in adj. EBITDA to \$0.3m. Management is upbeat on the prospects for Lokies, its intelligent padlock, following the successful launch in April 2019 and it has been running proofs of concept in multiple markets. Starcom is also demonstrating good traction with the higher margin versions of Helios as well as the newer generation products, Tetis and Kylos. Starcom has a proven product portfolio of advanced wireless solutions for the remote tracking, monitoring and protection of assets and people. It has also demonstrated the availability to develop innovative products that combines multiple communications techniques for specific applications. Meanwhile the number of connected devices continues to grow rapidly with the rise of the Internet of Things. Forecasts that were upgraded with the pre-close remain unchanged.

Exhibit 1: Revenue split



Source: Company; Allenby Capital

Exhibit 2: Revenue and gross margin progression



Source: Source: Company; Allenby Capital

## Financial performance

Group revenue increased 14% to \$6.8m. There was a significant improvement in H2 trading with revenue up 28% to \$3.7m, whereas H1 had been flat at \$3.1m. Hardware revenue accounted for the bulk of the increase with Software as a Service (SaaS) revenue, excluding one-time income, +10% at \$2.0m. The contribution from the low margin legacy vehicle tracking Helios product continues to fall and represented 41% of hardware sales (FY18: 48%; FY17: 58%). There was no particular revenue concentration in FY19 with the largest customer accounting for 10% of revenue and the business is also geographically spread.

The ongoing shift in product mix towards higher end IoT segments resulted in gross margin increasing 70bps to 41.0% (41.3% in H2) whereas total operating expenditure increased 5% to \$3.4m and much of this related to non-cash items (depreciation and share based payments). The combination of increased revenue, margin appreciation and measured cost expansion resulted in the positive swing in adj. EBITDA to \$0.3m.

There was a small cash outflow from operations of \$8k (FY18: \$695k) as the small increase in trade receivables (\$0.1m) was more than offset by increase in trade payables of \$669k (FY18 outflow: \$110k). Cash was bolstered by April's placing (\$780k) and year end cash was \$158k (FY18: \$89k). Net debt reduced \$272k to \$163k.

## Outlook

Given the strength of Starcom's product portfolio, the scope for increased deployment in the existing client base and a substantial sales pipeline, management expects the revenue growth rate will increase this year. Core sources of revenue are expected to be Lokies, Kylos (CubeMonk), Helios (Zero Motorcycles), the IoT module (CropX) and Tetis (WIMC Solutions).

The ongoing shift in the business towards the higher margin latest generation products should also boost gross margins further. Meanwhile management plans to expand its sales and marketing operations as well as maintaining investment in R&D. As a result, although we expect gross profit to increase \$0.7m, there is only a \$0.15m increase in FY20 adj. EBITDA.

## Lokies

Starcom launched Lokies, its smart keyless padlock successor to WatchLock, in April 2019 and the company reports a positive initial response and it has been running a number of proof of concepts and initial orders have been placed by customers in Russia, Israel, Kazakhstan, Mexico, Bulgaria and Poland.

**Exhibit 3: Lokies**

Source: Company

Lokies is an Internet of Things (IoT) based padlock that can be operated remotely and does not require a key. It is energy efficient and Bluetooth enabled and can connect to nearby devices and sensors, thus enabling smarter security, longer life and more effective monitoring of the asset it is protecting. Lokies has a specially designed extendable shackle equipped with proprietary technology that can detect tampering, making it among the most advanced padlocks on the market. Lokies has been fully developed and built by Starcom that owns 100% of the intellectual property. Starcom has also developed a new SaaS platform for Lokies.

Starcom has signed an agreement with the Russian distributor that previously tested the product and had ordered an initial 500 units. This conditional agreement sets purchase/supply targets and Starcom is aiming for the delivery of up to \$2m of Lokies in 2020. The three-year agreement provides exclusivity to the distributor in Russia, subject to the distributor hitting certain targets.

### Kylos

In February, Starcom announced that it had entered a three-year Supply and Support agreement with CubeMonk Inc, a US provider of shipping related services, for Kylos Air units to be integrated in CubeMonk's unit load device (ULD), SmartCube. This follows 2019's successful pilot that involved a few hundred Kylos Air units as part of CubeMonk's tracking service for air containers and was worth \$0.2m.

**Exhibit 4: CubeMonk Unit Load Device**

Source: Company

Whilst the new agreement with CubeMonk does not contain any minimum purchase commitments, Starcom expects a significant increase in orders for Kylos Air units this year and the companies entered a longer-term relationship to cover future orders post period end.

Starcom has been working with CubeMonk to adapt and implement Kylos Air for use in CubeMonk's ULD. The Kylos Air units are connected through Starcom's online control software and will monitor key container parameters including location, internal temperature and shocks.

### Kylos - unique features

The units are automatically shut off during take-off and restart immediately on landing in order to comply with aviation regulations – a unique feature that has enabled Kylos Air to gain the necessary safety certifications for in-air utilisation. Management believes that similar OEM arrangements can be achieved for a variety of third-party applications in the shipping and container tracking industry.

### Bosch

Since September 2017, Starcom has also had an agreement for the supply of Kylos Air products to Bosch, which is marketed as the TDL140, as part of its suite of connected devices and solutions. Bosch is in the process of securing approval of the TDL140 with its various air freight customers and it has been approved as an active tracking device by Swiss WorldCargo, the air freight division of Swiss International Air Lines Ltd.

Whilst this approval has yet to lead to any additional orders, it represents an important step towards Bosch achieving sales of the TDL140 and Bosch has been actively marketing the product for some months as well as undertaking testing to achieve equivalent approvals and certifications from other airlines. Southwest Airlines has also approved the use of Kylos Air.

Starcom continues the implementation of its long-term contract with Israel Chemicals Ltd (ICL), a NYSE-listed Israeli conglomerate and a global manufacturer of products based on unique minerals for the agriculture, food and engineered materials industries. ICL uses Kylos Forever to track and monitor its sensitive cargo as it is shipped in tanks.

In certain instances, Starcom's products are being designed into new products and/or services and there can be no guarantee of commercial success of its customer's offerings

irrespective of the performance of the Starcom module. Starcom's diversified offering provides some protection against any individual project failure.

For example, in February 2019, Starcom announced a revised three-year agreement with Xplosive Solutions Pty Ltd for the supply of Kylos units intended for use in the protection of cattle. Although a limited number of initial goods were shipped under the revised agreement, it became apparent in August that Xplosive was unable to continue with the contractual arrangements for local reasons. As a result, Starcom concluded that the contract was terminated. The initial agreement was signed in 2017 and latest agreement was anticipated to deliver c. \$500k in revenue over the three-year period.

Some projects have also been subject to delay. In November 2018, Starcom announced an agreement with a local distributor in North Africa for the supply of a number of Helios Advanced units together with BIO CAN fuel sensors. This combines the ability to monitor fuel consumption as well as standard location tracking.

The initial order was expected to be worth \$1.1m with delivery by the end of 2018 and the agreement also provided for the supply of further equipment with potential value of up to \$2.5m during 2019. In the event, there was a delay in the release of funds until the end of January 2019 when a portion of the initial orderware was received. In June, a further payment was received and Starcom shipped the hardware.

#### Helios

In February 2020, Starcom signed a Statement of Work with Zero Motorcycles Inc for the development of certain technology enhancements over the next three months to the Starcom Helios units that are integrated with Zero's ZR/F motorbike.

Exhibit 5: Zero Motorcycles ZR/F



Source: Company

The enhanced units should increase connectivity with the motorbikes enabling Zero to centrally track and control a greater number of ZR/F motorcycles as it scales production. In return, Starcom will receive a small increase in the recurring monthly SaaS revenue generated per connected motorcycle.

Sales of the Zero SR/F model, launched in February 2019, have been low to date but Zero has indicated that it anticipates a significant increase in demand in 2020. The Helios monitoring system enables Zero and the rider to track the motorcycle's condition in terms of various parameters, including range, battery utilisation and location. In addition, Zero can perform software upgrades to the battery and engine management systems remotely, potentially prolonging the life of the propulsion system.

In December, Starcom announced that it had received a new order from an existing customer in the Ukraine for \$1.3m of Helios units over a three-year period. An initial down-payment of \$200k has been received against the first instalment of \$435k payable by the customer. The order is for a new advanced Helios unit with Bluetooth and CANBUS connections that provide direct connectivity with a vehicle's computer to analyse a variety of vehicle and driver behaviour data.

#### IoT

CropX, an Israeli company that has developed devices for farmers to accurately measure the irrigation of their crops in real time through the deployment of sensors in the field, utilises a modified version of Kylos Air as the communications module.

CropX has completed its product ramp up process and has recently placed additional orders for delivery during H1 2020. This comes after a successful integration of the LoRa (Long Range) communications technology into the Starcom IoT platform, enabling low-cost, low-power monitoring in a mesh networking infrastructure.

**Tetis**

WIMC Solutions, a US-based provider of real-time monitoring services for international shipping containers, placed a new order for Starcom's Tetis shipping container tracking device in March 2019 and is actively promoting the product in the container and cargo delivery sector. WIMC has also confirmed that Tetis has been approved by the Paraguayan Department of Customs and Duty.

Under the initial agreement that was announced in January 2018, WIMC placed orders for only 1,500 Tetis units. The new agreement provides for an increased order of up to 30,000 Tetis units over a three-year period although there is no minimum guarantee. There is a slightly lower price per unit but there is still SaaS revenue for each unit installed.

Management also reports greater interest in the container market of the need to provide more tracking and security.

## Exhibit 6: Summary financials

## PROFIT &amp; LOSS

Year End December (\$000s)	FY 2017A	FY 2018A	FY 2019A	FY 2020E	FY 2021E
Revenue	5,440	5,994	6,817	8,498	9,807
YoY Growth	6.0%	10.2%	13.7%	24.7%	15.4%
Gross profit	2,080	2,418	2,798	3,460	4,036
Gross margin	38.2%	40.3%	41.0%	40.7%	41.2%
Total operating expenses	-2,969	-3,300	-3,504	-3,809	-3,951
YoY growth	-6.0%	11.1%	6.2%	8.7%	3.7%
Adj. EBITDA	-193	-7	296	451	925
Adj. EBITDA margin	-3.5%	-0.1%	4.3%	5.3%	9.4%
Adj. profit before tax	-756	-144	-233	171	645
Profit before tax (reported)	-1,350	-831	-1,019	-449	-15
Shares in issue (diluted)	187,032	272,695	329,934	329,934	329,934
Adj. earnings per share (p)	-0.3	-0.1	-0.1	0.0	0.2

## CASH FLOW

Year End December (\$000s)	FY 2017A	FY 2018A	FY 2019A	FY 2020E	FY 2021E
Cash flow from operations before tax	-1,080	-695	-8	-43	446
Net cash flow from investing activities	-345	-370	-465	-360	-360
Net cash flow from financing activities	1,483	1,061	542	250	-50
Net increase / (decrease) in cash	58	-4	69	-153	36
Cash at end of period	93	89	158	5	41
<b>Net cash</b>	<b>-644</b>	<b>-435</b>	<b>-163</b>	<b>-431</b>	<b>-344</b>

## BALANCE SHEET

Year End December (\$000s)	FY 2017A	FY 2018A	FY 2019A	FY 2020E	FY 2021E
Total non-current assets	2,804	2,846	2,779	2,511	2,231
Other current assets (excluding cash)	3,358	4,009	4,501	4,780	5,287
Cash and cash equivalents	148	149	219	65	102
Total current assets	3,506	4,158	4,720	4,845	5,389
<b>TOTAL ASSETS</b>	<b>6,310</b>	<b>7,004</b>	<b>7,499</b>	<b>7,356</b>	<b>7,620</b>
Total current liabilities	-3,123	-3,023	-3,326	-3,554	-3,791
Total non-current liabilities	-155	-120	-282	-282	-282
<b>TOTAL LIABILITIES</b>	<b>-3,278</b>	<b>-3,143</b>	<b>-3,608</b>	<b>-3,836</b>	<b>-4,073</b>
Net current assets	383	1,135	1,394	1,291	1,597
<b>NET ASSETS</b>	<b>3,032</b>	<b>3,861</b>	<b>3,891</b>	<b>3,520</b>	<b>3,546</b>

Source: Source: Company; Allenby Capital

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