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ASX ANNOUNCEMENT

Senetas Corporation Limited Full-Year Results Announcement For the year to 30 June 2018

Senetas full year profit at the top end of market guidance range

Senetas Corporation Ltd (ASX: SEN) (Senetas / the Company), a leading developer and manufacturer of certified, high-assurance encryption hardware; virtualised (software based) network encryption; and advanced encrypted file sharing application, is pleased to announce its results for the year ended 30 June 2018 (FY18).

Commenting on the FY18 results, Senetas CEO, Andrew Wilson, said: "Operating revenue of $18.97 million is underpinned by a 39% growth in product sales by Senetas's global distribution partner Gemalto. Pleasingly, the strong growth in product sales was supported by the first sales of our new 100Gbps encryptor during the period and we are excited by the sales momentum developing.

"A key milestone for the year was the launch in the second half of our virtualised (software based) encryption products. Importantly, the new virtualised solutions include transport layer interdependence capabilities across Layer 2, 3 and 4 networks, a first for Senetas. These new products and capabilities significantly increase the use cases and addressable market for Senetas's encryption solutions and we expect will be a key driver of future revenue growth for the Company.

"The virtualised (software based) products combined with the transport layer interdependence changes in our hardware devices increase Senetas's addressable market by more than 3 times. Further it has allowed Senetas to transition from solely a hardware R&D and manufacturing company into a company that is also a cyber security software business.

"We expect in the coming years that, whilst we will still see continuing strong growth in our hardware encryption devices, we will also see a very significant contribution to revenue from our cyber security software business.

"The company's cash flow and balance sheet continue to strengthen providing important strategic flexibility for the Company and the capacity for ongoing investment in new product development."

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FY18 highlights

Record high for Senetas operating revenue which was up 8% to $18.97 million (FY17: $17.59 million) with strong growth in product sales partly offset by lower maintenance revenue. Revenue growth was led by a 39% increase in product sales revenue from Senetas's global distribution partner, Gemalto NV.

- Profit before income tax (PBT) of $4.44 million (including a $1.36 million impairment of an unlisted investment). PBT prior to impairment was $5.80 million which is at the high end of the guidance range announced in July 2018, and up 10% on the prior period (FY17: $5.26 million)
- Gross profit margin increased to 81% (FY17: 79%)
- Profit after income tax of $1.96 million (FY17: $2.88 million) (including $1.36 million impairment of an unlisted investment)
- Strong balance sheet with $23.26 million of cash provides flexibility for strategic investments and new product initiatives
- Initial sales of the ultra-high speed 100Gbps ethernet encryptor with 2 of Gemalto's end use customers having deployed it in their network in FY18 and a third large customer recently purchasing
- Market launch of the CV Series virtualised (software based) encryption solution via Gemalto and ADVA

Operational review

Revenue growth in FY18 was driven by 39% growth in product sales by Senetas's global distribution partner, Gemalto NV. Key customers contributed strongly to sales growth for 1–10 Gbps encryptors during the year, and initial sales of the new ultra-high speed 100Gbps encryptor made a good contribution to second half sales. Strong growth in product sales revenue was partially offset by lower maintenance revenue. As previously advised, the growth in maintenance revenue was expected to moderate as a key customer continued to transition from Senetas SONET products to cheaper Senetas Ethernet products.

Gross margins expanded to 81% as inventory levels at the Company's international distribution partner, Gemalto, were reduced during the year.

Mr Wilson said, "The 39% growth in Gemalto product sales during the year reflects both a strengthening of our relationship with Gemalto and the growing underlying demand worldwide for encryption solutions. Senetas is working more closely than ever with Gemalto on identifying and realising new sales opportunities and the sales results in FY18 are a testament to that. The recent adoption by Gemalto of SureDrop into its Data Protection on Demand platform (DPOD) is also a strong reflection of the close collaboration between us.

"SureDrop delivers a state-of-the-art encrypted file sharing, collaboration and synchronisation solution. It is the most secure file sharing application available and uniquely ensures customers' total control over data location and sovereignty. Importantly, SureDrop integrates with Gemalto's key management technologies.

"Recent sales of the new ultra-high speed 100Gbps ethernet encryptor have been encouraging and we have a growing number of customer trials underway. Pleasingly the most recent sale of 100Gbps encryptors to Gemalto in early FY19 was for a Fortune 500 global technology company that has not previously used Senetas encryptors in its network, so we are excited to see that this product is opening up new market opportunities for Senetas encryption solutions.

"The recent product launches by both Gemalto and ADVA of our virtualised (software based) encryption solutions has been a key milestone for Senetas. The virtualised (software based) solutions represent an important opportunity for Senetas to significantly expand the addressable market for its encryption products by providing cost-effective, scalable, flexible solutions that are easy to deploy and manage. The use cases for the virtualised (software based) products released this year are significantly enhanced by transport layer interdependence capabilities across Layers 2, 3 and 4 networks, for the first time in a Senetas product. Transport layer interdependence capabilities are also expected to be released in our hardware encryptors during FY19.

"The process to obtain a new European certification for our core hardware products is another important step in broadening the addressable market for Senetas's products. We expect that process to obtain the new certification will be completed in FY19.

R&D and new product development

The Company's primary R&D focus in FY18 was on development of our virtualised (software based) encryption products, transport layer interdependence capabilities for virtualised (software based) and hardware encryptors and achieving additional certifications.

R&D expenditure in FY18 was slightly higher than the prior year and is expected to be similar or slightly higher again in FY19.

The CV Series virtualised (software based) encryption products currently have transport layer interdependence capabilities and can operate successfully in complex / large scale networks and private cloud environments; however, some limitations remain in relation to use within public cloud environments.

A virtual network (often called virtualising or software defined networking) is the process of combining hardware and software network resources and functionality into a single, software-based administrative entity. Virtualising encryption technologies runs a risk of reducing the level of security and also performance. Organisations seek virtual (software based) technologies to reduce the cost of acquiring and managing more and more hardware devices as data flows and storage needs rise.

Senetas has met this market demand and increased R&D expenditure to ensure it can produce the most secure, reliable and efficient products the market demands. It is also using its expertise to acquire appropriate security accreditations for these new software products.

This development has resulted in the production of 2 new product sets with new addressable markets. The CV Series virtualised (software based) products distributed through Gemalto and Senetas's embedded virtual (software based) encryptor with ADVA's Ensemble Connector technology. The latter produces a totally new route to market and addressable market for Senetas.

Accordingly, the primary R&D focus for FY19 will be ongoing development of the CV Series encryptors to provide enhanced capabilities in public cloud environments.

In addition, Senetas will be finalising transport layer interdependence capabilities for its hardware encryptors. This means that Senetas hardware encryptors will now address a substantially greater market. Previously Senetas encryptors protected traffic over layer 2 networks which represent only about 20% of total network traffic. The new development which will result in new products in FY19 will address layer 2, 3 and 4 networks thereby covering over 85% of all network traffic.

Senetas's new custom encryption solution for Eastern Europe continues to progress through that market's certification process. This was a customer funded development with the potential to create good sales opportunities for Senetas once certified; however, significant geopolitical risk exists that may impact sales.

Senetas does not expect any material financial impact from the new Australian R&D rules in effect from 1 July 2018.

Balance sheet and cash flow

Senetas' balance remains strong with no debt and significant cash reserves. Net assets increased 10% to $23.55 million and the cash balance at 30 June 2018 was $23.26 million.

Net operating cash flow was $5.20 million in FY18 significantly higher than FY17 reflecting higher sales and a reduction in inventory levels during the year.

The Board continues to implement a conservative capital management policy in order to conserve capital for continued investment in attractive R&D, new product development ensuring that Senetas is well positioned to take advantage of compelling investment opportunities, and to meet any business challenges.

Unlisted investments

DeepRadiology Inc.

DeepRadiology has not yet achieved required regulatory approval for its technology and the company has therefore missed milestone and projected revenue targets. Given the level of uncertainty surrounding the value of the investment the board has resolved to impair the investment in DeepRadiology from $1.36 million to nil.

Smart Antenna Technologies Ltd. (SAT)

Senetas made an additional investment of $1.03 million in SAT during FY18. The Company's percentage equity interest remains similar as other SAT investors made proportional additional investments. The investment in SAT is carried on the balance sheet at $1.89 million. This investment is performing to expectations and its carrying value reflects fair value at reporting date.

EON Reality Inc. (EON)

The investment in EON currently has a carrying value of nil on Senetas's balance sheet and will continue to do so until a liquidity event such as a capital raising or the planned IPO provides the Senetas Board with an independent valuation of the investment.

Priorities for FY19

The key priorities for FY19 are to build upon the product sales momentum developed in FY18 and to deliver the initial sales of new products including the virtualised (software based) encryption solutions and SureDrop.

- Initial customer trials for virtualised (software based) encryptions solutions are underway with both Gemalto and ADVA
- Senetas's global distribution partner, Gemalto, has commenced marketing SureDrop to some of its customers – and customer trials are underway in the APAC region
- Drive further sales of the ultra-high speed 100Gbps encyptor – building on FY18 sales momentum and additional sales already completed in FY19
- Progress development of additional capabilities for virtualised (software based) products – in particular to conform with requirements for public cloud environments
- Complete development of new hardware encryptors with transport layer independence across Layers 2, 3 and 4
- Achieve new European certification
- Further develop partner relationships – new products and technology development and enhanced sales support

Revenue growth

Over time, Senetas's transition to a multi-product business is expected to significantly expand the addressable market for its products and drive strong revenue growth. Key revenue growth drivers will include:

- A tightening global regulatory landscape around data protection and data breach notification
- Significantly expanded use cases for Senetas's products with the capability for transport layer interdependence across Layers 2, 3 and 4
- Market adoption of virtualised (software based) encryption allowing Senetas to penetrate deeper into customer networks with cost-effective, flexible and easy to deploy and manage encryption solutions
- Increased momentum towards adoption of 100Gbps networks
- Increasing market penetration with traditional Senetas high speed encryptors
- The development of further new technology partnerships that incorporate Senetas's technology
- A larger portion of the overall revenue being derived from software based solutions being delivered as a service (SaaS)
- The software based solutions will deliver an increasing portion of annuity style revenues

Outlook

Commenting on the Company's outlook, Mr Wilson said: "With the release of new products and the significant expansion in Senetas's addressable market over the past year we expect good sales growth to continue in FY19.

"We do not expect our distribution to be adversely affected by the acquisition of Gemalto by Thales. The combination of these businesses will create the world's second largest cyber security business which will greatly enhance Senetas's distribution capacity.

"As is the norm with the adoption of new technologies, our new products may take a little time to gain traction in the market; however, we expect the developing momentum of 100Gbps encryptor sales and strong customer interest in virtual (software based) encryption solutions and SureDrop will provide meaningful growth opportunities in FY19 on top of the traditional hardware encryption business.

"The 100Gbps encryptor, virtualised (software based) encryption solutions, our expanding capabilities across Layers 2, 3 and 4 and commercialising software products will become much more significant contributors as sales momentum builds.

"We expect in the coming years that, whilst we will still see continuing strong growth in our hardware encryption devices, we will also see a very significant contribution to revenue from our cyber security software business."

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About Senetas Corporation Limited

Senetas, an Australian public listed company (ASX:SEN), is a leading developer of data encryption solutions for enterprise, government and technology service providers. From certified high-assurance encryption hardware and virtualised encryption, to the most secure file sharing application providing data sovereignty control, all Senetas solutions are based on the same leading security, high performance and crypto-agile platform.

Senetas encryption solutions leverage state-of-the-art encryption key management and crypto-agility by design, providing long-term data protection in a post-Quantum computing world. They share the same designed-in data protection without compromising network and application performance or user experience.

Senetas CN Series, certified high-assurance encryption hardware, provide maximum data protection for core Ethernet network infrastructure. A preferred option for government, enterprise, defence and communications service providers, Senetas CN Series encryptors are certified by independent testing authorities (Common Criteria, FIPS and NATO) as "suitable for government and defence use".

Senetas CV Series virtual encryptors provide robust data protection for high-scale extended and virtualised networks. The CV Series provides security benefits of virtualised encryption's rapid scalability and flexibility; delivering cost-effective deployment to meet changing business and IT needs.

SureDrop delivers a state-of-the-art encrypted file sharing, collaboration and synchronisation solution. It is the most secure file sharing application available and uniquely ensures customers' total control over data location and sovereignty. Whilst maximising users' experience, SureDrop leverages the Senetas encryption platform.

Senetas encryptors have been trusted to protect much of the world's most sensitive information for nearly 20 years. They are used to protect everything from government and defence data and secrets, to intellectual property and business data, to financial transactions, CCTV networks, SCADA critical infrastructure control systems and citizen identity.

Senetas encryption solutions are used in more than 35 countries. They are distributed and supported internationally by Gemalto, the world's largest data security company, with its SafeNet Identity and Data Protection products.

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