intercede

Intercede Group plc

Interim Report 2017

DIGITAL TRUST

INTERCEDE GROUP plc

Interim Results for the Six Months Ended 30 September 2017

Chairman's Statement

Introduction

Intercede has made a good start to the year, achieving MyID contract wins from significant new customers, generating a pipeline for newly released products and substantially enhancing its sales and marketing capability. The Group's ability to convert its recent product development into meaningful revenue generation is likely to play an important role in Intercede's short to medium term growth prospects.

The on-premise version of MyID continues to appeal to governments, defence contractors and large enterprises as evidenced by contract wins in the first six months of this year. These include:

- The award of a MyID contract from a major US Aerospace & Defence contractor to manage digital identities for 130,000 devices. MyID is now used by five of the seven largest Aerospace & Defence companies.
- A new MyID license sale to a large UK defence organisation. This customer is expected to generate further significant professional services revenue over the next 12 months.
- An initial MyID license sale to the largest US military shipbuilding company. A successful implementation is expected to result in a follow-on order for over 20,000 licenses.
- An initial MyID license sale to one of the world's largest diversified natural resource companies, with the potential rollout to a workforce of more than 100,000 based in 50+ countries.

The Group has developed a range of related applications from its core MyID platform. These have been designed to take advantage of the growing awareness of, and requirement for, cyber security. In the last 12 months, Intercede has launched a cloud-based version of MyID, including variants designed to secure employee authentication and consumer facing applications and websites. These additions to the wide-ranging product suite provide the Group with a subscription based service suitable for enterprises and service providers around the world. Aligned to Intercede's enhanced and expanded sales and marketing function, the Group believes that it has positioned itself well to benefit from significant emerging opportunities.

The potential for growth in all of the Group's markets reflects the backdrop of a growing number of high profile cyber-attacks. In turn, this has led to an expectation that the global market for cyber security products and services will grow strongly over the medium term with Verizon reporting in their annual Data Breach Investigation Report that 81% of hacking-related breaches in 2016 involved stolen and/or weak passwords, up from 63% in 2015. That situation cannot continue and Intercede believes the world is at a "user authentication tipping point".

At the core of Intercede's technology is cryptographic key management, which has been proven to prevent such breaches by only allowing access to verified devices that have been unlocked by verified users. This contrasts with alternatives such as biometric security or SMS one-time passwords, which although having a place, are also open to compromise. Intercede is therefore well placed to benefit from the global investment in cyber security that is expected to grow to $100 billion by 2019.

Financial Results

Revenues in the period totalled £3,651,000, a 29% increase compared to the corresponding period last year. This growth was driven by further contract wins within the Group's core market; on-premise deployment of its MyID product. Intercede is now providing MyID to large enterprises in a wide range of industries. From its core Government Agency customer base, the Group is now working with a considerable proportion of the world's leading Aerospace & Defence contractors and an increasing number of customers from other sectors including Finance, Healthcare and Natural Resources. Intercede remains convinced that Government Agencies and large enterprises represent a significant market place for the Group's products.

Compared to the first half of the prior year, operating expenses rose by 4.0% to £6,704,000 (2016: £6,448,000). Costs continue to be tightly managed, but the Group has acted to expand and refresh its sales and marketing activities in recognition of the need to convert product development into meaningful revenue generation.

Staff costs continue to represent the main area of expense, representing 75% of total operating costs (2016: 77%). Intercede had 124 employees and contractors as at 30 September 2017 (30 September 2016: 127). The average number of employees and contractors during the period was 123 (2016: 128).

A £1,141,000 taxation credit for the period (2016: £898,000 taxation credit) primarily reflects the 2017 Research & Development ("R&D") claim which results from the Group's strategic investment activities. While the 2016 claim was received during October 2016, the 2017 R&D claim was received prior to 30 September 2017. The Group is a beneficiary of the UK Government's efforts to encourage innovation by allowing 130% of qualifying R&D expenditure to be offset against taxable profits and allowing 14.5% of the lower of R&D losses or taxable losses to be paid as tax credits.

A loss for the period of £2,146,000 (2016: loss of £2,773,000) resulted in a basic and a fully diluted loss per share of 4.3p (2016: basic and fully diluted loss per share of 5.7p).

Cash balances as at 30 September 2017 totalled £4,818,000 compared to £6,891,000 as at 31 March 2017 and £1,377,000 as at 30 September 2016. Intercede raised £4,623,000 (net of expenses) from the issue of Convertible Loan Notes ("CLN") and new equity in January 2017 and a further £485,000 (net of expenses) from the same CLN instruments in August 2017.

Product Development and Partnerships

Intercede's software and services enable Trusted Digital Identities to be created, deployed and managed securely and at scale.

To widen the market into which Intercede can sell its products, MyID can be deployed in various formats to meet the demands of a comprehensive range of authentication use cases:

- On-premise – typically adopted within the most security conscious environments such as the aerospace, defence and government sectors that demand all infrastructure and software is directly under their control. Highly configurable and feature rich.
- Cloud-based – similar functionality and features as the on-premise solution but designed for widespread deployment in enterprise markets that are increasingly adopting infrastructure, platform and software as a service working models.
- Mobile and Web – a frictionless, easy to deploy and highly secure two-factor authentication solution for web and mobile applications. Targeted at service providers and application developers that require a highly secure, user friendly and economic means to reliably authenticate their customers and eliminate passwords.

Intercede continues to engage under NDA with industry IT majors. While it is premature to predict when and if significant revenue streams will flow from these partnerships, a commercial breakthrough with any one of these partners could create an inflexion point in Intercede sales revenues. The engagements are a recognition of Intercede's world lead in cryptographic key management, authentication expertise and security technologies. Intercede's solutions remain contemporary, relevant and cannot be readily duplicated by industry majors themselves.

Intercede is also engaging in Internet of Things (IoT) based proofs-of-concept activity when it makes commercial sense to do so. For example, a MyID solution for smart security cameras was demonstrated at a conference in Washington DC in June in collaboration with a significant industrial partner. This project is expected to generate first revenues in the current financial year as it goes through a pilot stage across a number of secure US Government sites.

The Group's ground breaking IoT research capability was highlighted when Imagination Technology and Intercede showcased a solution for enhanced IoT security at BT's bi-annual Innovation 2017 event in June. The demonstration of the 'Trust Continuum' shows how systems-on-chips (SoCs) for home gateway routers can be architected to address the growing security and management challenges presented by the proliferation of IoT devices, services and technologies entering the home. This is the type of innovative exercise into which Intercede reinvests some of its R&D tax credit.

Sales and Marketing

To better represent the Intercede portfolio to a wider audience, the Group has relaunched its sales and marketing proposition to be more 'customer solutions' oriented. In support of this the Intercede website, www.intercede.com, has been redesigned and refreshed. In addition, the product suite will be unified under one brand name; MyID. MyID is positioned as an enterprise-grade authentication and credentials management solution that enables organizations to replace passwords with trusted digital identities.

Intercede's ability to address the widening cyber security market is dependent on a sales team that is focused clearly on its vision, mission and goals. A new team is now in place including the appointments of Helen Adams as Chief Sales Officer and Chuck Pol as Non-Executive Director.

Helen Adams joined the Group on 5 June 2017 from ARM Holdings plc, the world's leading semiconductor intellectual property supplier, where she was Vice President of Regional Sales for both Europe and Asia/Pacific.

Chuck Pol was appointed with effect from 1 June 2017 as a Non-Executive Director. He recently served as Chairperson of Vodafone Americas, a role in which he led the development of applications for the Internet of Things.

In addition, there have been several new hires in the US and RoW sales teams. Due to the long sales cycle for enterprise solutions, it is expected that this refreshed sales team will mainly deliver a sales revenue uplift in the next financial period and beyond.

Strategy and Outlook

At the core of Intercede's strategy is the MyID platform which has become a benchmark for Digital Trust within government circles and amongst some of the world's largest security sensitive organizations. Over time the Group's products have evolved from providing Digital Trust between connected people to include connectivity between devices, applications and the mass produced electrical goods that will make up the IoT market.

Cyber-threats, whether driven by individuals, organisations or nation states are increasing in frequency and sophistication and the economic cost is growing exponentially. Additionally, the threat landscape is expanding with the growth of the IoT and developments such as connected cars. In that environment, the Group is experiencing continuing demand in its traditional markets but, perhaps most importantly, Intercede is seeing opportunities to deliver the power of the MyID platform as a cloud-based service.

MyID as a service has the potential to open new and potentially large markets that were not previously accessible. One such example is enabling enterprises to issue digital credentials to mobile devices used by employees to replace usernames and passwords. Another is providing consumers with the ability to authenticate, sign and encrypt digital banking transactions. Pilot implementations with several network operators, banks and application platform providers will continue in the current financial year. Successful implementations will enable commercial activities to start in earnest for target markets for this product, including those that are impacted by new regulations in the financial services and consumer sectors such as Payment Services Directive 2 (PSD2) and the General Data Protection Regulations (GDPR).

MyID's evolution into the IoT securely provisions apps to a device and 'binds' them to the secure element of the device's chip so that the app cannot be compromised by cyber attacks. The growth potential of this market is significant and, by 2020, is estimated to be more than 50 billion devices with each 'thing' needing to validate the trustworthiness of its peers across a network. Each point of trust is an opportunity for Intercede to provide an enabling service.

Some opportunities will take time to mature, but the Group's management team continues to be optimistic.

Richard Parris
Chairman & Chief Executive
27 November 2017

Consolidated Statement of Comprehensive Income

For the period ended 30 September 2017

	6 months ended 30 September 2017 £'000	6 months ended 30 September 2016 £'000	Year ended 31 March 2017 £'000
Continuing operations			
Revenue	**3,651**	2,828	8,286
Cost of sales	**(22)**	(58)	(116)
Gross profit	**3,629**	2,770	8,170
Operating expenses	**(6,704)**	(6,448)	(12,891)
Operating loss	**(3,075)**	(3,678)	(4,721)
Finance income	**5**	7	13
Finance costs	**(217)**	–	(70)
Loss before tax	**(3,287)**	(3,671)	(4,778)
Taxation	**1,141**	898	888
Loss for the period	**(2,146)**	(2,773)	(3,890)
Total comprehensive expense attributable to owners of the parent company	**(2,146)**	(2,773)	(3,890)
Loss per share (pence)			
- basic	**(4.3)p**	(5.7)p	(8.0)p
- diluted	**(4.3)p**	(5.7)p	(8.0)p

Consolidated Balance Sheet

As at 30 September 2017

	As at 30 September 2017 £'000	As at 30 September 2016 £'000	As at 31 March 2017 £'000
Non-current assets			
Property, plant and equipment	**636**	822	695
Current assets			
Trade and other receivables	**1,910**	2,718	1,280
Cash and cash equivalents	**4,818**	1,377	6,891
	6,728	4,095	8,171
Total assets	**7,364**	4,917	8,866
Equity			
Share capital	**505**	491	499
Share premium	**673**	232	673
Equity reserve	**60**	–	60
Merger reserve	**1,508**	1,508	1,508
(Losses)/retained earnings	**(4,285)**	(1,441)	(2,354)
Total equity	**(1,539)**	790	386
Non-current liabilities			
Convertible loan notes	**4,641**	–	4,124
Deferred revenue	**185**	77	141
	4,826	77	4,265
Current liabilities			
Trade and other payables	**1,517**	1,745	1,390
Deferred revenue	**2,560**	2,305	2,825
	4,077	4,050	4,215
Total liabilities	**8,903**	4,127	8,480
Total equity and liabilities	**7,364**	4,917	8,866

Consolidated Statement of Changes in Equity

For the period ended 30 September 2017

	Share capital £'000	Share premium £'000	Equity reserve £'000	Merger reserve £'000	(Losses)/ Retained earnings £'000	Total £'000
At 1 April 2017	499	673	60	1,508	(2,354)	386
Purchase of own shares	**–**	**–**	**–**	**–**	**(93)**	**(93)**
Re-issuance of treasury shares	**–**	**–**	**–**	**–**	**138**	**138**
Employee share option plan charge	**–**	**–**	**–**	**–**	**8**	**8**
Employee share incentive plan charge	**–**	**–**	**–**	**–**	**162**	**162**
Issue of ordinary shares	**6**	**–**	**–**	**–**	**–**	**6**
Loss for the period and total comprehensive expense	**–**	**–**	**–**	**–**	**(2,146)**	**(2,146)**
At 30 September 2017	**505**	**673**	**60**	**1,508**	**(4,285)**	**(1,539)**
At 1 April 2016	487	232	–	1,508	1,131	3,358
Purchase of own shares	–	–	–	–	(68)	(68)
Employee share option plan charge	–	–	–	–	47	47
Employee share incentive plan charge	–	–	–	–	222	222
Issue of ordinary shares	4	–	–	–	–	4
Loss for the period and total comprehensive expense	–	–	–	–	(2,773)	(2,773)
At 30 September 2016	491	232	–	1,508	(1,441)	790
At 1 April 2016	487	232	–	1,508	1,131	3,358
Purchase of own shares	–	–	–	–	(143)	(143)
Employee share option plan charge	–	–	–	–	60	60
Employee share incentive plan charge	–	–	–	–	488	488
Issue of ordinary shares	12	441	–	–	–	453
Equity component of convertible loan notes	–	–	60	–	–	60
Loss for the year and total comprehensive expense	–	–	–	–	(3,890)	(3,890)
At 31 March 2017	499	673	60	1,508	(2,354)	386

Consolidated Cash Flow Statement

For the period ended 30 September 2017

	6 months ended 30 September 2017 £'000	6 months ended 30 September 2016 £'000	Year ended 31 March 2017 £'000
Cash flows from operating activities			
Operating loss	**(3,075)**	(3,678)	(4,721)
Depreciation	**82**	103	194
Loss on disposal of property, plant and equipment	**–**	–	48
Employee share option plan charge	**8**	47	60
Employee share incentive plan charge	**162**	222	488
Employee unit incentive plan charge/(credit)	**7**	(4)	(20)
Employee unit incentive plan payment	**–**	–	(28)
Increase in trade and other receivables	**(573)**	(821)	(364)
Increase/(decrease) in trade and other payables	**85**	(46)	(417)
(Decrease)/increase in deferred revenue	**(221)**	236	820
Cash used in operations	**(3,525)**	(3,941)	(3,940)
Finance income	**4**	9	14
Finance costs on convertible loan notes	**(150)**	–	–
Taxation	**1,141**	(24)	888
Net cash used in operating activities	**(2,530)**	(3,956)	(3,038)
Investing activities			
Purchases of property, plant and equipment	**(23)**	(61)	(73)
Cash used in investing activities	**(23)**	(61)	(73)
Financing activities			
Purchase of own shares	**(93)**	(64)	(143)
Proceeds from re-issuance of treasury shares	**138**	–	–
Proceeds from issue of ordinary share capital	**6**	–	453
Proceeds from issue of convertible loan notes	**510**	–	4,495
Convertible loan note issue costs	**(25)**	–	(321)
Cash generated from/(used in) financing activities	**536**	(64)	4,484
Net (decrease)/increase in cash and cash equivalents	**(2,017)**	(4,081)	1,373
Cash and cash equivalents at the beginning of the period	**6,891**	5,289	5,289
Exchange (losses)/gains on cash and cash equivalents	**(56)**	169	229
Cash and cash equivalents at the end of the period	**4,818**	1,377	6,891

Notes to the Consolidated Accounts

For the period ended 30 September 2017

1. Preparation of the interim financial statements

These interim financial statements have been prepared under IFRS as adopted by the European Union and on the basis of the accounting policies set out in the Group's Annual Report for the year ended 31 March 2017.

The Group is not required to apply IAS 34 Interim Financial Reporting at this time.

These interim financial statements have not been audited and do not constitute statutory accounts as defined in Section 434 of the Companies Act 2006. Statutory accounts for the year ended 31 March 2017 have been delivered to the Registrar of Companies. The Auditors' Report on those accounts was unqualified and did not contain any statement under Section 498 (2) or (3) of the Companies Act 2006.

The Interim Report will be mailed to shareholders within the next few weeks and copies will be available on the website (www.intercede.com) and at the registered office: Intercede Group plc, Lutterworth Hall, St Mary's Road, Lutterworth, Leicestershire, LE17 4PS.

2. Revenue

All of the Group's revenue, operating losses and net assets originate from operations in the UK. The Directors consider that the activities of the Group constitute a single business segment.

The split of revenue by geographical destination of the end customer can be analysed as follows:

	6 months ended 30 September 2017 £'000	6 months ended 30 September 2016 £'000	Year ended 31 March 2017 £'000
UK	**187**	139	403
Rest of Europe	**451**	461	960
North America	**2,774**	1,987	6,367
Rest of World	**239**	241	556
	3,651	2,828	8,286

3. Taxation

Taxation represents the net effect of amounts receivable from HMRC in respect of R&D claims and US corporation tax payable.

4. Loss per share

The calculations of the loss per ordinary share are based on the loss for the period and the weighted average number of ordinary shares in issue during each period. The basic and diluted loss per share are the same as potential dilution cannot be applied to a loss making period.

	6 months ended 30 September 2017 £'000	6 months ended 30 September 2016 £'000	Year ended 31 March 2017 £'000
Loss for the period	**(2,146)**	(2,773)	(3,890)
	Number	Number	Number
Weighted average number of shares			
– basic	**49,944,619**	48,507,555	48,835,080
– diluted	**49,944,619**	48,507,555	48,835,080
	Pence	Pence	Pence
Loss per share			
– basic	**(4.3)p**	(5.7)p	(8.0)p
– diluted	**(4.3)p**	(5.7)p	(8.0)p

The weighted average number of shares used in the calculation of basic and diluted loss per share for each period were calculated as follows:

	6 months ended 30 September 2017 Number	6 months ended 30 September 2016 Number	Year ended 31 March 2017 Number
Issued ordinary shares at start of period	**49,903,143**	48,735,005	48,735,005
Effect of treasury shares	**(189,197)**	(294,000)	(294,000)
Effect of issue of ordinary shares	**230,673**	66,550	394,075
Weighted average number of shares			
– basic	**49,944,619**	48,507,555	48,835,080
Add back effect of treasury shares	**N/A**	N/A	N/A
Effect of share options in issue	**N/A**	N/A	N/A
Effect of convertible loan notes in issue	**N/A**	N/A	N/A
Weighted average number of shares			
– diluted	**49,944,619**	48,507,555	48,835,080

5. Dividend

The Directors do not recommend the payment of a dividend.

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