

Tesseract Limited
13 605 672 928

APPENDIX 4E

Reporting period

Reporting period: Financial year ended 30 June 2017

Comparative period: Financial year ended 30 June 2016

Results for announcement to the market

Key information	\$	Up/Down	% Change
Revenue from ordinary activities	5,404,504	Up	13.7
Loss after tax from ordinary activities attributable to members	(3,511,111)	Up	1,505.8
Net loss attributable to members	(3,511,111)	Up	1,505.8

Key highlights during the year

- **Annual revenue growth of 13.7%.**
- **Cash flow positive** in the June quarter.
- **Sale of Sonar/MyNet IP to Family Zone Cyber Safety Limited (ASX:FZO) for \$3.69M**, consisting of \$3.25M cash and \$0.44M in FZO shares.
- **Received \$0.31M from the ATO** as a Research and Development grant on 7 July 2017.
- Significant product development resulting in the **launch of CyberBIZ**, an innovative cyber solution designed to target 1.2M Australian SMBs.
- **Strategic vendor partnerships** formed with AlienVault and Palo Alto Networks.
- **Revised sales strategy** delivering greenfield managed firewall business and product diversification into SIEM and connectivity.
- Signed **strategic funding/rental arrangement** with Dell Financial Services
- **Reduction of personnel costs.**

Commentary

FY2017 was an eventful year for Tesseract. Being our first full financial year as a listed company, we engaged in a number of key activities to establish our business, build competency for future growth, optimise the return on company assets, assess and develop new market opportunities, whilst continuing to grow revenue.

Tesseract's FY2017 revenue of \$5.40M represents year-on-year revenue growth of 13.7%, and is representative of a solid business experiencing transformation. Whilst investing in business development initiatives, the establishment of Tesseract's executive management team and the evaluation of emerging market opportunities, Tesseract continued to grow our revenue year-on-year by signing long-term customer contracts (typically 3 years) locking in annuity revenue for the years ahead.

A highlight of FY2017 was the sale of the Sonar/MyNet IP and as a separate transaction the associated customer contracts to Family Zone. Tesseract acquired the IP and customer contracts as part of the Blue Reef acquisition in FY2016. Tesseract acquired Blue Reef customers and assets (including Sonar/MyNet IP) for \$2.83M consisting of \$1M cash and 12.9M fully paid ordinary TNT shares.

In less than a year, Tesseract sold the Sonar/MyNet IP to Family Zone for a total of \$3.69M, incorporating \$3.25M cash and \$0.44M in FZO shares which have subsequently been sold. This transaction effectively

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netted Tesseract \$2.69M in cash, relieved Tesseract of the heavy costs associated with developing the Sonar/MyNet software and significantly reduced our staff costs. From a profit and loss perspective Tesseract realised a gain of \$571,794 on the sale of the IP and a gain of \$569,694 on the sale of the customer contracts.

In conjunction with revenue growth, management of personnel and other costs remains a key focus of the Board and Executive team. In conserving cash flow while recruiting and retaining key operational staff the Group had previously implemented an employee share plan that, while contributing \$0.69m to employee costs, had no impact on cash flow.

Tesseract recognises that product development and business growth requires investment, and this is reflected in increased costs during FY2017 compared to FY2016 for items such as occupancy costs, where we built a world class Security Operations Centre to support our clients. However, while the Group has invested and will continue to invest in new product development and new business, Tesseract notes that the focus on costs management and cash conservation resulted in a net cash outflow for the year of \$0.52M, and a cash balance at the end of the year of \$2.86M.

As noted earlier the Group divested of its Sonar/MyNet IP, while continuing to develop and leverage relevant key products such as CyberBIZ for our defined markets including SMBs. In undertaking this initiative, the Group has been able to strategically streamline development costs that will have a significant impact to FY2018 personnel costs enabling a direct and focussed approach to the ongoing sales and marketing expenditure. Annualised personnel cost savings as impacted by the sale of the IP is in excess of \$2.0M.

Tesseract is committed to growing our business through the optimisation of new and evolving market opportunities. To do this, we cannot simply continue to do what we have done in the past, instead, we must continue to evaluate changing market conditions, keep pace with emerging technologies and satisfy changing market demands. During FY2017 Tesseract formed two strategic partnerships with global vendors (AlienVault and Palo Alto Networks) enabling us to broaden our reach. We also developed CyberBIZ, an innovative and comprehensive security service targeting SMB customers. The SMB market in Australia consists of 1.2M SMBs. This market is under-serviced by managed security service offerings, making CyberBIZ a rich opportunity for Tesseract. Tesseract seeks to execute a direct and channel sales model to promote and sell into this vast market.

Dividends paid and proposed

No dividend has been proposed to be paid or is payable for the year ended 30 June 2017, nor for the comparative period.

Net tangible assets per share

	2017	2016
	\$/share	\$/share
Net tangible assets per share	\$0.02	\$0.02

Control gained or lost over entities in the year

Not applicable

Investment in Associates and Joint Ventures

Not applicable.

Status of Audit

The report is based on accounts which are in the process of being audited.

Attachments

The preliminary financial report of Tesserent Limited for the year ended 30 June 2017 is attached.

Tesseract Limited and its controlled entities

Consolidated statement of profit or loss and other comprehensive income

For the year ended 30 June 2017

	Note	2017	Restated
		\$	2016
			\$
Revenue from continuing operations	3	5,404,504	4,753,854
Other income	4	1,476,938	660,969
Cost of goods sold		(2,347,575)	(1,947,656)
Employee benefits expense	5	(4,127,401)	(1,830,077)
Depreciation and amortisation expense		(617,303)	(289,532)
Finance costs		(8,152)	(91,993)
Initial public offering costs		-	(246,932)
Occupancy costs		(688,074)	(198,845)
Consulting and legal costs		(734,695)	(552,981)
Bad and doubtful debts		(40,916)	(33,833)
Other expenses		(1,826,425)	(735,157)
		<u>(10,390,541)</u>	<u>(5,927,006)</u>
Loss before income tax		<u>(3,509,099)</u>	<u>(512,183)</u>
Tax (expense) / credit		(2,012)	293,529
Net loss for the year		<u>(3,511,111)</u>	<u>(218,654)</u>
Other comprehensive income		-	-
Total comprehensive income for the year		<u>(3,511,111)</u>	<u>(218,654)</u>
Earnings per share			
Basic earnings per share (cents)	2	(3.03)	(0.29)
Diluted earnings per share (cents)	2	(3.03)	(0.29)

Tesseract Limited and its controlled entities
Consolidated statement of financial position
As at 30 June 2017

	Note	2017 \$	Restated 2016 \$
Assets			
Cash and cash equivalents		2,860,648	3,380,740
Trade and other receivables	6	799,568	331,246
Prepayments		160,698	89,067
Inventories		25,981	147,576
Current tax asset		765,430	282,274
Other assets		834	71,511
Total current assets		4,613,159	4,302,414
Trade and other receivables	6	-	1,064
Plant and equipment		694,727	561,100
Intangible assets	7	867,572	4,485,762
Deferred tax asset		467,387	667,288
Other non-current assets		298,598	76,655
Total non-current assets		2,328,284	5,791,869
Total assets		6,941,443	10,094,283
Liabilities			
Trade and other payables	8	1,277,767	1,250,371
Unearned income		709,463	815,905
Provisions		646,464	1,078,567
Total current liabilities		2,633,694	3,144,843
Provisions		206,541	29,691
Total non-current liabilities		206,541	29,691
Total liabilities		2,840,235	3,174,534
Net assets		4,101,208	6,919,749
Equity			
Issued capital	9	10,140,892	9,917,792
Reserves	9	705,347	235,877
Accumulated losses		(6,745,031)	(3,233,920)
Total equity		4,101,208	6,919,749

Tesseract Limited and its controlled entities
Consolidated statement of changes in equity
For the year ended 30 June 2017

	Issued capital	Reserves	Accumulated losses	Total equity
	\$	\$	\$	\$
Balance at 1 July 2015	1,609,260	-	(3,015,266)	(1,406,006)
Comprehensive income				
Loss for the year (restated)	-	-	(218,654)	(218,654)
Other comprehensive income for the year	-	-	-	-
Total comprehensive income for the year	-	-	(218,654)	(218,654)
Transactions with owners, in their capacity as owners, and other transfers				
Shares issued during the year	9,301,224	-	-	9,301,224
Capital raising costs	(992,692)	-	-	(992,692)
Shares and options granted during the year	-	235,877	-	235,877
Total transactions with owners and other transfers	8,308,532	235,877	-	8,544,409
Balance at 30 June 2016 (restated)	9,917,792	235,877	(3,233,920)	6,919,749
Balance at 1 July 2016 (restated)	9,917,792	235,877	(3,233,920)	6,919,749
Comprehensive income				
Loss for the year	-	-	(3,511,111)	(3,511,111)
Other comprehensive income for the year	-	-	-	-
Total comprehensive income for the year	-	-	(3,511,111)	(3,511,111)
Transactions with owners, in their capacity as owners, and other transfers				
Shares issued during the year	223,100	(223,100)	-	-
Shares and options granted during the year	-	692,570	-	692,570
Total transactions with owners and other transfers	223,100	469,470	-	692,570
Balance at 30 June 2017	10,140,892	705,347	(6,745,031)	4,101,208

Tesseract Limited and its controlled entities
Consolidated statement of cash flows
For the year ended 30 June 2017

	Note	2017 \$	2016 \$
Cash flows from operations			
Receipts from customers		6,385,337	4,796,725
Payments to suppliers and employees		(9,154,623)	(4,999,596)
		(2,769,286)	(202,871)
Income tax paid		(17,905)	(25,673)
Interest received		31,983	38,357
Interest paid		(8,152)	(91,993)
Net cash outflow from operating activities		(2,763,360)	(282,180)
Cash flows from investing activities			
Purchase of plant and equipment		(728,897)	(271,710)
Purchase of intangibles		(249,560)	-
Acquisitions of business, net of cash paid out	1	(500,000)	(450,111)
Payout on sale of customer contracts	11	(164,401)	-
Proceeds from sale of available-for-sale financial assets		429,000	-
Proceeds from sale of plant and equipment		457,126	-
Proceeds from disposal of IP	10	3,000,000	-
Net cash inflow/(outflow) from investing activities		2,243,268	(721,821)
Cash flows from financing activities			
Repayment of borrowings		-	(700,000)
Proceeds from issuing of shares		-	6,739,145
Payments for initial public offering		-	(1,760,687)
Loans repaid to related parties		-	(410,312)
Net cash inflow from financing activities		-	3,868,146
Net (decrease)/increase in cash and cash equivalents		(520,092)	2,864,145
Cash and cash equivalents at the beginning of the financial year		3,380,740	516,595
Cash and cash equivalents at the end of the financial year		2,860,648	3,380,740

Tesseract Limited and its controlled entities

Notes to the preliminary final report

For the year ended 30 June 2017

1. Business Combination – finalisation of provisional accounting

On 9 May 2016 Tesseract Australia Pty Ltd, a subsidiary of Tesseract Limited, acquired the business of Blue Reef Pty Ltd including all tangible and intangible assets and liabilities.

For 30 June 2016, this business combination had initially been accounted for on a provisional basis in accordance with AASB 3 Business Combinations. Therefore the fair value of assets acquired, liabilities and contingent liabilities assumed were initially estimated by the consolidated entity taking into consideration all available information at the reporting date. At 30 June 2016 the Group recorded goodwill as the only intangible asset. Fair value adjustments on the finalisation of the business combination accounting is retrospective, where applicable, to the period the combination occurred and therefore may have an impact on the assets and liabilities, depreciation and amortisation reported.

The consolidated entity has finalised the accounting for this business combination and in doing so recognised Software and Customer Contracts as intangible assets. As noted above the finalisation accounting is retrospective and therefore the adjustment impacts the 30 June 2016 financial year.

Determination of fair value of intangible assets on acquisition

Software

As announced on 16 December 2016, the Group completed the sale of the original Blue Reef Pty Ltd IP acquired as part of the business combination to Family Zone Cyber Safety Limited (ASX:FZO). This transaction was for the sale of the Blue Reef IP on a separate and stand-alone basis and therefore enabled a fair value to be determined for the Blue Reef IP acquired in the original transaction.

Therefore using the FZO IP sale transaction and after allowing for minor timing and software development cost adjustments, the Group was in a position to determine the fair value of the IP as at the original transaction date as being \$3.43m.

Customer contracts

The fair value of the customer contracts was determined in consultation with an industry expert by reference to the net present value of the incremental financial benefit estimated to be received by the Group as a result of receiving the benefit of these contracts.

Based upon contracted sales and average net profit margins over remaining contract period, forecast profit ranges were determined. Using a weighted average cost of capital of 15.08% the forecast cash flows were discounted to their net present value. The Group adopted \$210,000 for the fair value of customer contracts acquired.

Set out below is the impact to finalisation of the provisional accounting based on the 30 June 2016 financial statements.

Adjustment to 30 June 2016 statement of profit or loss and comprehensive income:

	(Loss) before income tax	Tax expense / (credit)	Net (loss) for the year
	\$	\$	\$
Provisional accounting basis	(1,024,507)	(270,641)	(753,866)
Adjustments to finalise provisional accounting			
• Bargain purchase gain	530,946	-	530,946
• Capitalised development costs	72,357	-	72,357
• Amortisation – software	(86,567)	(21,565)	(65,002)
• Amortisation – customer contracts	(4,412)	(1,323)	(3,089)
Post provisional accounting adjustments	(512,183)	(293,529)	(218,654)

Tesserent Limited and its controlled entities

Notes to the preliminary final report

For the year ended 30 June 2017

1. Business Combination – finalisation of provisional accounting - continued

Details of the original purchase consideration terms, fair value of the net assets acquired as recorded on the provisional basis and the final position as impacting the fair value of net assets acquired, and intangible assets are as follows:

	2016
Purchase consideration:	\$
Cash paid	500,000
Shares issued ¹	1,828,250
Deferred consideration – cash ²	500,000
Total purchase consideration	2,828,250

¹ 12,875,000 shares are provided as part consideration for the transaction. Of these shares, 9,656,250 were placed in voluntary escrow for a period of 24 months effective from the transaction date. The value applicable to the equity consideration was based on the share price at transaction date with a marketability discount of 15% applied to the value of the escrowed shares.

² The company paid the balance of the deferred consideration in two instalments of \$250,000 on 9th November 2016 and 19th December 2016.

The assets and liabilities recognised within the statement of financial position as at 30 June 2016 as a result of the acquisition are as follows

	Final	Provisional Basis	
	Fair Value	Fair Value	Variance
	\$	\$	\$
Plant and equipment	225,730	225,730	-
Software	3,434,406	-	3,434,406
Customer contracts	210,000	-	210,000
Employee provisions	(154,260)	(154,260)	-
Trade creditors	(27,270)	(27,270)	-
Provision for onerous contracts	(223,032)	(223,032)	-
Deferred tax asset	113,188	113,188	-
Deferred tax liability	(219,567)	-	(219,567)
Net identifiable liabilities acquired	3,359,196	(65,644)	3,424,838
(Less)/Add: (bargain purchase) / goodwill	(530,946)	2,893,894	3,424,838
Purchase consideration	2,828,250	2,828,250	-

The bargain purchase gain is attributable to the underlying business capability and operational performance. It is not be assessable for tax purposes.

Tesseract Limited and its controlled entities

Notes to the preliminary final report

For the year ended 30 June 2017

2. Earnings per share

Basic earnings per share is calculated by dividing the profit attributable to the owners of Tesseract Limited, excluding any costs of servicing equity other than ordinary shares, by the weighted average number of ordinary shares outstanding during the financial year.

	2017	2016
	\$	\$
Earnings per share from continuing operations		
Loss after income tax (basic)	(3,511,111)	(218,654)
Loss after income tax (diluted)	(3,511,111)	(218,654)
Weighted average number of shares used in calculating basic earnings per share	115,738,337	74,310,516
Basic earnings per share (cents per share)	(3.03)	(0.29)
Diluted earnings per share (cents per share)	(3.03)	(0.29)

3. Revenue

Sales revenue	5,375,117	4,713,558
Interest	29,387	40,296
Total revenue	5,404,504	4,753,854

4. Other income

Gain on sale of intellectual property (Note 10)	571,794	-
Gain on sale of customer contracts (Note 11)	569,694	-
Research and development tax concession	163,837	94,091
Bargain purchase gain (Note 1)	-	530,946
Other	171,613	35,932
	1,476,938	660,969

5. Employee benefits expense

Salaries and wages	2,773,765	1,222,747
Superannuation	298,111	140,899
Director Fees	225,000	161,300
Payroll tax	137,955	45,476
Other employee related expenses	-	23,778
Share based payments	692,570	235,877
	4,127,401	1,830,077

6. Trade and other receivables

Current		
Trade receivables	382,734	341,670
Provision for impairment	(33,000)	(13,020)
Other receivables	449,834	2,596
	799,568	331,246

Tesseract Limited and its controlled entities
Notes to the preliminary final report
For the year ended 30 June 2017

6. Trade and other receivables - continued

	2017	2016
	\$	\$
Non-current		
Amounts receivable from related parties	-	1,064
	-	1,064

7. Intangible assets

Goodwill	777,375	777,375
Intellectual property	-	3,420,197
Customer contracts	-	205,589
Other intangibles	90,197	82,601
	867,572	4,485,762

8. Trade and other payables

Trade payables	720,392	549,826
Sundry payables and accrued expenses	557,375	200,545
Deferred consideration	-	500,000
	1,277,767	1,250,371

9. Capital and reserves

Number of shares

	2017	2016
	No	No
On issue at start of year	115,334,600	4,947,090
Tesseract Australia Pty Ltd shares surrendered	-	(4,947,089)
Tesseract Limited shares issued to the shareholders of Tesseract Australia Pty Ltd	-	44,988,750
Shares issued to directors	-	4,200,000
Shares issued on conversion of loan	-	18,270,849
Shares issued pursuant to the capital raising	-	35,000,000
Shares issued on acquisition of business	-	12,875,000
Shares issued to employees	1,440,000	-
Total shares on issue	116,774,600	115,334,600

Cost

	2017	2016
	\$	\$
On issue at the start of the year	9,917,792	1,609,260
Shares issued to directors	-	350,000
Shares issued on conversion of loan	-	122,974
Shares issued pursuant to the capital raising	-	7,000,000
Costs associate with capital raising	-	(992,692)
Shares issued on acquisition of business	-	1,828,250
Shares issued to employees	223,100	-
Share capital at the end of the year	10,140,892	9,917,792

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Notes to the preliminary final report
For the year ended 30 June 2017

	2017	2016
	\$	\$
9. Capital and reserves - continued		
Reserves		
Share based payments reserve	705,347	235,877

10. Sale of intellectual property

On the 16 December 2016 Tesseract completed the sale of the Sonar/MyNet IP ('IP') to Family Zone Cyber Safety Limited (ASX:FZO) ('FZO') for \$3.5m cash and 1.0m shares in FZO. The IP had originally been acquired as part of the Blue Reef business acquisition. The settlement terms of this transaction was subsequently amended in June 2017 whereby the cash value was changed from \$3.5m to \$3.25m and Tesseract were issued 1.0m shares in FZO.

Transaction summary is as follows:

	2017
	\$
Cash consideration	
Received as at 30 June 2017	3,000,000
Deferred consideration (net of GST)	
- 6 monthly instalments from July 2017	250,000
FZO Shares at fair value	442,446
Total Consideration	3,692,446
Employee liabilities transferred	104,925
Plant & equipment sold at wdv	(9,570)
Reversal of DTA/DTL	103,523
Value of IP (wdv)	(3,319,530)
Gain on sale of IP	571,794

Tesseract Limited and its controlled entities

Notes to the preliminary final report

For the year ended 30 June 2017

11. Sale of customer contracts

Following the sale of the Sonar/MyNet IP in December 2016, FZO approached the Group with an offer to acquire the customer contracts associated with the IP (Sonar/MyNet Customers) that had been sold to them in December 2016. Following detailed analysis and consideration of both the financial and operational impacts Tesseract completed the sale of customer contracts on 5th June 2017.

The underlying terms of the transaction was that FZO would commence invoicing the Sonar/MyNet Customers from the date of acquisition with any invoicing and cash received prior to the acquisition date remaining with the Group. Typically, a customer contract has a three-year term with invoicing occurring monthly, yearly or three years up front. Revenue is recognised evenly over the term of the contract as per the requirements of AASB 118 Revenue. The difference between the amount invoiced to a customer and what has been recognised as revenue is held on the balance sheet as unearned revenue. As at the date of the sale, the Group had \$878,226 of unearned revenue associated with Sonar/MyNet Customers.

From the date of sale, the Group had no further customer servicing requirements to the Sonar Customers and therefore were in a position to recognise in the profit or loss the balance of the unearned revenue. The recognition of this unearned revenue was no longer associated with servicing Sonar/MyNet Customers but was directly linked to the sale of the Sonar/MyNet Customer contracts. On this basis the Group recognised the balance of the unearned income as contributing to the gain on sale of customer contracts.

Transaction summary is as follows:

	2017
	\$
Value of customer contracts (wdv)	(175,986)
Recognition of deferred revenue	878,226
Onerous contract value released ¹	31,855
Pay out of agreed customer contract value	<u>(164,401)</u>
Gain on sale of customer contracts	<u>569,694</u>

(1) From when the Group acquired the customer base from Blue Reef they were required to service customers including payment for third party software used by the customers. Costs that were incurred from the date of acquisition up to and including the date of the first invoice to the customer were classified as onerous expenses with a provision established as at the date of acquisition.

Tesseract Limited and its controlled entities

Notes to the preliminary final report

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12. Segment report

An operating segment is a component of an entity that engages in business activities from which it may earn revenue and incur expenses, whose operating results are regularly reviewed by the Group's Chief Operating Decision Maker (CODM) in order to effectively allocate Group resources and assess performance.

The Group has identified its operating segments based on the internal reports that are reviewed and used by the Chief Executive Officer CEO in the capacity of CODM. Two operating segments have been identified: IT Security Managed Services and Software Licensing.

The CEO reviews Profit before tax. The accounting policies adopted for internal reporting to the CEO are consistent with those adopted in the financial statements.

	IT Security Managed Services	Software Licensing	Inter segment eliminations	Totals
2017	\$	\$	\$	\$
Revenues				
Sales to external customers	5,043,856	331,261	-	5,375,117
Inter segment sales	7,530	359,763	(367,293)	-
Total sales revenue	5,051,386	691,024	(367,293)	5,412,478
Gain on sale of intellectual property	571,794	-	-	571,794
Gain on sale customer contracts	569,694	-	-	569,694
Other revenue	364,837	-	-	364,837
Total revenue	6,557,711	691,024	(367,293)	6,881,442
Profit/(loss)before income tax expense	(3,963,429)	454,330	-	(3,509,099)
Total segment assets	5,755,241	1,186,202	-	6,941,443
Total segment liabilities	2,395,982	444,253	-	2,840,235
	IT Security Managed Services	Software Licensing	Inter segment eliminations	Totals
2016	\$	\$	\$	\$
Revenues				
Sales to external customers	4,360,642	352,916	-	4,713,558
Inter segment sales	28,304	386,010	(414,314)	-
Total sales revenue	4,388,946	738,926	(414,314)	4,713,558
Other income – gain on sale of software	530,946	-	-	530,946
Other revenue	170,319	-	-	170,319
Total revenue	5,090,211	738,926	(414,314)	5,414,823
Profit/loss before income tax expense	(906,009)	393,826	-	(512,183)
Total segment assets	8,964,610	1,129,673	-	10,094,283
Total segment liabilities	2,438,689	735,845	-	3,174,534