

3Q COVID-ed, 4Q has started strongly

HSC Technology is a hardware and software company for the health and aged care industry. It is helping to shift the industry from reactive to proactive care, improving operational efficiencies of the sector. As at 30 September 2021, HSC Technology has a 0.47% market penetration of the potential aged care market in Australia. We see the company’s market penetration expanding to 4% by the end of CY25, with medium-term revenue growth of 50-70% p.a.

Key takeaways from 4C

- **Active subscriptions 8,100, up 9% QoQ as HSC gained 3bp of market penetration for the quarter**, ending the quarter on our estimates at 47bp. Growth has slowed from 6bp in 2Q and 9bp in 1Q as COVID lockdowns brought about a stalling in decisions and lack of access to sites. We have pulled back our CY21 year-end expectations to 10,068 active subscriptions, equating to 58bp of market penetration, down from previously expecting 65bp. We have pushed earnings
- As such, our DCF valuation has pulled back to \$0.048, implying almost 2x upside from the current share price.
- **4Q has started strongly** with HSC announcing two significant contracts with Australian Unity for its facilities in South Yarra and Kilsyth, Melbourne for \$1.9m to supply and install hardware devices, along with recurring revenue of \$0.26-0.28m pa through subscriptions across 255 aged care and assisted living apartments.
- **Net cash of \$2.2m**, with annualised cash burn for 3Q of \$4.3m. Cash burn has picked up on purchasing inventory ahead of large contracts. While supply chain issues mean that inventory is taking much longer to arrive into Australia. Funding may need to be addressed if these issues continue into 4Q.

Confirming our investment thesis

- **Structural demand** for technological assistance in aged care supported by demographics, Royal Commission recommendations into continuous monitoring, global digitisation and limited trained staff in aged care.
- **Competitive advantage** from HSC’s software offering given exclusive licence over the CSIRO’s algorithm. While hardware sales are the cash generator of the business, the software side provides the value-add.
- With a current **cash balance of \$2.2m**, we expect HSC Technology to be cash flow positive over CY22.
- **Valuation:** Our base-case 12-month forward discounted cash flow valuation is \$0.048, implying 184% upside from the current share price. This assumes a further 16% dilution in issued shares from options and performance rights.

HSC TECHNOLOGY GROUP

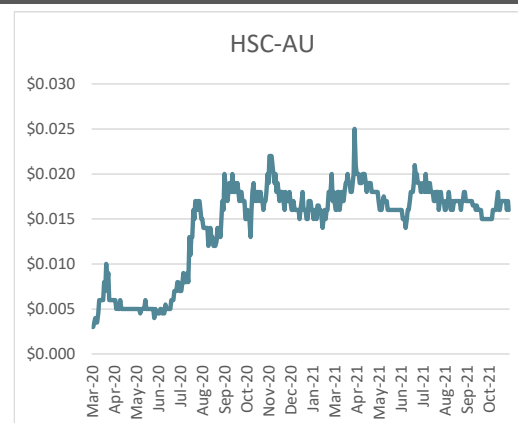
With medical-grade wearables, tracking technology and monitoring devices all linked through Internet of Things (IoT) networks, HSC Technology Group is changing the way healthcare is delivered and creating safer environments. HSC’s Assistive Technology suite is designed to enable personalised and proactive care which increases staff productivity, reduces costs and minimises unnecessary adverse medical situations.

<https://www.hsctg.com.au/>

Stock	HSC.ASX
Price	A\$0.017
Market cap	A\$34m
Valuation (per share)	A\$0.048

Ongoing	New contract sales and partnership agreements with major aged care providers
Ongoing	New products on R&D advancements

HSC Share Price (A\$)



Source: FactSet.

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Financial Forecasts

HSC TECHNOLOGY
HSC-AU
12 month relative performance versus S&P/ASX 200
Year end 31 December
MARKET DATA

Price	\$	0.017
DCF Valuation - 12 month	\$	0.048
Total return - 12 month	%	184%
52 week high / low	\$	0.013-0.025
Market capitalisation	\$m	33.5
Shares on issue (ordinary)	m	1,967.7
Options / rights	m	312.0
Shares on issue (diluted)	m	2,279.7


INVESTMENT FUNDAMENTALS

	CY19A	CY20A	CY21E	CY22E	CY23E	
Reported NPAT	\$m	-4.4	-2.4	-1.5	0.0	2.0
Underlying NPAT	\$m	-4.4	-1.6	-1.5	0.0	2.0
Reported EPS (diluted)	¢	-0.5	-0.1	-0.1	0.0	0.1
Underlying EPS (diluted)	¢	-0.5	-0.1	-0.1	0.0	0.1
...Growth	%	-58%	-83%	-23%	-99%	nm
Underlying PER	x					17.9
Operating cash flow per share	¢	-0.4	-0.1	-0.1	0.0	0.1
Free cash flow per share	¢	-0.3	-0.1	-0.1	0.0	0.1
Price to free cash flow per share	x	-1.8	-27.3	-31.0	103.8	15.9
FCF yield	%	-55%	-4%	-3%	1%	6%

Dividend	¢	0.0	0.0	0.0	0.0	0.0
Payout	%	0%	0%	0%	0%	0%
Yield	%	0%	0%	0%	0%	0%
Franking	%	0%	0%	0%	0%	0%

Enterprise value	\$m	5.2	25.7	29.7	30.0	27.2
EV/Sales	x	4.5	8.1	6.7	3.4	1.9
EV/EBITDA	x	-1.4	-27.9	-22.0	448.5	13.4
EV/EBIT	x	-1.2	-16.9	-18.7	-546.2	13.8
Price to book (NAV)	x	0.0	0.3	0.6	0.6	0.6
Price to NTA	x	0.0	0.5	0.8	0.8	0.7

KEY RATIOS

	CY19A	CY20A	CY21E	CY22E	CY23E	
EBITDA margin	%	-534.8	-87.6	-92.1	2.3	39.9
EBIT margin	%	-629.0	-144.3	-108.7	-1.9	38.7
NPAT margin	%	-636.5	-226.6	-105.7	-0.5	39.6
Underlying ROE	%	nm	nm	nm	nm	17.7
Underlying ROA	%	nm	nm	nm	nm	12.7
Net tangible assets per share	¢	0.3	0.3	0.2	0.3	0.5
Book value per share	¢	0.7	0.5	0.3	0.4	0.7
Net debt / (cash)	\$m	-2.2	-4.5	-3.7	-4.9	-10.4
Interest cover (EBIT / net interest)	x	116.3	45.5	-35.8	-1.4	43.1
Gearing (net debt / EBITDA)	x	0.6	4.8	2.8	nm	nm
Leverage (net debt / (net debt + equity))	x	-1.8	-5.0	-6.8	-7.0	-10.7

DUPONT ANALYSIS (on Underlying)

	CY19A	CY20A	CY21E	CY22E	CY23E	
Net Profit Margin	%	-636.5	-226.6	-105.7	-0.5	39.6
Asset Turnover	x	0.1	0.2	0.2	0.3	0.3
Return on Assets	%	-73.0	-34.1	-24.9	-0.2	12.7
Financial Leverage	x	1.7	1.3	1.5	1.5	1.4
Return on Equity	%	-126.6	-44.6	-36.1	-0.3	17.7

KEY PERFORMANCE INDICATORS

	CY19A	CY20A	CY21E	CY22E	CY23E	
Number of subscribers/users		0	4,700	10,068	22,269	41,067
Market penetration	%	0.00%	0.29%	0.58%	1.20%	2.06%
Average Revenue Per User	\$	\$ -	\$ 52	\$ 52	\$ 54	\$ 55
Software Revenue	\$m	0.0	0.2	0.5	1.2	2.3
Growth	%			114%	128%	90%
Hardware Revenue	\$m	0.0	2.9	3.7	7.4	12.1
Growth	%			29%	101%	63%

QTRLY DATA

	3Q20	4Q20	1Q21	2Q21	3Q21
Number of subscribers	4,500	4,700	6,300	7,400	8,100
New subscribers	1,800	200	1,600	1,100	700
Market penetration	0.28%	0.29%	0.38%	0.44%	0.47%

Source: HSC reports, MST Access estimates

PROFIT AND LOSS

	CY19A	CY20A	CY21E	CY22E	CY23E	
Revenue	\$m	1.1	3.2	4.4	8.8	14.5
Gross Revenue	\$m	0.7	1.1	1.5	2.9	5.1
Operating Expenses	\$m	-4.4	-2.0	-2.8	-2.9	-3.1
EBITDA	\$m	-3.7	-0.9	-1.3	0.1	2.0
Depreciation & amortisation	\$m	-0.7	-0.6	-0.2	-0.1	-0.1
EBIT	\$m	-4.3	-1.5	-1.6	-0.1	2.0
Net interest	\$m	0.0	0.0	0.0	0.0	0.0
Non-operating income	\$m	0.0	-0.8	0.0	0.0	0.0
Tax expense	\$m	0.0	0.0	0.0	0.0	0.0
Reported NPAT	\$m	-4.4	-2.4	-1.5	0.0	2.0
Adjustments to underlying	\$m	0.0	0.8	0.0	0.0	0.0
Underlying NPAT	\$m	-4.4	-1.6	-1.5	0.0	2.0

Weighted average basic shares	m	814.8	1,495.3	1,927.2	2,008.7	2,131.7
Weighted average diluted shares	m	814.8	1,670.3	2,170.7	2,289.7	2,284.7

GROWTH PROFILE

	CY19A	CY20A	CY21E	CY22E	CY23E	
Revenue	%	626.7	178.8	38.9	99.5	64.9
Gross Revenue	%	3,702.3	52.5	39.2	99.8	74.3
EBIT	%	nm	nm	nm	nm	nm
Underlying NPAT	%	nm	nm	nm	nm	nm
Underlying EPS	%	nm	nm	nm	nm	nm
DPS	%	n/a	n/a	n/a	n/a	n/a

BALANCE SHEET

	CY19A	CY20A	CY21E	CY22E	CY23E	
Cash	\$m	2.7	4.5	3.7	4.9	10.4
Receivables	\$m	0.9	0.2	0.3	0.5	0.9
Other	\$m	0.7	2.0	2.0	3.1	4.5
Current	\$m	4.3	6.7	6.0	8.5	15.8
Property, plant & equip	\$m	0.4	0.2	0.2	0.1	0.0
Goodwill and intangibles	\$m	1.4	0.1	0.1	0.0	0.0
Other	\$m	0.0	0.0	0.0	0.0	0.0
Non current	\$m	1.8	0.3	0.2	0.1	0.1
Total assets	\$m	6.0	7.0	6.2	8.6	15.9
Payables	\$m	1.4	1.1	1.1	2.2	3.6
Borrowings	\$m	0.5	0.0	0.0	0.0	0.0
Other	\$m	0.6	0.5	0.8	0.8	0.8
Total liabilities	\$m	2.5	1.7	1.9	3.0	4.5
Net assets	\$m	3.5	5.4	4.3	5.5	11.4

Equity	\$m	11.9	16.0	16.5	17.3	20.4
Retained earnings	\$m	-8.4	-10.6	-12.2	-11.7	-9.0
Shareholder's equity	\$m	3.5	5.4	4.3	5.5	11.4

CASH FLOW

	CY19A	CY20A	CY21E	CY22E	CY23E	
Net Income (Cashflow)	\$m	-4.3	-1.5	-1.6	-0.1	2.0
Depreciation & Amortization	\$m	0.7	0.6	0.2	0.1	0.1
Change in Net Operating Assets	\$m	-0.1	0.6	0.1	0.3	0.4
Other Non-Cash Items, Total	\$m	0.3	-0.9	0.0	0.0	0.0
Operating cash flow	\$m	-3.4	-1.2	-1.3	0.4	2.4
Capital expenditure	\$m	-1.0	0.0	0.0	0.0	0.0
Acquisitions/divestment/other	\$m	-0.1	0.1	0.0	0.0	0.0
Investing cash flow	\$m	-1.0	0.1	0.0	0.0	0.0
Equity	\$m	3.2	2.9	0.5	0.7	3.2
Increase / (decrease) in borrowings	\$m	0.5	0.0	0.0	0.0	0.0
Dividend/other	\$m	0.0	-0.1	0.0	0.0	0.0
Financing cash flow	\$m	3.7	2.8	0.5	0.7	3.2
Net cash flow	\$m	-0.7	1.7	-0.7	1.1	5.6
Free cash flow	\$m	-4.4	-1.2	-1.3	0.4	2.4

Valuation: Base-Case DCF Value of \$0.048

Exhibit 1 – MST Access DCF

DCF	CY21E	CY22E	CY23E	CY24E	CY25E
EBIT	-1.59	-0.05	1.97	4.86	8.51
Less: Taxes	0.00	0.00	0.00	0.00	0.00
Post-tax EBIT	-1.59	-0.05	1.97	4.86	8.51
Plus: D&A	0.24	0.12	0.06	0.03	0.02
Post-tax cash flow	-1.35	0.07	2.04	4.89	8.52
Less: Capex					
Less: Change in WC	-0.05	-0.27	-0.35	-0.47	-0.56
Free cash flow	-1.40	-0.20	1.69	4.42	7.96
Discount coefficient	0.2	1.2	2.2	3.2	4.2
Discounted cash flow	-1.38	-0.18	1.32	3.09	4.98
Sum of discount streams	33.6	CAPM			
Terminal growth	3.0%	Risk free rate		2.50%	
Future value into perpetuity	190.2	Equity beta		2.0	
NPV of terminal value	67.7	Equity risk premium		4.72%	
PV of cash flows	101.3	Cost of equity		11.9%	
PLUS: Value of tax losses	3.5	Debt		0%	
Add: Net Cash	2.2	Equity		100%	
Add: Options	3.1	Interest rate		5.0%	
Equity value	110.1	Tax rate		30%	
Diluted shares	2279.7	WACC		11.9%	
Value per share (A\$)	\$ 0.048				
Upside	184%				

Source: MST Access.

Risks

- **The Australian aged care and disability industry is supported by government funding. There is a risk that the government cannot fund or chooses not to fund the industry. Alternatively, the government could improve funding specifically towards staffing that could see a slower take up of HSC's products as staff focus on "spot checks" rather than "continuous monitoring".**
- Given the company has access to patient data through software, data leaks or compromises on privacy, could be reputationally damaging.
- Associated reputational risk if HSC's products are supplied in a facility with questionable practices.
- Introduction of unknown regulatory change, which impacts the industry and /or product certification.
- Industry digital adoption is slower than expected, which would see HSC's earnings pushed out and/or not eventuate.
- The 3G replacement cycle is pushed out beyond the 2024 deadline, which could see HSC's earnings from this revenue stream pushed out.
- A new or existing company brings to market a superior product, taking market share away from HSC's products.
- A pandemic, that could slow down adoption from the supply and demand side of the equation.
- The company is currently dependent upon manufacturers for their hardware. Supplier issues could have a knock effect to HSC, including shortages of stock, failure of the product and product recall.
- The company currently has a relationship with the CSIRO for the algorithm within their software. This relationship could be terminated, which would require HSC to look for alternative relationships.
- This is a small company, and the business is currently very dependent upon the CEO and key salesperson, Graham Russell. Russell has significant value tied up with the company, owning 7% of the company with an additional 2% in pending performance rights.
- Ongoing share dilution through the issuance of employee performance rights and the vesting of shares to the "First Milestone", which is to the previous shareholders of the company, HomeStay Care Pty Ltd.

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