

Building up ahead of sales

Reported their 1H result. Key takeaway is that they are building out in advance of a greater sales push as they look set to gain market share in personal emergency response systems (PERS) ahead of the pending 3G shutdown. New reseller partnerships with VitalCALL/Chubb and Tunstall Healthcare confirm this.

1H Result highlights

- Reported 1H loss of \$1.01m, broadly in line with pcp. Revenue of \$1.83m was up 10% on pcp, driven by greater market penetration (44bp, vs 17bp June 2020). Gross margin 35%.
- Market share gains in the replacement of the 3G PERS is evident with new distribution partnerships. These include ADT (\$1.6m over 12mths), Sapio and Telstra for Anglicare’s Retirement Living (initially 2,300 units), Tunstall Healthcare (3yr reseller agreement) and VitalCALL/Chubb (reseller agreement to their national client base).
- We expect to see revenue to nearly double over the 2H with market penetration picking up from 44bp currently to end the year at 65bp.
- Expenses were marginally ahead of our expectations as they build up staff and marketing ahead of a greater push into future sales. This has seen our CY21 EBITDA estimate decrease by \$0.6m to be a loss of \$1.0m, broadly in line with CY20. This has minimal impact on outer years. We continue to expect HSC to be FCF positive over CY22.
- Outlook: No significant impact from COVID, but extended shut down in NSW and VIC, may slow down the sales cycle as sales and operations do not have access to sites.
- Cash balance of \$3.3m with monthly burn for the last quarter at \$85k per month.

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 \$3.3m, we expect HSC Technology to be cash flow positive over CY22.
- Valuation: Our base-case 12-month forward discounted cash flow valuation is \$0.051, implying 185% upside from the current share price. This assumes a further 16% dilution in issued shares from options and performance rights.
- Please see initiation for our more comprehensive view on the stock.

HSC TECHNOLOGY GROUP

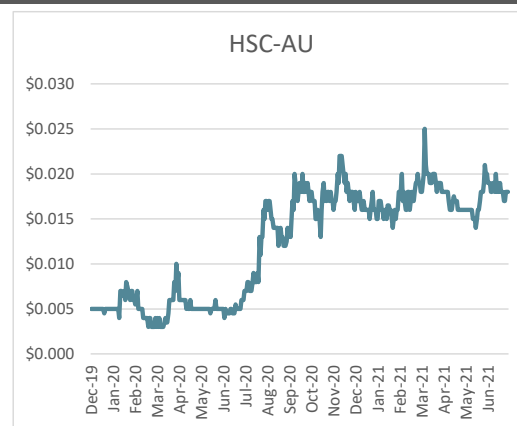
With medical-grade wearables, tracking technology and monitoring devices all linked through Internet of Things (IoT) networks, HSC Technology Group is changing the way healthcare is delivered and creating safer environments. HSC’s Assistive Technology suite is designed to enable personalised and proactive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

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

Stock	HSC.ASX
Price	A\$0.018
Market cap	A\$35m
Valuation (per share)	A\$0.051

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.

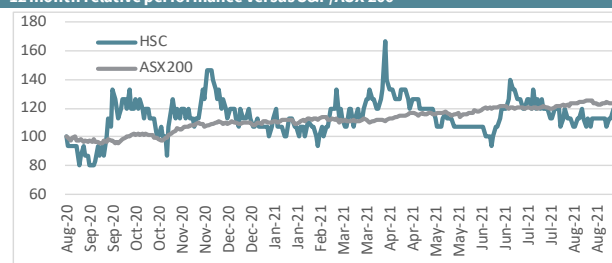
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Financial Forecasts

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

Price	\$	0.018
DCF Valuation - 12 month	\$	0.051
Total return - 12 month	%	185%
52 week high / low	\$	0.012-0.025
Market capitalisation	\$m	35.4
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	-1.2	0.2	2.4
Underlying NPAT	\$m -4.4	-1.6	-1.2	0.2	2.4
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%	-42%	-119%	950%
Underlying PER	x			157.0	15.9
Operating cash flow per share	¢ -0.4	-0.1	0.0	0.0	0.1
Free cash flow per share	¢ -0.3	-0.1	0.0	0.0	0.1
Price to free cash flow per share	x -1.8	-27.3	-50.5	72.3	14.4
FCF yield	% -55%	-4%	-2%	1%	7%

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	31.2	31.4	28.3
EV/Sales	x	7.5	24.5	16.9	9.8	5.1
EV/EBITDA	x	-1.4	-27.9	-32.2	101.5	11.7
EV/EBIT	x	-1.2	-16.9	-25.7	167.6	12.0
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	-52.7	9.7	44.0
EBIT margin	% -629.0	-144.3	-65.9	5.9	42.9
NPAT margin	% -636.5	-226.6	-63.5	7.2	43.8
Underlying ROE	% nm	nm	nm	3.7	19.2
Underlying ROA	% nm	nm	nm	2.5	14.1
Net tangible assets per share	¢ 0.3	0.3	0.2	0.3	0.6
Book value per share	¢ 0.7	0.5	0.4	0.5	0.8
Net debt/(cash)	\$m -2.2	-4.5	-4.2	-5.5	-11.5
Interest cover (EBIT / net interest)	x 116.3	45.5	-27.3	4.3	48.1
Gearing (net debt / EBITDA)	x 0.6	4.8	4.3	nm	nm
Leverage (net debt / (net debt + equity))	x -1.8	-5.0	-6.9	-7.9	-11.6

DUPONT ANALYSIS (on Underlying)

	CY19A	CY20A	CY21E	CY22E	CY23E
Net Profit Margin	% -636.5	-226.6	-63.5	7.2	43.8
Asset Turnover	x 0.1	0.2	0.3	0.3	0.3
Return on Assets	% -73.0	-34.1	-16.7	2.5	14.1
Financial Leverage	x 1.7	1.3	1.5	1.5	1.4
Return on Equity	% -126.6	-44.6	-24.3	3.7	19.2

KEY PERFORMANCE INDICATORS

	CY19A	CY20A	CY21E	CY22E	CY23E
Number of subscribers/users	0	4,700	11,321	23,232	41,739
Market penetration	% 0.00%	0.29%	0.65%	1.25%	2.09%
Average Revenue Per User	\$ \$ -	\$ 52	\$ 54	\$ 55	\$ 57
Software Revenue	\$m 0.0	0.2	0.6	1.3	2.4
Growth	%		148%	111%	85%
Hardware Revenue	\$m 0.0	2.9	4.6	7.5	12.3
Growth	%		61%	64%	63%

QTRLY DATA

	2Q20	3Q20	4Q20	1Q21	2Q21
Number of subscribers	2,700	4,500	4,700	6,300	7,400
New subscribers	700	1,800	200	1,600	1,100
Market penetration	0.17%	0.28%	0.29%	0.38%	0.44%

Source: HSC reports, MST Access estimates

PROFIT AND LOSS

	CY19A	CY20A	CY21E	CY22E	CY23E
Revenue	\$m 1.1	3.2	5.4	9.0	14.8
Gross Revenue	\$m 0.7	1.1	1.8	3.2	5.5
Operating Expenses	\$m -4.4	-2.0	-2.8	-2.9	-3.1
EBITDA	\$m -3.7	-0.9	-1.0	0.3	2.4
Depreciation & amortisation	\$m -0.7	-0.6	-0.2	-0.1	-0.1
EBIT	\$m -4.3	-1.5	-1.2	0.2	2.4
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	-1.2	0.2	2.4
Adjustments to underlying	\$m 0.0	0.8	0.0	0.0	0.0
Underlying NPAT	\$m -4.4	-1.6	-1.2	0.2	2.4
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	69.7	66.8	65.1
EBITDA	% -12.9	-75.0	5.3	-131.8	685.0
EBIT	% -3.5	-65.0	-20.0	-115.4	1,163.5
Underlying NPAT	% -2.7	-64.6	-24.6	-119.7	947.8
Underlying EPS	% -57.8	-82.7	-42.0	-118.7	950.1
DPS	% n/a	n/a	n/a	n/a	n/a

BALANCE SHEET

	CY19A	CY20A	CY21E	CY22E	CY23E
Cash	\$m 2.7	4.5	4.2	5.5	11.5
Receivables	\$m 0.9	0.2	0.3	0.6	0.9
Other	\$m 0.7	2.0	2.2	3.1	4.6
Current	\$m 4.3	6.7	6.7	9.2	17.0
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	7.0	9.3	17.1
Payables	\$m 1.4	1.1	1.3	2.2	3.7
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	2.2	3.1	4.6
Net assets	\$m 3.5	5.4	4.8	6.2	12.5
Equity	\$m 11.9	16.0	16.5	17.3	20.5
Retained earnings	\$m -8.4	-10.6	-11.7	-11.1	-7.9
Shareholder's equity	\$m 3.5	5.4	4.8	6.2	12.5

CASH FLOW

	CY19A	CY20A	CY21E	CY22E	CY23E
Net Income (Cashflow)	\$m -4.3	-1.5	-1.2	0.2	2.4
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	0.2	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	-0.8	0.6	2.8
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	0.6	0.8	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	0.6	0.8	3.2
Net cash flow	\$m -0.7	1.7	-0.3	1.3	6.0
Free cash flow	\$m -4.4	-1.2	-0.8	0.6	2.8

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. HSC has recently restructured with new management and moved away from a direct-to-consumer focus towards a direct-to-business approach, enabling larger and faster growth opportunities. As at 30 June 2021, HSC Technology has a 0.44% 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.

Valuation

Our base case 12 month forward discounted cash flow valuation is \$0.051, implying 185% potential upside from the current share price. This assumes further 16% dilution in issued shares from options and performance rights.

- If we assume that there are no additional subscriptions and associated hardware sales from existing subscribers, our DCF valuation falls to \$0.040, implying 125% upside.
- If we also assume that the churn rate of subscribers and hardware increases from 15% to 30%, our valuation falls further to \$0.034, implying 91% upside.

When comparing to listed peers, Intellicare (ICR-AU) is trading on CY20 EV/Sales of 13.8x vs HSC Technology at 10.0x.

Considering the "Rule of 40" when looking at revenue growth and profitability, HSC is sitting above 40% over the coming three years.

There is a strong ESG angle with HSC, with its focus on the 'social' components of society, as it seeks to improve the living standards and quality of life for the elderly and those with disabilities.

Exhibit 1 – MST Access DCF

DCF	CY21E	CY22E	CY23E	CY24E	CY25E
EBIT	-1.21	0.19	2.36	5.45	9.34
Less: Taxes	0.00	0.00	0.00	0.00	0.00
Post-tax EBIT	-1.21	0.19	2.36	5.45	9.34
Plus: D&A	0.24	0.12	0.06	0.03	0.02
Post-tax cash flow	-0.97	0.31	2.42	5.48	9.35
Less: Capex					
Less: Change in WC	-0.11	-0.22	-0.36	-0.48	-0.57
Free cash flow	-1.08	0.09	2.07	5.00	8.78
Discount coefficient	0.3	1.3	2.3	3.3	4.3
Discounted cash flow	-1.04	0.08	1.59	3.43	5.38
Sum of discount streams	36.6				
Terminal growth	3.0%				
Future value into perpetuity	202.1				
NPV of terminal value	70.5				
PV of cash flows	107.1				
PLUS: Value of tax losses	3.5				
Add: Net Cash	3.5				
Add: Options	3.1				
Equity value	117.1				
Diluted shares	2279.7				
Value per share (A\$)	\$ 0.051				
Upside	185%				

Source: MST Access.

Key assumptions of our DCF

- **Churn of 15%:** This may be too conservative, given this is a B2B rather than B2C business, where the hardware may be reused within an aged care facility.
- **Market share of 10%** in the 3Q replacement cycle as opposed to management's view of 30-40%.
- **Average subscription rates of \$1/week**, growing at 3% pa –the pricing growth may be higher given some hardware systems offer greater monitoring.
- **Potentially conservative hardware prices:** Similarly, on averages we may have underestimated the sale price over the range of hardware.
- **Additional subscriptions and sensors.** We have assumed 1 in 10 existing subscribers take on a new subscription and new sensor each year.
- **Terminal year is CY30.**
- **Tax losses of \$12.8m** implies that they are unlikely to pay cash tax until CY26 on our estimates.

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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