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Adacel Technologies Limited **(ASX: ADA)**

ASX Announcement

20 February, 2020

Adacel delivers first half pbt above prior period (excluding one-off items), re-initiates ordinary dividend; and updates guidance for FY2020

Highlights

- Profit before tax of \$2.6 million, excluding \$0.5 million related to non-recurring litigation costs and the impact of the adoption of AASB 16 Leases
- As of February 19, 2020, approximately 93% of forecast revenues for FY2020 are booked or in the backlog
- The Company will resume payment of dividends, declaring an interim dividend of 1.00 cent per share (unfranked)
- The Company updates its FY2020 earnings guidance of profit before tax between \$5.5 million and \$5.8 million excluding non-recurring litigation costs and the impact of the adoption of AASB 16 Leases of an estimated \$1.1 million to \$1.4 million

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Financial Overview

Key Financial Measures \$'000	Half year ended 31 December		
	2019	2018	Variation
Revenue	19,714	23,750	(17.0%)
Gross margin	7,181	8,408	(14.6%)
Gross margin %	36.4%	35.4%	
EBITDA	3,225	2,633	22.5%
EBITDA %	16.4%	11.1%	
Profit before tax (PBT)	2,108	2,249	(6.3%)
PBT % of revenues	10.7%	9.5%	
<i>Non-recurring items*</i>	536	127	
<i>Normalised PBT (excluding non-recurring items)*</i>	2,644	2,376	11.3%
<i>Normalised PBT* % revenues</i>	13.4%	10.0%	
Profit after tax	1,188	1,454	(18.3%)
Earnings per share (cents)	1.5	1.9	(21.1%)
Interim dividend (cents)	1.00	1.00	

* *Non-recurring items include litigation costs and the impact of the adoption of AASB 16 Leases in H1 FY 2020 and litigation costs in H1 FY 2019*

Acting CEO Daniel Verret said, "We are pleased and encouraged by the rapid implementation of changes early in the half-year designed to stabilize the business and return it to profitability. The management disciplines have provided enhanced line of sight to both forecast revenue and costs, as well as operational efficiency metrics. Importantly, we are on track to complete our Air Traffic Management projects in Fiji and Portugal this financial year as planned and, as a consequence of its expanded scope, the Guadeloupe project in the French Territories is now forecast to complete in FY2021."

For the half year ended 31 December 2019, and after excluding \$0.5 million related to non-recurring litigation costs and the impact of the adoption of AASB 16 Leases, the Company delivered a normalised profit before tax (PBT) of \$2.6 million compared to \$2.4 million for the prior corresponding period. Reported PBT for the half-year ended 31 December 2019 was \$2.1 million compared to \$2.2 million for the corresponding period last year.

The Company delivered revenues of \$19.7 million, and whilst this was 17.0% lower than the prior corresponding period, the gross margin of \$7.2 million was delivered at a modestly higher gross margin percentage. Gross margin which includes an allocation of overhead and other fixed costs increased from 35.4% in H1 FY2019 to 36.4% this year.

Earnings before interest, tax, and depreciation (EBITDA) increased to \$3.2 million compared to \$2.6 million for the same period last year. This includes a positive impact of \$0.7 million following the adoption of AASB 16 Leases. Excluding the impact of the adoption of AASB 16, EBITDA for H1 FY2020 would have been \$2.5 million.

The Company had net cash flows from operating activities totalling \$0.4 million in H1 FY2020. Based on the payment milestones contained in key contracts, it is anticipated that there will be higher cash conversion in H2 FY2020 as we complete several of our large ATM projects. As at 19 February 2020, the Company's cash balance was \$2.7M million. The Company is forecasting cash of between \$4.0 million and \$4.5 million at 30 June 2020, excluding the payment of dividends.

Business Segment Reporting

\$'000	Half Year Ended 31 December	
	2019	2018
<i>Revenue</i>		
Systems	4,062	9,568
Services	15,652	14,182
Total	19,714	23,750
<i>Gross margin</i>		
Systems	(472)	1,185
Services	7,653	7,223
Total	7,181	8,408
<i>Gross margin %</i>		
Systems	(11.6%)	12.4%
Services	48.9%	50.9%
Total	36.4%	35.4%

Systems

The Systems segment represents sales of integrated software systems and products covering operational air traffic management as well as simulation and training applications. This segment also includes hardware and software upgrade sales.

Revenues in our Systems segment decreased from \$9.6 million to \$4.1 million. The Company is currently executing a lower number of system implementations when compared to the prior half-year period.

ATM and ATC Systems revenues accounted for 7.9% and 11.9%, respectively of total Company revenues compared to 8.7% and 22.5%, respectively for the prior period. As at 31 December 2019, the Fiji ATM project is approximately 80% complete and we expect to complete the project in FY2020 consistent with the objectives we had established in July 2019. During H1 FY2020, we received additional orders of approximately \$1.7 million from our customer in Guadeloupe to fund further system enhancements, hardware and maintenance. As at 31 December 2019, the expanded Guadeloupe project was approximately 85% complete. We expect to complete the project, including the expanded scope, in FY2021.

While gross margin for H1 FY2020 was impacted as we had lower revenues compared to H1 FY2019, the execution of our existing projects is expected to complete on budget. On an individual basis, we expect each project to generate positive contribution margin with the exception of the Guadeloupe project for which a provision for onerous contract was recorded in FY2019. Because gross margin includes an allocation of fixed costs incurred to support both segments, we reported a loss for the segment. However, with the successful completion of the Fiji project in FY2020 and the continued progress of the Guadeloupe project into FY2021, we are confident that our Aurora platform for Approach and Tower control systems can be successfully deployed to a number of new customers. We have identified approximately 30 potential customer sites and have commenced discussions with several relating to proposals and upcoming bids.

Services

The Services segment includes all recurring revenue, including software maintenance and all aspects of system support, field services, and on-site technical services.

For H1 FY2020, Services revenues made up 79.4% of total revenues. Revenues increased by \$1.5 million or 10.4% driven mainly by higher revenues from our military contracts.

ATM Services revenues accounted for 55.8% of total revenues compared to 48.0% in the prior period while ATC Services revenues accounted for 23.6% of H1 FY2019 total revenues compared to 19.3% in the prior period. We continue to work closely with all our existing customers to ensure the successful execution and enhancement of their ATM and ATC platforms.

Gross margin for H1 FY2020 was 48.9% for the segment compared to 50.9% in H1 FY2019.

A number of previously installed systems have now entered the extended support phase of their lifecycle and have provided an additional modest increase in services revenue.

Revenue from North American customers in the period comprised approximately 78% of total revenues compared to 65% in the prior period reflecting the stability of our North American customers and the recurring revenue base tied to multi-year contracts.

Litigation

As previously disclosed, the Company commenced legal proceedings against Adsync Technologies Inc., a systems service provider which was awarded a contract by the Federal Aviation Administration in 2017. Adacel's legal proceedings claim that Adsync has violated the Company's intellectual property rights and the Company intends to vigorously pursue its enforcement, seeking both payment for the software licenses as well as monetary damages. Separately, the Company's former CEO has filed a breach of contract claim against the Company and the matter is currently in arbitration in the state of Florida. The Company believes it has honoured its obligations under the contract and will vigorously defend itself. All expenses incurred to date on these matters have been recognised in the financial results.

Dividend

The Board has re-initiated its ordinary dividend program and declared an interim dividend of 1.00 cent per share, unfranked. The dividend will have a Record Date of 28 February 2020 and will be paid on 15 April 2020.

Outlook

The Company updates its FY2020 full-year guidance of profit before tax of between \$5.5 million and \$5.8 million, excluding the effect of one-off items relating to litigation and the impact of the adoption of AASB 16 Leases.

Chairman, Michael McConnell, said: "We entered FY2020 with a clear plan to focus on our core products and services while bringing to completion three significant projects. Management has done a tremendous job executing that plan, rebuilding morale and confidence amongst both our employees and customers while stabilizing the operations of the Company. I sincerely thank each and every member of our team for navigating this difficult period with commitment and professionalism. We are looking ahead to FY2021. Our pipeline is focused and growing, our operations are understood and efficient and we are positioned to demonstrate the underlying earnings power of the company in FY2021.

This media release includes references to non-AASB measures including Gross Margin, EBITDA and Normalised PBT. The directors believe the presentation of non-AASB financial measures are useful for the users of this media release as they provide additional and relevant information that reflect the underlying financial performance of the business. Non-AASB financial measures have not been subject to audit or review.

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About Adacel

Adacel is listed on the ASX and is a leading developer of operational air traffic management systems, speech recognition applications and advanced air traffic control simulation and training solutions. Further information on the Company can be found on its website at www.adacel.com

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