zenterio

Q3 Interim Report
1 July — 30 September 2014

Accelerated demand for Zenterio's independent operating system.

July – September 2014

- Deployed license base
  - Service enabled license base growth of 20% adding net 97,785 licenses to accumulated 597,326
  - Total license base growth of 6% adding net 97,785 licenses to accumulated 1,801,822
- Average monthly service revenue per deployed license (ARPU) SEK 0 (0)
- EBITDA SEK -14 million (-18)
- Net loss SEK -22 million (-24)

January – September 2014

- Deployed license base
  - Service enabled license base growth of 102% adding net 301,291 licenses to accumulated 597,326
  - Total license base growth of 36% adding net 479,691 licenses to accumulated 1,801,822
- Average monthly service revenue per deployed license (ARPU) SEK 0 (0)
- EBITDA SEK -61 million (-39)
- Net loss SEK -85 million (-56)

Key events in Q3 2014

- Acquisition of 27M Group AB, doubling Zenterio's in-house product development capacity
- Zenterio partnered with Viaccess-Orca, and Zenterio OS thus became integrated in four of the world's eighth-largest TV platforms
- Zenterio won a significant business deal – delivering Zenterio OS to Telecom Romania – a leading Romanian TV operator and subsidiary of Deutsche Telekom

Events after the reporting period

- Market demand for Zenterio OS has materialized more rapidly than expected rendering a unique, but also challenging, opportunity to accelerate the business in the short to medium term
- Zenterio in final negotiations with two strategic acquisition candidates
- Funding process to support strategic acquisitions and continued expansion initiated
- Zenterio's largest shareholder, Scope, has committed to support funding
- Initiation of IPO process with Nasdaq Stockholm with the aim to list Zenterio on the main market

Q4 2014 guidance

- Zenterio expects to triple the accumulated deployed service-enabled license base during Q4 2014 to an accumulated 1.5 million service enabled licenses rendering a growth of more than 400% compared to 31 December 2013
- The expected license growth in Q4 2014 exemplifies the significant scale opportunities that Zenterio's business model embodies

Word from the CEO

Zenterio rapidly expands its reach via partnerships and new deals!

Because several global partners sell our software solutions to pay-TV operators worldwide, new business leads flow in rapidly. We predicted strong uptake, and we see key distribution channels (particularly on the OEM side) and customer segments (IPTV operators) that are growing faster than anticipated.

Naturally, support and delivery success are business critical for meeting our partners' and customers' expectations, and these successes will have very positive effect on achieving our long-term goals. Zenterio is 100% committed to properly scaling to meet the increased demand, and our number one challenge right now is to focus on where the big business is.

As part of that commitment we acquired 27M during the third quarter – a company with a background similar to ours – with well-recognized expertise in software development within our area. The acquisition will almost double our engineering and project management capacity and add an independent test and certification business.

Besides 27M, Zenterio is in final negotiations with two additional strategic acquisition candidates, subject only to financing. These acquisitions will complement accelerated growth, reduce the dependency on external consultants, secure project delivery, and broaden competence within the service offering area.

Scope, Zenterio's largest sharholder, has committed to support funding of these acquisition initiatives. Zenterio's operations had a very hectic quarter –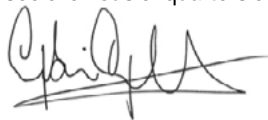 in parallel with rapid progress on items that has crucial impact on our long-term position. We added yet another global system partner, Viaccess-Orca, an Orange subsidiary with 20 years in the industry and presence in 35 countries. This partnership is off to a flying start with two commercial deals already won.

Our project teams performed very well under high pressure and commercially delivered several large operator solutions in record time (i.g., such as M7 and Telekom Romania). We are particularly proud of the IPTV deployment for Deutsche Telekom in Romania, because it marks our third country rollout within the Deutsche Telekom group. The project led to the strengthening of existing partnerships and the start of new ones.

Projects scheduled for deliveries at year-end 2014 and early 2015 are on track, and if everything continues according to plan, then we'll achieve the targeted number of 1.5 million deployed service enabled licenses by year-end 2014.

Building on the rapidly increasing license base, we're continuously developing our service revenue offerings. We're excited that we soon will be able to directly and indirectly offer attractive service offering to operators. You'll hear much more about this in coming quarters.

We're very confident that our business momentum will continue to accelerate, because it's based on years of efforts to position Zenterio in the center of the TV industry transformation. Going forward, we see even busier quarters on the horizon.

Robin Rutili, CEO

Zenterio background

Zenterio emerged from Nokia's former (divested) Home Communication division; in 2002, the software R&D team took it over. Former Nokia CTO and general manager of the Home Communication Division led the team, which continues to work for Zenterio. These team members are among the world's most experienced software developers.

Our market

Today, 895 million households worldwide have pay-TV subscriptions (Deloitte: "Telecom, Media & Telecommunications Predictions 2014", 2013), which is the market that Zenterio targets.

The highly fragmented market uses various operating systems. Hundreds of different operating systems flood the TV market – unlike the PC and mobile-device markets that only use a few. Each new service, such as a video streaming service or pop-up advertising, must function with all the hardware (e.g., set-top boxes (STB), TV screens, and tablets), which currently has separate operating systems.

Lack of a single standard inhibits rapid application and product development for the TV market, which hasn't taken off in the same way as the PC and mobile-device markets have. A fragmented software environment has been one of the operators' main challenges in terms of developing and launching new TV services.

For the new TV services and applications market to rapidly develop, there must be a market-wide standardization of operating systems.

With Zenterio's OS, TV operators and STB suppliers get a standardized software platform that allows for easier, faster development of interactive TV services and applications, which are compatible with all existing hardware. Industry stakeholders also strive for this situation.

Zenterio's independent OS significantly improves TV operators' opportunities to increase revenue by launching new services for their customers (e.g., video-on-demand and interactive advertising applications) at lower cost and with better time-to-market.

By reducing development and deployment complexity, Zenterio's independent solution enables operators to offer their customers much richer TV experiences in which TVs, tablets, smartphones, and other devices are integrated. This capability offers Zenterio's customers enormous advantages.

Zenterio's solution is well positioned to become a global software standard for interactive-TV service deliveries.

Zenterio's business model

Zenterio sells licenses to system integrators, STB providers, and pay-TV operators. With Zenterio's software, operators can more quickly offer new, more sophisticated services to their customers at lower cost. Zenterio's OS allows operators to harmonize their operating environment with a standardized software platform.

With Zenterio's independent solution, operators can offer specific interactive TV services that consumers demand – and a flexible software platform on which operators can develop the next generation of interactive services and new pay-TV offerings in the future.
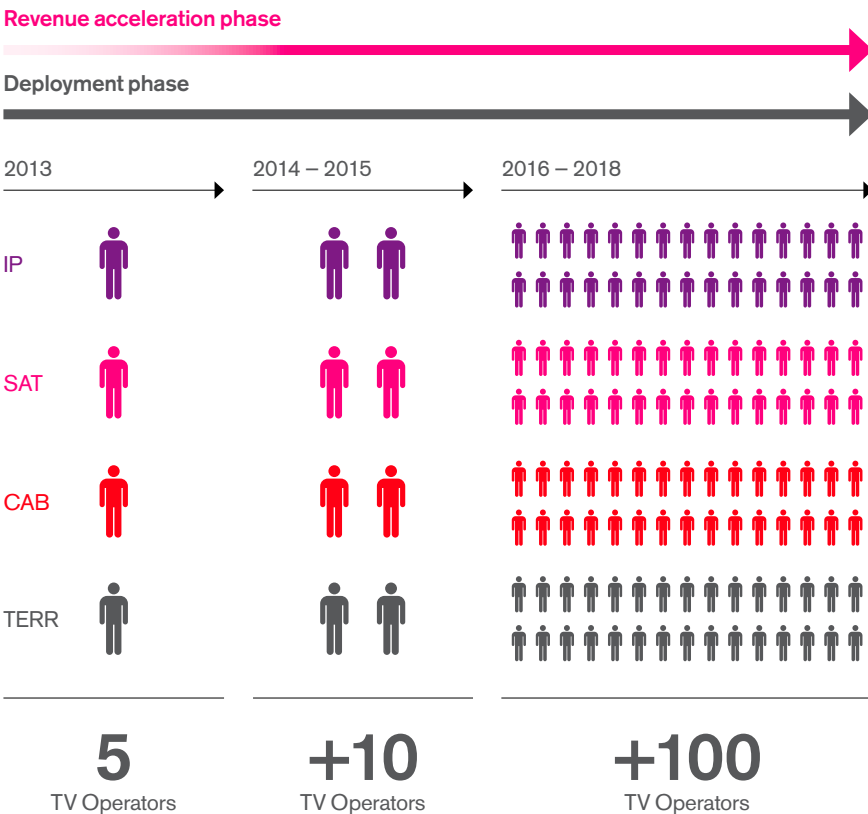
At a time when linear TV viewing decreases, great need exists for operators to upgrade their pay-TV offerings with new, interactive services. But innovative efforts get complicated because up to 100 different operating systems are used in the operators' hardware.

Zenterio has a unique, partner-structure-based distribution model, which the company uses with several key partners. Zenterio's partners include three out of five of the world's largest system integrators – Ericsson, Huawei, and Viaccess-Orca; two of the world's leading hardware manufacturers – Pace and Technicolor, and the world's largest chip manufacturer – MStar.

The driving forces behind Zenterio's business include the number of installed licenses for the Zenterio OS, integration, consulting, plus maintenance and support – including upgrades and revenue generated from services per installed license (ARPU).

Once critical mass is reached in its installed license base, which generates software license and maintenance fees for Zenterio, the company will start reselling a package of attractive services from leading application companies. Zenterio expects to reach a critical mass with its installed license base in 2015; at that point, it will be launching its first package of services that will include an advertising solution integrated into pay-TV operators' user interfaces.

Revenue acceleration phase

Deployment phase

2013	2014 – 2015	2016 – 2018
IP		
SAT		
CAB		
TERR		
5	**+10**	**+100**
TV Operators	TV Operators	TV Operators

Deployment phase

The pace at which Zenterio deploys its OS depends on the number of pay-TV operators that select the company's software. To reach as many operators as possible, during the past few years Zenterio has partnered with some of the largest consumer electronics companies in the world, major TV solutions providers and system integrators. Partners normally offer Zenterio OS as part of their total offering to pay-TV operators.

Being selected to become a global partner validates Zenterio's strength, its software capabilities, and its partners' trust in its technical capabilities and scaling capacities. Because of the complexity, specific product requirements, and initial high costs involved in launching projects, each partner often only selects one or a very limited number of global partners for supplying client software. These dynamics result in long-term partnerships with strong product commitment to the Zenterio OS – once it's selected and integrated.

Deployed base business update
During the third quarter, Zenterio entered a strategic partnership with Viaccess-Orca, a global TV solutions provider. Zenterio's OS is now available for half of the world's largest software platforms for TV. In addition, Zenterio has seen increased involvement of several of its partners, and Zenterio is expanding its delivery capacity to meet increased demands.

Zenterio has made substantial investments to meet demands from the first wave of customer projects to come out of the company's partnerships. Zenterio continues to invest in new growth opportunities via partnerships.

Three years ago, Deutsche Telekom initiated a program to harmonize the technology used to distribute TV on all nine European markets in which Deutsche Telekom offers pay-TV services. A key component has been to harmonize the highly fragmented software environment in the customer base. Zenterio has delivered solutions for Deutsche Telekom in Hungary, Slovakia, and Romania. During October, Telecom Romania initiated a rollout of a new IPTV solution in which Zenterio OS platform forms a key component and the foundation for Telekom Romania's offering of new interactive TV services.

Telecom Romania now has the software solution that large TV operators need to deliver future TV experiences to their customers.

Zenterio expects that sales to Deutsche Telekom will continue to increase in coming years and that Deutsche Telekom will be a very important reference for Zenterio and for Zenterio's partners.

By the end of September, the total license base reached 1.8 million, which is an increase of 0.5 million compared to third quarter 2013.

Zenterio's service-enabled license base increased to 597,326 by the end of September 2014. Throughout 2014, the company has been very active in several markets in which the transition from analogue to digital TV broadcasting is occurring.

New customer license rollouts continue as planned. Zenterio expects to accelerate growth in the fourth quarter and to reach 1.5 million deployed service-enabled licenses by year-end 2014 – compared to 0.3 million at year-end 2013. A swap-out case and a few early-rollout-phase projects drive expected accelerated growth during the fourth quarter.

Continued strong demand for Zenterio's OS is expected, and the subsequent growth will form a solid foundation for a successful 2015.

Service enabled installed license base
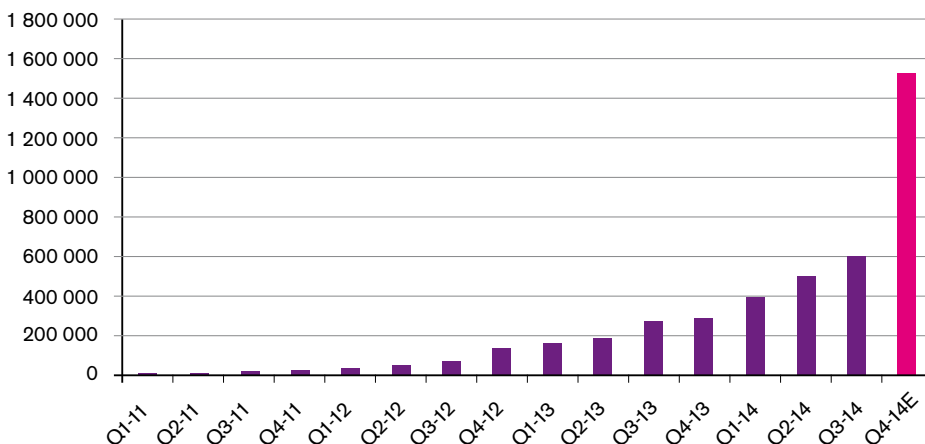
Service revenues

Zenterio will start to offer advertising solutions, applications, and services – such as Netflix, HBO Go, and YouTube – to operators that run Zenterio OS. The revenue model from such reseller agreements will be recurring monthly and documented as average service revenue per user (ARPU) in Zenterio's reporting. Because Zenterio has yet to launch its initial service revenue package, the current average service revenue per user (ARPU) is SEK 0 (0). With current deployment-base growth, Zenterio will begin offering these services in 2015.

Service revenue business update
Zenterio is communicating with several TV operators about services that they want to launch in the initial part of their service packages. Zenterio's responsibility for offering an advertising and application solution with one of the world's largest OEMs is one example. Zenterio is also communicating with several local and global content providers; these discussions are expected to be concluded before year-end 2014. Zenterio will continue to invest in a variety of concepts for service revenues and will continue working with its current pay-TV operator customers to develop attractive service offerings.

Rapid growth and acquisition of 27M Group

Zenterio is growing rapidly. The growth has been even higher than expected due to a large inflow of new projects. To be able to deliver on this inflow, Zenterio has recruited new employees and evaluated various strategic acquisitions. This inflow of new project often comes with initial investments, and Zenterio's board has actively supported more accelerated growth of the organisation to secure customer delivery.

In the third quarter 2014, Zenterio expanded its Linköping development operations via the 27M Group acquisition – to manage increased demand for the company's software solution. With this deal, Zenterio strengthens its development capacity with an additional 40 system developers in Linköping and shortens time-to-market for its operator customers. Zenterio currently employs about 150 persons of 24 nationalities. Its headquarters are in Stockholm, with development and sales offices in Linköping, Prague and Milan.

The 27M Group has been an important long-term business development partner for Zenterio; has extensive experience in software development, testing, and implementation for TV operators; and has delivered solutions for companies such as Boxer, TiVo, and ComHem. Besides enhanced development operations, synergies will be realized on the revenue and expense sides. The 27M Group forecasts sales of about SEK 50 million in 2014 and a 10% EBITDA margin. About 40% of total sales relates to Zenterio and the remaining 60% to customers outside Zenterio.

Financial development, January – September

Sales amounted to SEK 51 million (47), whereof hardware revenue generated SEK 15 million (26) and license and integration revenue generated SEK 35 million (20). Decline in hardware revenue is a function of a phase-out of the hardware offering – thus facilitating more clear focus on delivery of the Zenterio OS. Gross profit, excluding activated work for own account, improved 46% to SEK 37 million (25).

In the third quarter 2014, Zenterio expanded its delivery capacity to match increased inflow of new business opportunities. Consequently, operating cost rose to SEK 121 million (85) due to increased staff cost – from internal and external consultants. Overall, loss for the period amounted to SEK 85 million (56). This trend is aligned with the overall plan, and the loss is aligned with planned investments for new customers and partners. With the acquisition of 27M Group, announced in July 2014, Zenterio doubled its software engineering capacity.

The 27M Group was consolidated as of 1 September 2014, and its resources were extensively allocated to Zenterio projects during the third quarter 2014. So Zenterio could reduce some of its dependency on external companies. The 27M Group's external sales amounts to SEK 2 million, with a neutral result for the period.

On 30 September 2014, cash and cash equivalents amounted to SEK 36.5 million (SEK 1.8 million on 31 December 2013). Zenterio also had an unused overdraft facility amounting to worth SEK 11 million and a remaining SEK 25 million out of a SEK 37 million loan facility from an American debt fund.

In May 2014, Zenterio raised SEK 115 million in new capital via an issue of new ordinary shares; Nordic financial institutions invested most of the capital. The capital will primarily be used to finance continued growth, and it was also used for repayment of a SEK 15 million loan. The loan repayment was made in May 2014. In September 2014, 2 million shares were issued to complete the 27M acquisition. The total number of shares is 46,778,135 – after these new share issues. The shareholder equity, as of 30 September 2014, amounted to SEK 131 million.

Selected consolidated financials

Selected consolidated financials

Zenterio prepares financial statements in accordance with the Swedish Annual Accounts Act and recommendations and statements from Swedish Accounting Standards Board and FAR/SRS.

Profit and loss statements

Consolidated statement of comprehensive income, kSEK	Jul-Sept 2014	Jul-Sept 2013	Jan-Sept 2014	Jan-Sept 2013
License and consulting	16,699	4,998	35,055	19,650
Sales of hardware	8,363	6,206	14,691	25,841
Activated work for own account	7,720	7,154	23,250	20,771
Other income	636	515	1,250	1,058
Total income	**33,419**	**18,874**	**74,246**	**67,319**
Cost of sales	-6,913	-5,567	-13,960	-21,201
Depreciation and amortization	-7,693	-5,755	-20,733	-16,330
Other operating cost	-40,294	-31,157	-121,011	-84,811
Total operating costs	**-54,900**	**-42,480**	**-155,704**	**-122,342**
Operating result	**-21,482**	**-23,606**	**-81,458**	**-55,022**
Financial items	-347	-286	-3,717	-1,401
Result for the period	**-21,829**	**-23,892**	**-85,175**	**-56,423**

Balance sheets

Consolidated balance sheet, kSEK	30 Sept 2014	31 Dec 2013	31 Dec 2012
Assets			
Total non-current assets	**112,059**	**71,575**	**63,726**
Current assets			
Inventory etc.			
Raw materials	0	0	2
Advances to suppliers	524	0	7,717
Current receivables			
Other current receivables	35,475	19,305	18,049
Cash and cash equivalents	36,504	1,814	3,810
Total current assets	**72,503**	**21,119**	**29,578**
Total Assets	**184,561**	**92,694**	**93,304**

Consolidated balance sheet, kSEK	30 Sept 2014	31 Dec 2013	31 Dec 2012
Shareholders' Equity and Liabilities			
Total shareholders' equity	**130,822**	**51,312**	**64,852**
Total non-current liabilities	**7,691**	**168**	**289**
Total current liabilities	**46,048**	**41,214**	**28,163**
Total Shareholders' Equity and Liabilities	**184,561**	**92,694**	**93,304**

Cash flow statements

Consolidated cash flow statement, kSEK	Jul-Sept 2014	Jul-Sept 2013	Jan-Sept 2014	Jan-Sept 2013
Cash flow from operations before change in WC	-14,333	-18,295	-65,231	-40,960
Cash flow from operations after change in WC	-12,552	-17,893	-58,709	-26,291
Cash flow from investment activity	-45,159	-7,154	-61,079	-20,820
Cash flow from financing activity	36,355	49,703	154,478	69,549
Cash flow for the period	**-21,356**	**24,656**	**34,690**	**22,438**
Cash and cash equivalents at the beginning of the period	57,860	1,592	1,814	3,810
Cash and cash equivalents at the end of the period	**36,504**	**26,248**	**36,504**	**26,248**

Key figures

Key figures	Jul-Sept 2014	Jul-Sept 2013	Jan-Sept 2014	Jan-Sept 2013
Service enabled license base, closing balance	597,326	276,535	597,326	276,535
Total license base, closing balance	1,801,822	1,302,430	1,801,822	1,302,430
ARPU, kSEK	0	0	0	0
EBITDA, kSEK	-13,789	-17,851	-60,725	-38,693
Net profit, kSEK	-21,829	-23,892	-85,175	-56,423
Number of shares, closing balance	46,778,135	36,040,256	46,778,135	36,040,256
Average number of employees	115	94	102	84

Other

Assurance
This interim report provides a fair and true view of the company's business, financial position and results of operations and describes risks and uncertainties that the company faces.

Stockholm November 2014
The board of Zenterio AB (publ)

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