Signs first licensing agreement

Opens up vast Chinese market

XPE announced it has signed its first commercial non-exclusive licensing agreement with Lenze Technology (Lenze) and its Hong Kong-based subsidiary Complex Semiconductor for use of XPE's Device Browser (DeB).

Lenze to roll out ADRC functionality across its consumer chipsets

Under the terms of the agreement, Lenze will be able to use a white label version of XPE's DeB for its consumer products solutions, including wearables and home automation. Agreed license fees have been derived from XPE's standard pricing schedule, being US$ 0.15 per active download of the DeB used to remotely control one ADRC-enabled device. For future applications, including the ADRC device proxy, the ADRC daemon and XPE's Remote Modelling Language (RML), a license fee of US$ 1.00 per gateway applies in situations where multiple devices are being controlled from the DeB requiring connectivity other than ADRC (e.g. Wi-Fi, ZigBee) and US$ 2.00 per device in case the customer devices require use of XPE's full infrastructure platform. We believe actual, negotiated, license fees will be lower than these standard rates though.

Lenze's production numbers underscore the potential for XPE

Currently four Lenze devices requiring the DeB download are slated for near term roll out, i.e. in the first half of 2017 with revenues for XPE expected from 2HY17 onwards. This is in line with the assumptions we made in the financial model in our initiating research report.

While starting off with four devices, XPE expects to be able to roll out ADRC functionality to the vast majority of Lenze's products over the next eighteen months, this roll out being a function of the speed at which Telink Semiconductor (Telink), Lenze's supplier of ADRC-enabled chipsets, can finalize ADRC porting into its chipsets.

Given Lenze's forecasts to grow overall unit shipments of its devices from 100M in 2016 to more than 200M in 2017, we believe this deal signifies a major breakthrough for XPE from a potential revenue perspective. Furthermore, it illustrates the commercial viability of the technology, which XPE will be emphasizing with other prospective licensees, potentially expediting other license agreements. Based on the current sales funnel, we would expect XPE to sign additional customers in the near term.

XPE is becoming increasingly protocol agnostic

We recently had a chance to speak in-depth with XPE's MD Martin Despain about a number of things, including his views on XPE's longer term corporate strategy, the go-to-market approach and the Joint Venture

			FY16A	FY17E	FY18E	FY19E
Number of shares (m)	2,213	Revenues	0.0	0.9	4.1	17.4
Number of shares FD (m)	2,368	EBITDA	-2.9	-1.5	-1.9	6.3
Market capitalisation (A$ m)	64.2	NPAT	-3.1	-1.9	-2.6	5.6
Free Float (%)	77%	EPS FD	-0.001	-0.001	-0.001	0.002
12 month high/low A$	0.11 / 0.025	EV/EBITDA	N/A	N/A	N/A	8.5
Average daily volume (m)	31.3	EV/Sales	N/M	62.2	14.6	3.1

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agreement with Complex Semiconductor and its parent Lenze. In our view, the company is becoming increasingly protocol agnostic and is being positioned right in the middle of the Internet of Things (IoT), i.e. as an IoT software and infrastructure provider that can work together with most, if not all, players in this space.

XPE switching into high gear

Just in the last two quarters, a lot of things have happened at XPE. The company has joined the Open Connectivity Foundation (OCF) as platinum member, launched its DeB, hired an MD from Intel and ported ADRC to Intel's Smart Home gateway and STMicroelectronics' STM32 Ultra Low Power microcontroller. Furthermore, XPE showcased its ADRC-based Xerts system for digital content delivery at Microsoft's Partner Conference in Singapore and very recently signed an MOU with gateway provider Arcadyan Technology Corp for use of ADRC technology in Arcadyan's gateways and devices.

New MD to position XPE as IoT Infrastructure and Software provider

In September XPE hired Martin Despain, former General Manager within Intel's Internet of Things Group, to run XPE's day-to-day operations and to further shape the company's strategy. We believe one of his key priorities is to further focus the company on its sweet spot within the IoT, i.e. providing protocol agnostic, core infrastructure and software solutions that allow seamless interoperability between devices. While the software element of this offering will include security and data elements, at this stage the company is not specifically looking to own or manage third party data generated by IoT nodes, even though the technology does enable it.

We expect XPE to further develop its recently launched DeB beyond the current functionality for ADRC-compliant devices only, i.e. to facilitate interoperability with devices without embedded ADRC. XPE's new membership of the Open Connectivity Foundation (OCF) will be instrumental in this respect, especially now that the OCF has merged with AllSeen Alliance, another standard setting body for the IoT. This merger brings together IoTivity and AllJoyn, two of the main open IoT specification frameworks, and should reduce complexity and confusion around device interoperability.

> *In other words, there will be a lot more clarity about IoT standards for companies operating in the IoT value chain, from IC manufacturers through to Consumer Electronics companies and equipment providers, as well as for consumers. We believe this can only expedite growth and consumer adoption of the IoT going forward.*

Joint venture with Telink and Lenze to drive growth in China

On 20 September XPE announced it had signed the initial Joint Venture (JV) agreement with Lenze Technology, a customer and business partner of Telink Semiconductor. This JV has now resulted in XPE's license agreement with Lenze, which owns semiconductor manufacturing facilities in China.

With porting of ADRC to Telink IoT chipsets nearly completed, we expect broader commercial availability of Telink's ADRC-enabled chipset from CQ2 2017 onwards, i.e. once these chipsets have been designed-in to existing Telink products. In turn, this should enable XPE to start pushing hard to further penetrate the Chinese market together with Lenze on the back of availability of ADRC-enabled chipsets from Telink.

Additionally, it should enable XPE to monetize on the commercial opportunities with other potential customers, such as GE Lighting and Philips Lighting. We believe XPE is in discussions with these two global lighting players to potentially incorporate ADRC functionality in connected light bulbs, such as the Philips Hue.

Go-to-Market strategy should focus primarily on IC manufacturers

With regards to its marketing strategy, XPE has multiple entry points into the IoT value chain, including IC manufacturers, OEMs/ODMs and Consumer Electronics companies (Figure 1). While the company has engaged with players in all these segments, including Consumer Electronics companies, such as GE Lighting and Philips Electronics, we believe the most logical and cost effective go-to-market strategy centers around IC manufacturers.

Companies such as NXP, Texas Instruments, ARM, Qualcomm, Telink, Allwinner Technology, Rockchip and Intel all require solutions for device discovery, security and interoperability in IoT applications. And all have established sales forces with inroads into OEMs and Consumer Electronics companies. Even though XPE won't have full control over the sales processes of these potential licensees/partners, setting up license agreements and/or partnerships with these players should provide fast and broad market access.

OEMs and ODMs present a secondary market entry point, in our view. Companies like Advantech are often the first point of contact for many industrial customers requiring IoT functionality in their products and systems. Purely for that reason, OEMs are highly relevant for XPE and will require technical support. However, ultimately OEMs/ODMs will procure the required chipsets from their semiconductor suppliers, which is why we see IC manufacturers as XPE's primary market.

FIGURE 1: GO-TO-MARKET PRIORITIES
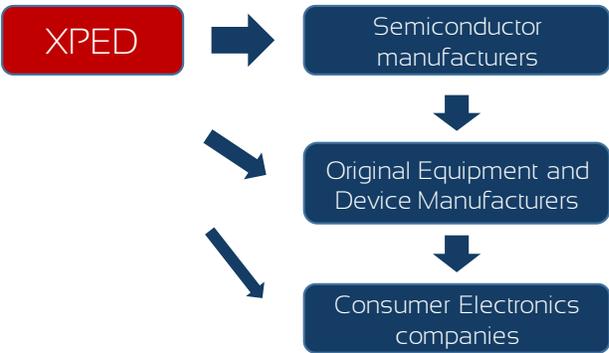
Source: TMT Analytics

A third entry point for XPE into the IoT market is the Consumer Electronics segment. While some companies in this space are vertically integrated and thus have their own IC manufacturing facilities, e.g. Samsung, we believe XPE's involvement in this space should focus mainly on creating awareness of ADRC technology and its applications areas. In other words, educating its customers' customers on the possibilities of ADRC. Furthermore, we see revenue opportunities in the areas of (white label) App development, similar to the Lenze deal, consumer data generation and loyalty programs using Xerts etc.

> *We believe the near to medium term revenue opportunities are largest in the first stage of the value chain, i.e. IC manufacturers, hence our view that this is the segment XPE should direct most of its resources to, at least in the medium term.*

A three-stage roll out strategy for the Device Browser

In terms of roll out strategy, we believe the above translates into three-staged roll out of XPE's DeB, the first one of which involves deployment of the current technology, i.e. driving downloads of the DeB to enable single and multi-ADRC device control (see the Lenze deal). As XPE further develops its technology to facilitate interoperability of ADRC-enabled devices with devices that

don't have embedded ADRC, XPE's DeB can become a device aggregator in the second stage of its roll out strategy. In the third stage, XPE aims to provide an overarching app that can monitor and manage a range of devices and users' social aspects, e.g. managing connected home appliances and music players, while users can simultaneously manage their calendar etc, all in one app.

Additional functionality such as compatibility with digital assistants may be required

We believe this third stage "Home Page For Life" vision may at some point require additional functionality to be integrated into the DeB. For instance, digital assistants, such as Siri (Apple), Cortana (Microsoft), Alexa (Amazon) and, our favorite, Google Assistant are not just gimmicks, but in due course will take over many of the home control functions that are currently still done manually. Devices such as Google Home and Amazon's Echo can already be paired with devices such as Philips Hue and Google Nest, which can subsequently be voice-controlled. In other words, pairing devices to a smart phone will likely need to be complemented with digital assistant interoperability, sooner rather than later, in our view.

Several near-term opportunities

Since April 2016 XPE has been working with Intel to bring ADRC technology to certain series of Intel's IoT gateways. Porting of ADRC was completed in May after which time initial discussions with potential OEM customers commenced. Allowing for a design-in phase of several months, we believe some of these discussions may be coming to fruition in the near term, i.e. with initial revenues sometime during 2HY CY17. We are not anticipating Intel to sign an outright license agreement with XPE. Rather, we expect XPE to be able to establish direct relationships with Intel's OEM/ODM customers that procure Intel's ADRC-enabled IoT gateways.

Additionally, we expect XPE's appearance at Microsoft's Partner conference in Singapore will have led to initial discussions with interested parties regarding digital content delivery enabled by ADRC functionality embedded in IoT endpoints, particularly consumer electronics. Timing of any deal is highly unpredictable, but such events typically result in very interesting commercial leads.

First revenues through JCT Healthcare

In the meantime, XPE generated its first revenues through JCT Healthcare's Nurse Call product range in 1Q17. On a cash basis, JCT generated A$ 274k in the September quarter. We expect this number will have been higher on a revenue basis and based on JCT's sales pipeline, which is potentially worth A$1.2M, we anticipate sequential revenue increases in the next several quarters. Furthermore, as JCT expands its sales efforts overseas, we expect a broader revenue base moving into FY18.

Conclusion

When we connect the dots of news flow in recent months we conclude that XPE's strategy is crystalizing further and that the company is on track to achieve first ADRC-related revenues in the second half of 2017. Additionally, we expect the Intel pedigree of the new MD will be highly beneficial in driving commercial opportunities with Intel as well as with other IC manufacturers and OEMs.

While XPE will need to further develop its technology, e.g. to facilitate broader device interoperability and to potentially enable compatibility with digital assistants, we believe the company's current IP and technology portfolio is very solid and provides a strong base for the first stage of the DeB roll out currently underway. Furthermore, we believe the license agreement with Lenze may expedite other commercial discussions currently ongoing, while the pending availability of ADRC-enabled chipsets from Telink will likely provide very strong sales momentum.

We reiterate our BUY rating for XPE as well as our price target of A$0.24 per share.

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