

Verisec

Sector: Information Technology

Good momentum

Freja eID – agreements in two interesting verticals

Verisec continues to enter agreements/partnerships at a high rate, among others; with ATG and one of Sweden's largest pharmacy. At this stage, there is still a lot of work to be done but there is no doubt that Verisec are executing in line with its strategy. The potential for Freja eID is clearly based on a long-term view, the exact numbers (and monetization) the coming year are of minor concern according to us. The most important factor to consider is the number of users – thus, to better grasp the development of the platform, insight into this metric would be highly desirable.

In line with estimates

The report for the third quarter of 2018 was in line with our expectations and showed no surprises. The core business had yet a stable quarter and net sales YTD (Q3'18) amounts to SEK 56.7, an increase of ~26 percent y/y.

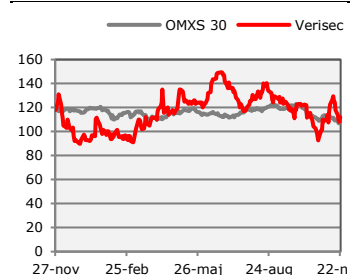
Valuation

Following the report, we only make minor estimate changes with no effect on the valuation. Based on our discount rate of 12.0 percent (used in all scenarios), we have a fair value range of SEK 50-354 with a base case of SEK 126 per share.

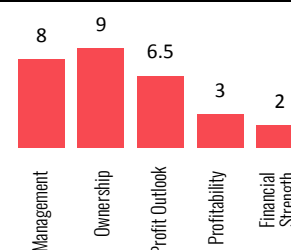
FAIR VALUE RANGE

BEAR	BASE	BULL
50.0	126.0	354.0

VERSUS OMXS30



REDEYE RATING



KEY STATS

Ticker	VERLST
Market	First North
Share Price (SEK)	113.0
Market Cap (MSEK)	539
Net Debt 18E (MSEK)	-25
Free Float	43 %

KEY FINANCIALS (SEKm)	2016	2017	2018E	2019E	2020E	2021E
Net sales	62	64	76	92	173	228
EBITDA	-15	-14	-24	-12	47	54
EBIT	-19	-22	-31	-24	38	46
EPS (adj.)	-4.0	-4.8	-6.5	-4.6	6.7	8.7
EV/Sales	5.6	8.5	6.8	5.8	2.7	1.8
EV/EBITDA	-24.0	-39.4	-21.4	-44.5	10.0	7.7
EV/EBIT	-18.5	-24.3	-16.7	-22.1	12.5	9.1
P/E	-21.1	-26.3	-17.4	-24.7	16.9	12.9

ANALYSTS

Havan Hanna
 havan.hanna@redeye.se
 Tomas Otterbeck
 tomas.otterbeck@redeye.se

In line with expectations

Verisecs report for the third quarter of 2018 showed sales and EBIT in line with expectations. Regarding Freja eID Verisec has made great progress in increasing the number of relevant services. The company communicates that they are steadily working to increase the number of users and services. Following the report, we only make minor estimate changes with an unchanged valuation as a result – our fair value ranges between SEK 50-354 with a base case of SEK 126 per share.

Core Business - no surprises

Net sales were in line with estimates and amounted to SEK 19.8 (18.5) million (expected: 20.3), an increase of 7.0 percent compared to the corresponding quarter last year. The growth during the quarter was attributable to Sweden and outside Europe. Growth has historically fluctuated, and thus it has been difficult to assess sales on a quarterly basis - the long sales cycle contributes to this. YTD (Q3'18) net sales amounts to SEK 56.7, an increase of ~26 percent y/y.

Verisec: Estimates vs. Outcome, Q3'18				
(SEKm)	Q3'17	Q3'18e	Outcome	Deviation (Abs)
Net sales	18.5	20.3	19.8	-0.5
Core Business	18.5	19.3	19.8	
Freja eID	0.0	1.0	n.a	
growth YoY (%)		10%	7%	
Activated costs	1.4	1.3	1.3	0.0
Total revenue	19.9	21.6	21.1	-0.5
COGS	-8.1	-7.5	-7.2	
Personnel costs	-8.4	-9.0	-10.2	
Other OPEX	-7.0	-6.7	-6.1	
EBITDA	-3.6	-1.6	-2.4	-0.8
D&A	-1.4	-1.8	-1.7	
EBIT	-5.0	-3.4	-4.1	-0.7
Gross-margin	56%	63%	64%	0.8 pp
EBITDA-margin	neg	neg	neg	
EBIT-margin	neg	neg	neg	

Source: Redeye Research, Verisec

Profitability wise EBIT was somewhat lower than expectations (EBIT loss of SEK 4.1 million against estimates of 3.4). Gross margin was 63.8 percent (estimates: 63.1), and other OPEX amounted to SEK 16.3 million (estimates: 15.7). Activated costs were in line with expectations at around SEK 1.3 million.

We have earlier highlighted that lumpiness in the gross margin will be evident as revenue mix (in terms of split between Goods and Services) will have an effect and fluctuates from quarter to quarter. This trend has been clear during the year where gross margin amounts to 63/58/64 percent in Q1'18/Q2'18/Q3'18.

Freja eID – execution continues

Verisec has made great progress in building a broad and relevant portfolio of services supporting Freja eID (still work to be done though). During the last period Verisec has entered partnerships/agreements with; DevCode Group, CGI and Group Inc, ATG, Vklass and one of Sweden's largest pharmacy chains. There is no doubt that Verisec is executing in line with its

strategy and that 2019 will be a very exciting year for the company, Verisec communicates that they are steadily working to increase the number of users and services.

The sales strategy for Freja eID is based on two components: to provide new services (partly through partners but also own services) and to attract new users. Looking back at 2018 it is clear that services has been the focus area for Freja eID (vs users), during 2019 we expect a shift to users. Verisec has made it clear that several new features will be launched in Freja eID – thus we expect sales and marketing activities to intensify going forward. We find this customer acquisition strategy really interesting as Verisec will be able to attract users even if the pole of service providers are not yet fully developed. We believe that the features themselves may suffice to attract new users, and with enough users (hard to put a number on the critical level) service providers will find their way to Freja eID. In that regard Verisec by itself may be the most important service provider to boost user growth. Thus during 2019 comments about the effects on user acquisition related to these features would be desirable. Also, insight to the number of users (the most important factor) would be highly necessary to better grasp the development of the platform. With a shift of focus to end users we think that all this should occur the coming year.

Sweden's pharmacy chains

The three biggest pharmacy chains in Sweden are Apoteket AB (~3 400 employees), Apotek Hjärtat (~2 000 employees) and Kronans Apotek (~1 600 employees).



As seen above, the number of employees are relatively low, however, we still consider the agreement to be very interesting as the healthcare vertical (in a broader term) are extremely far behind in terms of digitalization. The potential in the future should thus be very high for a service like Freja eID in this industry – a successful agreement with this particular pharmacy chain can potentially grab the attention of the rest of the industry.

ATG

ATG (AB Trav och Galopp) has chosen to introduce Freja eID as one of the identification methods on its platform, partly for the registration of new customers, but also for log in to ATG's gaming services. From January 1, 2019 it will be required that all players must be registered with an electronic identification, and ATG has chosen Freja eID as one of the alternatives on its platform. ATG has 500 000 users (players) in total.

The gambling sector is an interesting vertical for Verisec. Looking at the other gambling companies it is clear that BankID so far has been the primary solution, but transactions amongst the gambling customers are often small and frequent which makes Verisec's solution favorable due to the cost-control. Freja eID has the potential of being the number-one complement to BankID in Sweden, which would, of course, be a major opportunity. We expect that more gambling companies will introduce Freja eID as an identification method in 2019.

Financial estimates

Following the report, we only make minor estimate changes, see table below.

Verisec: Estimates changes, '18e-'20e			
(SEKm)	2018e	2019e	2020e
Net sales (new)	76	90	173
Net sales (old)	77	92	176
change (%)	-2	-2	-2
COGS (new)	-29	-31	-37
COGS (old)	-30	-31	-37
change (%)	-1	0	0
OPEX (new)	-76	-83	-94
OPEX (old)	-75	-83	-95
change (%)	1	-1	-1
EBIT (new)	-31	-26	38
EBIT (old)	-29	-25	40
change (%)	5	4	-5

Source: Redeye Research

Detailed estimates

Verisec: estimates '18e-'20e							
(SEKm)	Q1'18	Q2'18	Q3'18	Q4'18e	2018e	2019e	2020e
Net sales	17.7	19.2	19.8	19.0	75.7	90.0	173.0
Core Business	17.7	19.2	19.8	18.0	74.7	74.0	74.0
Freja eID	0.0	0.0	0.0	1.0	1.0	16.0	99.0
Growth YoY (%)	25%	55%	7%	19%	24%	19%	92%
Activated costs	0.9	1.4	1.3	1.4	5.0	5.5	6.0
Total revenue	18.7	20.6	21.1	20.4	80.7	95.5	179.0
COGS	-6.6	-8.1	-7.2	-7.5	-29.3	-30.5	-37.0
Personnel costs	-10.9	-11.5	-10.2	-12.0	-44.6	-47.0	-53.1
Other OPEX	-8.4	-8.0	-6.1	-8.5	-31.0	-35.6	-41.0
EBITDA	-7.2	-7.0	-2.4	-7.6	-24.1	-17.6	47.9
D&A	-1.6	-1.6	-1.7	-1.9	-6.8	-8.3	-10.1
EBIT	-8.7	-8.5	-4.1	-9.5	-31.0	-26.0	37.8
Gross-margin	63%	58%	64%	61%	61%	66%	79%
EBITDA-margin	neg	neg	neg	neg	neg	neg	28%
EBIT-margin	neg	neg	neg	neg	neg	neg	22%

Source: Redeye Research

Valuation

Based on our discount rate of 12.0 percent (used in all scenarios), we have a fair value range of SEK 50-354 with a base case of SEK 126 per share.

Bear Case 50.0 SEK

In our bear case scenario, we expect Freja eID to be used as a complement to more dominating standards such as BankID. In this scenario, Freja eID will not become one of the 2-4 most used electronic identities in Sweden. The landscape within this segment will become more competitive in the near future, and Freja eID will only be used within minor niche segments within, for example, the public sector. Most revenues will, therefore, come from Verisec's core business. Average EBIT margins will be around 4 percent during the period 2018-2022, with a growth rate of 17 percent.

Base Case 126.0 SEK

We expect Freja eID to become a standard in the public sector, for four main reasons: the technical platform in cooperation with Tieto; the infrastructure established in the cooperation with ATG; the certification from Sweden's E-identification Board; and the cost control offered by the pricing model. A number of member organizations and niche banks may also offer Freja eID as a complement to BankID during 2018-2019. We believe that retail chains and e-commerce could find cost savings and simplified customer's processes a good reason for joining Verisec's service. If Freja eID succeeds in achieving critical mass, we believe that gambling companies and various payment solutions providers may find a lot of interest. eIDAS and other regulations will be key future drivers for Freja eID. If the company succeed in its transformation to a platform company EBIT-margins around 40-50% is possible. However, at this early stage, we estimate the company will be able to maintain a margin at around 20 percent on a maturity level. This is in line with its historical margins. The economies of scale are evident, with its mobile solution providing substantial margins. The EBIT margin is expected to be around 9 percent with an average sales growth of 34 percent during the period 2018-2022.

Bull Case 354.0 SEK

In our bull case scenario, the strategic transformation into a platform company becomes successful with a good market penetration in most of the communicated customers segments. Freja eID is estimated to be a standard within the public sector in Sweden. Member organizations will be the other customer segment that will drive growth in the beginning. A number of niche banks in the Nordics will also offer Freja eID as a complement to BankID etcetera during the next coming years. During the years 2019-2022 other customers segments will follow suit including grocery chains, e-commerce, gambling companies and various payment solutions providers. Within this segments, however, Freja eID will be one of the 2-3 standards. The majority of the growth will come from Sweden and the Nordics during this years. eIDAS and other regulations will be key future drivers for Freja eID. The company will be able to maintain a margin at around 35 percent (previous 20%) on a maturity level. Verisec's average margins are set to be around 12 percent with a CAGR of approximately 50 percent during the period 2018-2022.

Catalysts

A major niche bank

Resurs Bank is already a service provider and we believe a number of other niche banks will highly likely offer Freja eID

Framework agreement

Framework agreement with a large cluster of municipalities

Big member organizations

We see the public sector and member organizations as the most likely customers in 2018-2019.

Investment Case

- Freja eID - the key growth driver
- We expect Freja eID to become a standard in the public sector
- A variety of other potential customer segments

The key growth driver in future years will be Verisec's Authentication as a Service (AaaS), called Freja eID, and its associated cloud services. A new legislation proposal "Reboot – omstart för den digitala förvaltningen" suggests that it from 2020 will be mandatory for all public sector entities to offer citizens to identify themselves to public services using the eID of their own choice, as long as this eID is officially approved. This opens up a user base for Freja eID that includes most Swedish citizens.

We expect Freja eID to become a standard in the public sector. The four most important factors that support Verisec's solution in this segment is; the technical platform in cooperation with Tieto, the infrastructure established in the cooperation with ATG, the certification from Sweden's E-identification Board and the cost control obtained from the pricing model. Freja eID will eventually build a portfolio of relevant services that can drive traffic and revenues for Verisec.

In addition to the public sector, Verisec has a variety of other potential customer segments. We believe that retail chains and e-commerce could regard better cost control as a good reason for joining Verisec's service. The simplicity offered by the proximity of ATG agents to stores and postal agents makes cooperation within this segment more logical. A number of niche banks and gambling companies could also offer Freja eID as a complement to BankID. If Freja eID succeeds in reaching a critical mass, we believe that gambling companies and various payment solutions providers will follow suit. eIDAS and other national and international regulations will be key future drivers for Freja eID.

Summary Redeye Rating

The rating consists of five valuation keys, each constituting an overall assessment of several factors that are rated on a scale of 0 to 2 points. The maximum score for a valuation key is 10 points.

Rating changes in the report

Management: 8.0

The allocation of capital by management can be considered value-accretive by observing its track record. Transparency could be increased to some extent in terms of more detailed segment revenues for example. Although, management has historically allowed Verisec to grow with profitability at a pace it can handle.

Ownership: 9.0

The stable ownership from Marquay Invest (57%) were the CEO and founder Johan Henrikson is a major shareholder has enabled the company to grow profitably and to constantly evolve its products and services. Swedbank Robur Ny Teknik owns 9.6% of the shares in the company.

Profit Outlook: 6.5

The company has since its inception been able to transform its product offering in line with user convenience trends. However, the competition is intense and there are a number of initiatives that pose a danger to the company in the longer term.

Profitability: 3.0

Verisec has historically had an impressive profitability record during periods of high growth. The last years the level of profitability has dropped due to its expansion and investments in Freja eID.

Financial Strength: 2.0

Verisec and its core business have a large proportion of recurring revenue and a relatively diversified allocation of revenue among its customers. Even though Verisec's net cash was SEK ~33 million by the end of Q3'18, one cannot rule out additional capital need if monetization of Freja eID will take more time than anticipated. As for now, we are uncertain about the near-term development for Freja eID. This uncertainty should disappear the coming quarters and a higher score will be motivated if Freja eID scales up sooner than expected (in terms of growth).

INCOME STATEMENT	2016	2017	2018E	2019E	2020E
Net sales	62	64	76	92	173
Total operating costs	-76	-77	-100	-104	-126
EBITDA	-15	-14	-24	-12	47
Depreciation	-2	-4	-6	-5	-2
Amortization	-3	-5	-1	-7	-8
Impairment charges	0	0	0	0	0
EBIT	-19	-22	-31	-24	38
Share in profits	0	0	0	0	0
Net financial items	1	1	0	0	0
Exchange rate dif.	0	0	0	0	0
Pre-tax profit	-18	-21	-31	-24	38
Tax	0	0	0	2	-6
Net earnings	-18	-21	-31	-22	32

BALANCE SHEET	2016	2017	2018E	2019E	2020E
Assets					
<i>Current assets</i>					
Cash in banks	40	18	25	30	66
Receivables	15	14	19	23	43
Inventories	2	2	1	2	3
Other current assets	15	16	16	16	16
Current assets	71	50	61	70	128
<i>Fixed assets</i>					
Tangible assets	4	5	5	5	9
Associated comp.	0	0	0	0	0
Investments	0	0	0	0	0
Goodwill	0	0	0	0	0
Cap. exp. for dev.	0	0	0	0	0
0 intangible rights	7	9	14	17	15
0 non-current assets	0	0	0	0	0
Total fixed assets	10	14	19	22	24
Deferred tax assets	0	0	0	0	0
Total (assets)	82	64	79	92	152
Liabilities					
<i>Current liabilities</i>					
Short-term debt	12	0	0	20	0
Accounts payable	23	39	45	55	104
0 current liabilities	3	0	0	0	0
Current liabilities	38	39	45	76	104
Long-term debt	0	0	0	0	0
0 long-term liabilities	0	0	0	0	0
Convertibles	0	0	0	0	0
Total Liabilities	38	39	45	76	104
Deferred tax liab	0	0	0	0	0
Provisions	0	0	0	0	0
Shareholders' equity	43	24	34	16	48
Minority interest (BS)	0	0	0	0	0
Minority & equity	43	24	34	16	48
Total liab & SE	82	64	79	92	152

FREE CASH FLOW	2016	2017	2018E	2019E	2020E
Net sales	62	64	76	92	173
Total operating costs	-76	-77	-100	-104	-126
Depreciations total	-4	-9	-7	-12	-10
EBIT	-19	-22	-31	-24	38
Taxes on EBIT	0	0	0	2	-6
NOPLAT	-19	-22	-31	-22	32
Depreciation	4	9	7	12	10
Gross cash flow	-15	-14	-24	-10	42
Change in WC	-16	13	2	5	27
Gross CAPEX	-6	-12	-12	-16	-12
Free cash flow	-37	-13	-34	-20	57

CAPITAL STRUCTURE	2016	2017	2018E	2019E	2020E
Equity ratio	53%	38%	42%	18%	32%
Debt/equity ratio	28%	0%	0%	125%	0%
Net debt	-28	-18	-25	-10	-66
Capital employed	16	6	9	7	-18
Capital turnover rate	0.8	1.0	1.0	1.0	1.1

GROWTH	2016	2017	2018E	2019E	2020E
Sales growth	-7%	3%	19%	21%	88%
EPS growth (adj)	99%	19%	35%	-30%	-246%

DCF VALUATION		CASH FLOW, MSEK	
WACC (%)	12.0 %	NPV FCF (2018-2020)	-6
		NPV FCF (2021-2027)	252
		NPV FCF (2028-)	338
		Non-operating assets	18
		Interest-bearing debt	0
		Fair value estimate MSEK	603
Assumptions 2017-2023 (%)			
Average sales growth	32.0 %	Fair value e. per share, SEK	126.4
EBIT margin	5.0 %	Share price, SEK	113.0

PROFITABILITY	2016	2017	2018E	2019E	2020E
ROE	-49%	-63%	-107%	-87%	99%
ROCE	-42%	-53%	-106%	-68%	89%
ROIC	9545%	-142%	-496%	-242%	464%
EBITDA margin	-24%	-22%	-32%	-13%	27%
EBIT margin	-31%	-35%	-41%	-26%	22%
Net margin	-29%	-33%	-41%	-24%	18%

DATA PER SHARE	2016	2017	2018E	2019E	2020E
EPS	-4.04	-4.80	-6.50	-4.57	6.69
EPS adj	-4.04	-4.80	-6.50	-4.57	6.69
Dividend	0.00	0.00	0.00	0.00	0.00
Net debt	-6.24	-4.10	-5.18	-1.99	-13.89
Total shares	4.44	4.44	4.77	4.77	4.77

VALUATION	2016	2017	2018E	2019E	2020E
EV	349.4	540.8	514.5	529.7	472.9
P/E	-21.1	-26.3	-17.4	-24.7	16.9
P/E diluted	-21.1	-26.3	-17.4	-24.7	16.9
P/Sales	6.1	8.8	7.1	5.9	3.1
EV/Sales	5.6	8.5	6.8	5.8	2.7
EV/EBITDA	-24.0	-39.4	-21.4	-44.5	10.0
EV/EBIT	-18.5	-24.3	-16.7	-22.1	12.5
P/BV	8.7	22.9	16.0	32.8	11.2

SHARE PERFORMANCE		GROWTH/YEAR	16/18E
1 month	22.0 %	Net sales	10.6 %
3 month	-15.4 %	Operating profit adj	27.8 %
12 month	-0.9 %	EPS, just	26.9 %
Since start of the year	21.5 %	Equity	-12.0 %

SHAREHOLDER STRUCTURE %	CAPITAL	VOTES
Marquay Invest AB	56.5 %	56.5 %
Swedbank Robur Fonder	9.6 %	9.6 %
Svolder	5.2 %	5.2 %
Handelsbanken Fonder	5.0 %	5.0 %
Merlinum AB	3.8 %	3.8 %
AMF Försäkring & Fonder	3.6 %	3.6 %
Kristofer von Beetzen	2.5 %	2.5 %
Arpeggio AB	1.5 %	1.5 %
Avanza Pension	1.0 %	1.0 %
Nordnet Pensionsförsäkring AB	0.6 %	0.6 %

SHARE INFORMATION	
Reuters code	
List	First North
Share price	113.0
Total shares, million	4.8
Market Cap, MSEK	539.2

MANAGEMENT & BOARD	
CEO	Johan Henrikson
CFO	Jakub Missuna
IR	Kristofer von Beetzen
Chairman	Christian Rajter

FINANCIAL INFORMATION	

ANALYSTS		Redeye AB
Havan Hanna		Mäster Samuelsgatan 42, 10tr
havan.hanna@redeye.se		111 57 Stockholm

Tomas Otterbeck
tomas.otterbeck@redeye.se

Redeye Rating and Background Definitions

The aim of a Redeye Rating is to help investors identify high-quality companies with attractive valuation.

Company Qualities

The aim of Company Qualities is to provide a well-structured and clear profile of a company's qualities (or operating risk) – its chances of surviving and its potential for achieving long-term stable profit growth.

We categorize a company's qualities on a ten-point scale based on five valuation keys; 1 – Management, 2 – Ownership, 3 – Profit Outlook, 4 – Profitability and 5 – Financial Strength.

Each valuation key is assessed based a number of quantitative and qualitative key factors that are weighted differently according to how important they are deemed to be. Each key factor is allocated a number of points based on its rating. The assessment of each valuation key is based on the total number of points for these individual factors. The rating scale ranges from 0 to +10 points.

The overall rating for each valuation key is indicated by the size of the bar shown in the chart. The relative size of the bars therefore reflects the rating distribution between the different valuation keys.

Management

Our Management rating represents an assessment of the ability of the board of directors and management to manage the company in the best interests of the shareholders. A good board and management can make a mediocre business concept profitable, while a poor board and management can even lead a strong company into crisis. The factors used to assess a company's management are: 1 – Execution, 2 – Capital allocation, 3 – Communication, 4 – Experience, 5 – Leadership and 6 – Integrity.

Ownership

Our Ownership rating represents an assessment of the ownership exercised for longer-term value creation. Owner commitment and expertise are key to a company's stability and the board's ability to take action. Companies with a dispersed ownership structure without a clear controlling shareholder have historically performed worse than the market index over time. The factors used to assess Ownership are: 1 – Ownership structure, 2 – Owner commitment, 3 – Institutional ownership, 4 – Abuse of power, 5 – Reputation, and 6 – Financial sustainability.

Profit Outlook

Our Profit Outlook rating represents an assessment of a company's potential to achieve long-term stable profit growth. Over the long-term, the share price roughly mirrors the company's earnings trend. A company that does not grow may be a good short-term investment, but is usually unwise in the long term. The factors used to assess Profit Outlook are: 1 – Business model, 2 – Sale potential, 3 – Market growth, 4 – Market position, and 5 – Competitiveness.

Profitability

Our Profitability rating represents an assessment of how effective a company has historically utilised its capital to generate profit. Companies cannot survive if they are not profitable. The assessment of how profitable a company has been is based on a number of key ratios and criteria over a period of up to the past five years: 1 – Return on total assets (ROA), 2 – Return on equity (ROE), 3 – Net profit margin, 4 – Free cash flow, and 5 – Operating profit margin or EBIT.

Financial Strength

Our Financial Strength rating represents an assessment of a company's ability to pay in the short and long term. The core of a company's financial strength is its balance sheet and cash flow. Even the greatest potential is of no benefit unless the balance sheet can cope with funding growth. The assessment of a company's financial strength is based on a number of key ratios and criteria: 1 – Times-interest-coverage ratio, 2 – Debt-to-equity ratio, 3 – Quick ratio, 4 – Current ratio, 5 – Sales turnover, 6 – Capital needs, 7 – Cyclicity, and 8 – Forthcoming binary events.

Redeye Equity Research team

Management

Björn Fahlén

bjorn.fahlen@redeye.se

Håkan Östling

hakan.ostling@redeye.se

Technology Team

Jonas Amnesten

jonas.amnesten@redeye.se

Henrik Alveskog

henrik.alveskog@redeye.se

Dennis Berggren

dennis.berggren@redeye.se

Havan Hanna

havan.hanna@redeye.se

Kristoffer Lindström

kristoffer.lindstrom@redeye.se

Fredrik Nilsson

fredrik.nilsson@redeye.se

Tomas Otterbeck

tomas.otterbeck@redeye.se

Eddie Palmgren

eddie.palmgren@redeye.se

Viktor Westman

viktor.westman@redeye.se

Editorial

Jim Andersson

jim.andersson@redeye.se

Eddie Palmgren

eddie.palmgren@redeye.se

Ludvig Svensson

ludvig.svensson@redeye.se

Life Science Team

Anders Hedlund

anders.hedlund@redeye.se

Arvid Necander

arvid.necander@redeye.se

Klas Palin

klas.palin@redeye.se

Mathias Spinnars

mathias.spinnars@redeye.se

Erik Nordström (Trainee)

erik.nordstrom@redeye.se

Jakob Svensson (Trainee)

jakob.svensson@redeye.se

Disclaimer

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Redeye Rating (2018-11-26)

Rating	Management	Ownership	Profit outlook	Profitability	Financial Strength
7,5p - 10,0p	44	47	19	10	21
3,5p - 7,0p	89	80	116	37	50
0,0p - 3,0p	13	19	11	99	75
Company N	146	146	146	146	146

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Conflict of interests

Havan Hanna owns shares in the company: No
Tomas Otterbeck owns shares in the company: No

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