

BEIJER electronics GROUP

Sector: Industrial Goods & Services

Reaching for the clouds

We initiate coverage of BEIJER electronics GROUP (BELE), which offers a long-term play on industrial digitalization and has emerged from a long turnaround better positioned than ever after eliminating its dependence on Mitsubishi Electric. It enjoys competitive advantages and has scope to reposition – and be revalued – as a leading provider in markets set to grow by up to 15% a year.

Beyond automation

Beijer Electronics is already far from an old automation company, as the success of its recently launched HMI-panels and its coming launch of a SaaS-based cloud solution demonstrate. We are especially upbeat about prospects for Westermo, which operates in non price-sensitive niches as the most reliable provider of 'rugged connectivity'.

Turnaround finally completed

The turnaround has taken more time than expected, but strong reports throughout 2018 have convinced investors that the process is complete. Both order intake and revenues are now at all-time highs after growing rapidly – up 37% and 18%, respectively, in Q4.

Fairly priced after surge

While acknowledging BELE's significant momentum and seeing good prospects for it to deliver both strong growth and profitability ahead of its financial targets, we see the share as fairly priced following this year's 55% rally. This has brought it to **our base case fair value of SEK 56 per share**, which is supported by our DCF analysis. It is also fairly priced in comparison with relevant international peers.

Positive prospects

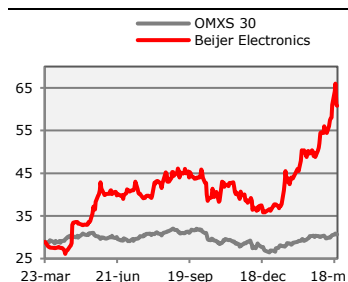
While current valuation is fair, BELE should be attractive to long-term investors seeking industrial IoT exposure. Increased profitability and an improved digitalization positioning should justify an increased valuation over time.

| KEY FINANCIALS (SEKm) | 2017 | 2018 | 2019E | 2020E | 2021E | 2022E |
|-----------------------|--------|------|-------|-------|-------|-------|
| Net sales | 1206 | 1417 | 1602 | 1767 | 1921 | 2054 |
| EBITDA | 90 | 151 | 202 | 263 | 307 | 339 |
| EBIT | 18 | 74 | 117 | 177 | 219 | 249 |
| EPS (adj.) | -0.2 | 1.5 | 2.9 | 4.5 | 5.7 | 6.6 |
| EV/Sales | 1.1 | 1.0 | 1.2 | 1.1 | 0.9 | 0.8 |
| EV/EBITDA | 14.2 | 9.7 | 9.7 | 7.1 | 5.7 | 4.9 |
| EV/EBIT | 71.4 | 19.7 | 16.8 | 10.6 | 8.1 | 6.6 |
| P/E | -157.3 | 23.8 | 19.5 | 12.4 | 9.7 | 8.4 |

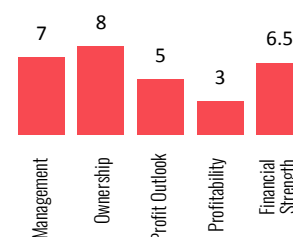
FAIR VALUE RANGE

| BEAR | BASE | BULL |
|------|------|------|
| 33.0 | 56.0 | 74.0 |

VERSUS OMXS30



REDEYE RATING



KEY STATS

| | |
|--------------------------|-----------|
| Ticker | BELE |
| Market | Small Cap |
| Share Price (SEK) | 56.0 |
| Market Cap (MSEK) | 1604 |
| Net Debt 19E (MSEK) | 354 |
| Free Float | 35 % |
| Avg. daily volume ('000) | 40 |

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Investment case

Turnaround finally completed. After a challenging period during 2016-17 where it undertook several measures that hurt its financials, BELE has convinced investors that its turnaround is finally complete. Strong reports throughout 2018 showed that the company is back on track – highlighted by growing order intake (now an all-time high) and sales by 37% and 18%, respectively, in Q4.

BELE is better positioned than before after quitting its distribution agreement with Mitsubishi Electric (which has reduced dependency and improved margins), updating its product portfolio, increasing the share of proprietary products, re-staffing its organization and with new management teams in place. We expect this to be reflected in continued profitability improvements that leverage on greater sales volumes and slightly improved gross margins. We forecast that the company will reach its profitability target (10% EBIT-margin) two years from now.

Digitalization to drive growth. Industrial digitalization is a trend to which all businesses are directly exposed. BELE's target markets are forecast to grow at CAGR of between 7% and 15% over the next five years (financial target of annual growth exceeding 7%).

Westermo, the group's golden nugget, has grown revenues and EBIT at CAGR of 9% and 10%, respectively, since the acquisition in 2008. Its current order intake and revenue growth are substantially higher, increasing by a respective 37% and 27% in 2018. It operates in non price-sensitive niche segments with long project deals, where it is positioned as the most reliable provider of rugged connectivity equipment. We expect the company to repeat its successful train networking efforts in rail trackside, where several existing customers operate, and power distribution. Westermo alone should be able to generate revenues and EBIT of SEK 810m and SEK 130m, respectively, by 2021.

Fairly priced after share price surge. While acknowledging its strong momentum and seeing room for continued growth and, in particular, increased profitability, our DCF value of SEK 56 per share suggests that BELE is fairly priced following this year's 55% rally. This is further supported by comparison with relevant international peers, against whom the share's forward-looking multiples seem fair.

Even so, BELE should offer good long-term returns for investors seeking exposure to the potential of industrial IoT. It is far from an old automation company, as its coming launch of a license-based software offering demonstrates. Its business is characterized by long relationships, with solutions designed into customers' systems, which suggests potentially durable competitive advantage due to switching costs. Repositioning as a leading provider of digital solutions could justify a higher valuation going forward.

Reports confirming continued high growth and improved profitability will be the most important events driving the share over the next year, we anticipate. Given its exceptional order intake growth in 2018, there is good reason to expect high sales and improved earnings throughout 2019, boosted by FX tailwinds in the near term as well.

Well positioned to grow with digitalisation trends

Counter Thesis

Cyclical business

A large share of the group's revenues stems from industrial clients. Thus, there is an inevitable risk that its sales will be negatively affected in a period of economic downturn. On the other hand, it becomes especially important to focus on investments in improved efficiency in such an environment. The latter pertains to the group's value proposition, and this dynamic could thus dampen negative effects.

Looking back to 2009, sales dropped by 15% while EBIT decreased by 45%. Yet the company remained profitable with an operating margin of 6% and solid positive cash flows, thus demonstrating that it could manoeuvre in this environment before returning to growth and increased profitability in 2010.

Failure to turn Korenix profitable

In recent years, Korenix has been hit by management problems, high staff turnover, and a strategic transformation. In 2018, the company negatively affected the group's EBIT by SEK -6m. Management claims that 2018 was a year of recovery and that Korenix should become profitable in 2019. There is, however, a risk that the turnaround could take longer time and that the company continues to burden the group's profitability.

Challenge to ramp up Westermo's supply

During the past two quarters, Westermo has experienced delivery problems that have negatively affected its margins, owing to its high growth spurring production and supply chain challenges. Westermo has undertaken measures that should solve these problems, but there is a risk that it will longer time before the company returns to normal profitability levels.

Catalysts

Higher and faster profitability improvements

We argue that the most relevant share price drivers are reports showing greater profitability improvements in a shorter period. The group's exceptional order intake paves the way for high sales growth during the coming year which should lead to continued profitability improvements. There is still a chance that BELE succeeds in showing greater and more rapid profitability improvements, reaching its financial target sooner than expected.

Successful fast track to the cloud launch (long-term)

During 2019, Beijer Electronics should launch its industrial IoT (IIoT) concept fast track to the cloud, a licence-based software offering bringing recurring revenues and increased margins. Although expecting the concept to account for a minor share of total sales, we believe that a successful launch would convince investors that Beijer Electronics is far from just an old automation company and that it could justify higher valuation multiples.

M&A

BELE has a history of acquisitions and continuously evaluates new prospects. As we deem its turnaround to be a fact and see a strengthened balance sheet, there is an increased likelihood of an acquisition during the coming two years. Our view is that it will most likely be a business that complements Beijer Electronics or Westermo, or otherwise an acquisition making up a fourth business entity. We point out, however, that far from all of BELE's previous acquisitions have been successful.

Content

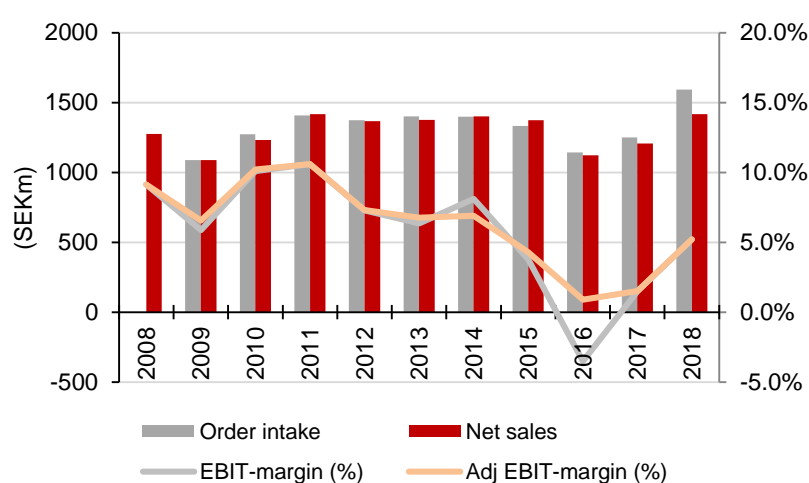
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About BEIJER electronics GROUP

BEIJER GROUP, listed on Nasdaq Stockholm Small Cap since 2000, offers industrial automation and data communication solutions. The initial core business entity, Beijer Electronics, was founded in 1981 as a Nordic distributor of Mitsubishi Electric's automation products. The group has subsequently broadened its offering through acquisitions and the development of own-label products.

Today, the group consists of three business entities: Beijer Electronics, Westermo, and Korenix. Its solutions are used to control, connect, present and communicate data. BELE applies a decentralised organisation philosophy, with the three entities run as individual businesses. Beijer Electronics accounts for the largest share of the group's total revenues while Westermo is the largest contributor to the group's profitability. Korenix is the smallest business, only accounting for approximately 7% of the group's sales and currently negatively affecting its profitability.

BELE: Financial development 2008-2018



Source: Redeye Research

*A number of tough years
in its wake*

BELE enters 2019 with a number of tough years behind it and has, in our view, just completed its turnaround. By 2015, the company had accumulated many problems that required the implementation of several tough measures. These, together with some poorly performing market segments, had a significant negative impact on the group's financials between 2015 and 2017. However, BELE has showed strong progress during 2018, not least reflected in its solid Q4 18 report, indicating that the group is back on track.

All entities showed growth during 2018, but Westermo and Beijer Electronics in particular account for the positive development. Westermo is reaping the benefits from its successful focus on train networking while Beijer Electronics is benefitting from the launch of new products. As visible in the graph above, the order intake is currently at all-time highs, while revenues are back at the levels seen around 2011-2015. Together, with additional factors, this convinces us that the turnaround can be deemed completed.

Turnaround completed –now better positioned than ever

Distribution partnership with Mitsubishi

From its inception in 1981 until 2015, Beijer Electronics was a distributor of Mitsubishi Electric's automation products. Mitsubishi also sold Beijer Electronics' operator panels under its own brand. However, the distribution partnership ultimately led to Beijer Electronics facing a risk of becoming too dependent on its partner while the companies' strategies also deviated considerably from each other.

As a result, the parties decided in 2015 not to renew their agreement to favour the development of own-label products, which at the time accounted for around 80% of sales. The decision to end the distribution agreement implied a revenue drop of around SEK 170m and losses during 2016-2017. During 2011-2014, Beijer Electronics' dependency had been even greater, it having generated around SEK 300m through Mitsubishi. Today, Beijer Electronics has returned to high order intake growth by eliminating its dependency on Mitsubishi and implementing a greater share of internally produced products (>90%).

Many products approached end-of-life

By the end of 2015, about 2/3 of the group's products were approaching end-of-life, leaving it facing a risk of ending up with an outdated product portfolio. Since then, the company has annually invested about SEK 150m in R&D to improve its product offering. As of today, the share of products approaching end-of-life amounts to 1/3, a substantial improvement over three years. The group has further improved its production capacity and increased the share of software development over these same years.

Several poorly performing acquisitions

Beijer Electronics Group has made several acquisitions since its listing. Far from all have been as successful as the solidly performing Westermo. These have spurred several divestments over the past four years, with the company weeding out poorly performing and non-core operations. For example, Beijer Electronics has divested its Finnish and Baltic operations and its earlier US Vehicle division. BELE had also accumulated a high level of debt, which it managed in 2017 by raising SEK 225m through a share issue to repay loans and strengthen its balance sheet. Its capital structure is now healthier with a current net debt of SEK 418m (ND/EBITDA < 2.8x).

Korenix problems and a restructured organisation

As if all of this was not enough, in 2017 BELE discovered that previous management and key employees in Korenix had acted disloyally by selling products outside the entity. BELE replaced management, supplanting all members except one. Korenix further launched initiatives to restructure its product offering, increase its delivery capacity and also to restructure its sales organisation in a move to strengthen its distribution network. Altogether, this spurred a substantial staff turnover, with more than one quarter of the staff having been replaced over the last two years.

This high staff turnover has not only been seen in Korenix. To handle the turnaround, the group has appointed a new management team for BEIJER GROUP and new CEOs and management members in each business entity. Hence, the entire organisation has undergone a heavy reconstruction phase. Korenix is still operating with losses, but it has only recently got its management team in place. Its order intake indicates that Korenix has found its position and that black numbers should be expected in 2019, which also is in line with managements' outlook.

The recent positive development and the above factors suggest that the turnaround should be deemed a fact and that BELE's troublesome period is in the past.

People

Per Samuelsson took over as group CEO in 2015 to manage the turnaround. Samuelsson was a good candidate to handle this transition, in our opinion, having faced similar challenges as CEO of Strålfors. We believe that Samuelsson has shown himself capable of taking rational but tough decisions, such as replacing the management in Westermo, which despite its great growth over a long period needed to get rid of its “family business” culture to advance to new levels. Samuelsson has taken significant efforts to put the right people in place, which seems to have had positive effects. His communication comes across as honest to us, with him openly discussing strategies, opportunities, and risks in a nuanced manner.

BELE’s management team is characterised by members with significant industry experience although with short tenure, all having been appointed during 2016 and 2017. We consider this short tenure reasonable as substantial changes were needed. It also means it is difficult to evaluate the current management. So far, the group has performed well under its new management.

Overall, the members of the board have significant industrial experience (Atlas Copco, Hexpol, etc.) and can provide relevant expertise. The Chairman of the Board, Bo Elisson, has a strong background thanks to his management positions within ABB. The company’s largest owner, Stena Sessan, is represented by Johan Wester. Management and board hold decent amounts of shares, which together with stock-based compensation plans ensure a financial incentive to deliver.

Management and board with significant industry experience

Largest shareholders

| # Owner | Capital(%) |
|--------------------|------------|
| 1 Stena | 29.8% |
| 2 SEB Fonder | 13.9% |
| 3 Svolder | 11.1% |
| 4 Nordea Fonder | 10.4% |
| 5 Fjärde AP-fonden | 6.2% |

Source: Holdings per 2018-12-31

The ownership structure is characterised by a large share of institutional owners. Stena Sessan has been the largest shareholder since its investment in 2001, indicating a truly long-term interest in the group. Svolder is another long-term owner, having made its first investment in 2006. We have a positive view on the ownership structure as the largest shareholders have the necessary financial muscles to support BELE if needed, and have done so in the past. The five largest owners together hold about 71% of the capital, indicating a low free float.

Business entity Beijer Electronics

Through the successful launch of new products, Beijer Electronics has returned to growth and profitability over the last two years. The company operates in a large fragmented market in growth terms, standing out as a provider of open solutions with lock-in effects. It is far from just an old automation company, as reflected by the launch of a SaaS-based cloud offering in 2019.

Beijer Electronics, based in Malmö, offers hardware and software-based solutions used to connect, control and present data. Its offering is split across four different categories; display solutions, operator communication, automation, and digitalisation, where operator communication (HMI-panels) and automation are the largest segments.

Within operator communication, Beijer Electronics offers HMI (Human Machine Interface) operator panels that are used to control and monitor machinery. In 2016, the company released a new series of panels called X2, which have been the primary driver of growth over the past two years. The X2 is available in about 50 different models and add-ons depending on the area of application. The offering not only consists of hardware but also in-house developed software used by machine builders to configure the machines and processes.



Stands out as a provider of open solutions running with most protocols

An advantage of Beijer Electronics' solutions is that they run with most of the commonly used protocols, implying that the products are compatible with all kinds of systems. The automation products vary in extent depending on the industry, with Beijer Electronics offering drives (such as frequency inverters, servo, and motion) and control systems (PLCs, logic computers controlling machines and processes).

The products are used in various markets, with industrial manufacturing as one of the largest segments. The primary benefit of its solutions is the user-friendly software, which decreases the complexity of digitalising processes. As well as being able to control the machines, the solutions yield better insights into the machines, allowing for an improved ability to forecast and efficiently plan maintenance. Together with the warning systems, this prevents production stops, which could mean significant cost savings for the targeted industries.



Illustration of Beijer Electronics' automation products, HMIs and software in use together.

Beijer Electronics also offers a set of IIoT gateways, products used to convert and collect data from equipment and connect it to the cloud. The products are advantageous as they can be applied to all existing machinery, independently of protocol and whether it contains automation products sold by Beijer Electronics. Although the solutions consist of both hard- and software, the company's business model has to date only been based on sales of hardware products and a small share of service agreements.

The company produces its operator panels at its facility in Taipei, mainly assembling components from external suppliers. The produced solutions are then sent to one of its three distribution centres in Asia, Europe, and North America.

Digitalisation – the driver of growth

Beijer Electronics is now ramping up its efforts to digitalise its customers' processes. The company has launched an initiative called *fast track to the cloud*, conceptualising the idea of collecting and uploading data to the cloud using its operator panels and gateways. This is an opportunity to increase the value-added and also initiate sales of software.

SaaS-based offering to be commercially launched during 2019

During summer 2018, Beijer Electronics ran pilot schemes with around 20 customers to evaluate the concept. It has stated that the solution has been very well received. More recently, the company has announced that fast track to the cloud will be launched during 2019. The business model is the sale of hardware (HMIs or IIoT gateways), with the cloud software used to store and analyse the uploaded data offered as a licence based subscription. It could thus drive additional hardware sales with new customers interested in implementing a full cloud concept as well as software license sales to existing customers. The revenue model brings appealing features such as stable recurring revenues with improved margins.

Customers

Beijer Electronics targets machine builders and OEM's within manufacturing, oil and gas, building automation, marine and offshore and water and wastewater segments. The list of customers includes large multinationals such as Atlas Copco, Alfa Laval and Emerson to mention a few.

End customers are reached through different sales channels. The company directly targets system integrators and OEMs, either using the solutions on their own or as a part of its solutions. Some customers also relabel Beijer Electronics' solutions with their own brands. In addition to direct sales, the company also uses a network of distributors to complement its local sales force.

The products are sold globally, and the company has about 4000 customers in total. In 2017, the ten largest customers represented 24% of sales, implying a low customer concentration. Europe is its largest geographical market, accounting for approximately half of its revenues, while America and Asia share the remaining 50%.

Market

According to a market study by Arc Advisory, the total market for HMI hardware, software and service is worth approximately SEK 36bn. This implies that Beijer Electronics current market share amounts to approximately 2-3%. The market is estimated by Arc Advisory to grow by about 6-7% per year, which is in line with BELE's financial objectives.

Favourable underlying market growth

MarketsandMarkets somewhat more optimistically, estimates that the HMI market will grow at a CAGR of around 9% and be worth USD 5.9bn by 2022. More interestingly, it sees cloud-based HMI growing at the highest rate until 2022.

Competitors

The market for HMI products is huge and fragmented. Within standard solutions, Beijer Electronics competes with global industrial companies such as Siemens, Rockwell, Mitsubishi Electric and Schneider Electric. Beijer Electronics is, however, also focused on rugged solutions for specific markets, where the competition is less intense. In the context of the total market, Beijer Electronics is a smaller player, while its position within rugged applications is stronger.

The most relevant competitor is **Red Lion** (US), owned by Spectris plc (LSE: SXS), which offers process control, HMI and networking solutions. Its relevancy stems from its focus on rugged solutions. In 2018, Spectris sales from its Industrial Control segment (also comprising Omega Engineering in addition to Red Lion) amounted to GBP 228m with an adjusted operating margin of 18.9%. Our view is that Red Lion is of a similar size to Beijer Electronics but with a greater focus on and position in the North American market. Through its offering of networking solutions (switches and routers), Red Lion also competes with Westermo and Korenix, and could thus be regarded as a relevant competitor for the entire group.

The large global competitors such as Rockwell, Siemens, and Honeywell have significantly broader offerings, with their relevant competing divisions consolidated in larger business segments. As an example, **Siemens AG** (FWB: SIE) has a Digital Factory division that produces both hardware and software in the same segment as Beijer Electronics, e.g., HMIs, with reported revenues of EUR 12.9bn and a profit margin of 20% in 2018. **Rockwell** (NYSE: ROK) is currently the world's largest player in industrial automation and information. Its control products and solutions segment reported revenues of about USD 3.5bn and an operating margin of 15.2% for 2018, illustrating the significant size difference.

There are also some Asian low-cost players, such as Taiwan's **Advantech** (TPE: 2395), which provides HMI and connectivity products globally. In 2017, the company reported revenues of USD 1.45bn, with the majority of its sales in China and North America, and an operating margin of 15.3%. Advantech, however, offers a much broader range of products and has less focus on rugged applications.

Our view is that there is no major difference in pricing strategies. Beijer Electronics' advantage is that it offers open solutions that can be applied in systems with components from other manufacturers whereas many of its larger competitors are inclined to offer full system solutions. This explains why software is its main differentiator.

In terms of competitive advantages, there are certain lock-in effects as the company's products are designed into customers' systems. It would require considerable effort for existing customers to replace Beijer Electronics' panels with competing solutions. Furthermore, the industry is characterised by long customer relationships, which together with the requirement for large investments to finalise a suite of smart technology solutions imposes barriers to entry.

Potentially durable competitive advantage in switching costs

Business entity Westermo

The group's golden nugget, Westermo, operates in non price-sensitive niche segments and is positioned as one of the most reliable providers of network equipment. Its recent focus on train networking has paid off, which is the primary explanation for its 27% sales growth in FY18. The company is now striving to establish equally strong positions within its new focus segments: rail trackside and power distribution.

Westermo, based in Västerås, develops and sells network solutions for communication in mission-critical applications. BELE acquired the company in 2007 at a price of about SEK 213m, corresponding to EV/S of 0.95x and EV/EBIT of 8x, i.e., fair multiples for a company that had shown average annual growth of 17% during the ten years before its acquisition.

The rationale behind the deal was to complement Beijer Electronics' operations as its automation and HMI customers would also need rugged network equipment. At the time, previous management mentioned that it also aimed for synergies in co-ordinated purchasing, production and sales. Although stating that it was able to realise synergies in purchasing and sales during 2008, the company subsequently adjusted its goal to having all subsidiaries run as individual businesses. In hindsight, it has clearly been a successful acquisition, with Westermo having grown sales and EBIT at a CAGR of 9% and 10%, respectively, since 2008.

Westermo has historically operated with a family business culture. As the company has grown, so has the need to establish a large professional organisation to ensure greater delivery capacities. This explains why BELE decided to appoint new management in Westermo. Although never compromising on the quality of its products, there has been room for production and supply chain efficiencies, for example. The latter is illustrated in the company's recent quarterly reports, where the high order intake growth prompted production challenges.



Westermo offers more than 1000 different models and variations of ethernet switches, extenders, modems, converters, and routers. It has thus a broad product portfolio with low production volumes for each product. The products are used in demanding environments, such as train networks, mining, oil and gas and process automation segments, which are applications affected by vibrations and large temperature differences and where downtime must be avoided at any cost. This is the primary USP of Westermo: it offers reliable communication products that always work.

Given that its customers act in mission-critical environments, they are willing to pay for reliable communication products, implying that Westermo operates in a non-price-sensitive market. One of the fastest-growing segments is train networking, where Westermo supplies network solutions used to control and monitor trains and to supply passenger information and infotainment systems. The solution, branded IP Train, is also used to connect video surveillance cameras.

Operating in a non-price-sensitive market

The solutions are based on its own hardware platforms and its internally developed operating system. Although the solutions consist of both hardware and software, Westermo's business model is based solely on the sales of hardware. We believe that this model will continue in the coming years as customers generally take software for granted and expect Westermo to provide software updates for free whenever needed. We further interpret management as not having clear ideas or initiatives for how to monetize on the software solutions.

Production takes place in the company's facility at Stora Sundby, Sweden. Westermo offers customer-specific adjustments for its larger OEM customers, for whom the products are usually branded, whereas the equipment sold to smaller customers tends to be standardised. Production mainly consists of own circuit boards and the assembly of external components. The company has struggled with capacity problems over the past year, and although it has invested in its production facility and undertaken measures to improve its supply chain, there should still be room for additional automatised processes and capacity improvements.

Focus segments

The company has recently stated a strategic focus on penetrating the rail trackside and power distribution markets, which together with train networking will constitute the three major focus markets. We consider this a reasonable step for the company, and we especially value the focus on trackside, given Westermo's already strong position within train networking. Many of the prospective customers within trackside are also already existing customers in train networking, such as Alstom, which besides trains also offers signaling systems used in rail traffic.

We further value the strategic initiatives that focus on niche segments and take Westermo from simply being a general provider of networking products for all applications in need of robust solutions. This should allow the company to concentrate its efforts and also achieve greater returns from producing solutions tailored to specific application areas. The focus on train networking has so far been very successful, and we believe the company should have a good chance to succeed in its new target segments as well.

Customers

Westermo sells directly to end-users, system integrators, OEM's and through distributors. The latter channel accounts for approximately 30% of sales. The company has about 5,000 customers of different sizes. Many are large international corporates, such as its three largest customers Bombardier, Progress Rail Locomotive and Toshiba. Other examples are ABB, Alstom, Epiroc, and LKAB. The ten largest customers accounted for 41% of 2017 sales, which is a large share given its total customer base of around 5,000.

Train networking is its largest customer segment, through which Westermo sells to almost all of the world's largest train companies, holding an estimated market share of around 15% according to the company. In train networking, both relationships and sales cycles are usually long, which should give Westermo the ability to predict and plan production accordingly. Europe accounts for the majority of the company's revenues (75%), followed by the US (13%) and then Asia (10%).

Competitors

Westermo's primary competitor is **Hirschmann**, a brand owned by the large US company Belden (NYSE: BDC). Hirschmann is also a known provider of reliable products. **GarrettCom** (also owned by Belden) is another competitor providing industrial networking products with an emphasis on ruggedness. Belden's network solutions (rugged wireless, gateways and switches), had revenues of USD 400m in 2017, with EBITDA-margin of 23.2%.

The second most relevant competitor is Taiwan's **Moxa**, which has a broader offering and is more inclined to compete on prices than Westermo and Hirschmann. Other competitors are **SCALANCE** and **RuggedCom** (acquired by Siemens in 2012), both of which provide industrial ethernet products. The Red Lion businesses **Sixnet** and **N-Tron** are also relevant competitors offering rugged products. **ORing** is another that sells products in the same type of industries as Westermo. Common among its competitors is the increasing focus on providing IIoT solutions.

One of the most reliable providers of robust network solutions

Westermo has established a very strong position in train networking in particular. It is positioned as the most reliable provider of robust networking solutions, a paramount factor for a company operating in mission-critical segments. This is quantified by its statement that it offers the lowest *mean time between failures*. Its products also have a long operational lifetime and are easy to configure and maintain.

Like Beijer Electronics, Westermo's business is characterised by long relationships. This is especially important for the segments it is targeting, where satisfied customers likely remain with Westermo as long as its products continue to show high levels of reliability. The company also offers Swedish in-house production, implying that it can work closely with and offer flexibility to customers with a Nordic presence.

Market

Industrial Ethernet market expected to grow by >9% over the next five years

A study by Arc Advisory estimates that the industrial ethernet and edge infrastructure market, relevant for both Westermo and Korenix, is worth SEK 13bn and will grow at a CAGR of approximately 9%. This would imply that the companies together hold a market share of about 3-4%. Global Market Insights has a more positive view, estimating that the industrial ethernet market should grow at a CAGR of 15% and reach a total market value of USD 72bn by 2024, with ethernet switches, hubs and gateways expected to account for a major share.

This market growth is driven by an increasing need for digitalisation within the targeted industries. As equipment and machines become connected, there is room for increased productivity and profitability. As additional machinery is connected, the amount of data increases. This implies a shift that makes software more important because it enables improved analysis opportunities, which is an important aspect to BELE's current phase.

Business entity Korenix

The group's smallest subsidiary (sales of SEK 117m in 2018) is an Asian version of Westermo. Korenix has a greater focus on wireless network equipment, especially for security and surveillance applications. Despite its improvements and our expectation that Korenix will start contributing to the group's profitability in due course, the business plays a less important role in our investment case.

Taiwanese company Korenix was founded by staff from Moxa in 2004. BELE acquired Korenix in 2010 for a total price of around SEK 130m, corresponding to EV/S of 2x. At the time, Korenix had grown its sales by more than 50% and its profitability was in line with Westermo's (~12% EBIT-margin). The rationale behind the acquisition was to broaden the group's industrial data communication offering, as Korenix offers similar products to Westermo (switches, routers, etc.) but to less mission-critical markets. Korenix's Asian presence would also give Westermo access to those markets.

Korenix also offers products for wireless communication (switches and routers) in surveillance and security applications. Its target segments are transport (buses, metro systems, trains, and roads), utility and manufacturing. It puts great focus on its "smart cities" solutions, primarily for security and surveillance. Like Westermo, Korenix's solutions consist of both hardware and software. Its business model is, however, only based on sales of hardware. Korenix develops customer-specific products for its larger OEM and key-customers.

Production, mainly the assembly of sourced components and the production of circuit boards, is based at its facility in Taipei, complemented by the use of external contract manufacturers. Korenix primarily sells through distributors (67% of sales), OEMs (27% of sales) and system integrators. The company has about 300 customers, with the ten largest customers accounting for 45% of its sales in 2017. About half of its sales are in Asia, and 40% in Europe. Examples of end-customers are Taiwan Department of Transportation and Schindler China.

In general, Korenix shares competitors with Westermo. The largest difference is that Korenix operates in Asia, implying that competitors with a greater presence in the region are more relevant, for example Moxa. As it sells to less mission-critical markets, competitors are generally more inclined to compete on pricing. Korenix is a smaller player with a strategy of developing products for specific application segments, such as public buses, and with a greater focus on wireless solutions. **As we see it, Korenix should have good opportunities to grow within its target segments and become a niche player, but we have not identified any evident sustainable competitive advantages.**

Tying it all together

BEIJER electronics GROUP is a decentralized organisation whose three entities are run as individual businesses. Common to all three is that they offer the connectivity solutions needed to achieve *Industrial IoT*. Most applications require both connectivity and automation/displays/HMIs, implying that the solutions could work in conjunction.

Although there are examples of shared customers, different areas in the customer organisation are often responsible for purchasing, imposing an obstacle to achieving cross-selling. The companies also use different distribution networks.

Thus, with its decentralised organisation philosophy, the group is not actively striving to achieve synergies in development, production, and sales. The efficiencies are limited to sharing IT infrastructure, such as common ERP systems. We have a positive view on this strategy as previous management did not achieve the synergies it had hoped for. Given that the entities have different focuses and offer different products for different product markets, we argue that it is positive that the entities run as individual businesses.

The entire group employs 713 people, distributed between Beijer Electronics (348), Westermo (209) and Korenix (143). According to management, the group has now found organizational stability, and we do not expect any drastic changes over the coming years.

Growth strategy

Although there are differences in the subsidiaries' strategies, the common driver of growth for the group is digitalisation. None of the business entities have stated initiatives of growth via expansion into new specific geographical markets, but instead aim to strategically focus on specific market segments and improve the product offering with a greater software focus. This is what will be important for the future digitalisation of the industry. A higher share of proprietary products and increased software will help continue to improve the group's gross margins.

Where will the company be in five years?

When asked where the company will be in five years, management states that it will likely have made some complementary acquisitions adding revenues of SEK 500-1,000m. It is also clear that management is focused on selling more software, especially in Beijer Electronics. All entities are benefiting from the digitalisation of the industry, and management states that its primary goal is to deliver complete IIoT-solutions, as exemplified by its goal to become one of the most prominent IoT companies in the Nordics.

Intentions of becoming one of the greatest IoT companies in the Nordics

R&D

The group spends about SEK 150m per year on R&D (>10% of sales), about half of which relates to software development. BELE has stated that 2/3 of its solutions should have a lifetime of up to ten years, which is up from approximately 1/3 three years ago. BELE has also put forward that it intends to keep R&D investments at current levels so as to remain competitive.

M&A

BELE states that it continuously evaluates M&A prospects. Given what management has mentioned to date, we find it most likely that this will be a minor acquisition to complement Beijer Electronics or Westermo, or a larger business to create a fourth operating entity.

Its current net debt of SEK 418m (ND/EBITDA 2.8x), should provide room for minor debt-financed acquisitions. If the group, however, finds an interesting but sizeable prospect that would make a new business entity, we find it likely that BELE would need to raise capital through a share issue. Management states that its main owners are supportive, and have given their approval to support BELE in such a move.

Financial goals

In 2016, the group set the following financial goals:

- Annual organic growth exceeding 7%
- Operating margin of 10% as an average over a business cycle

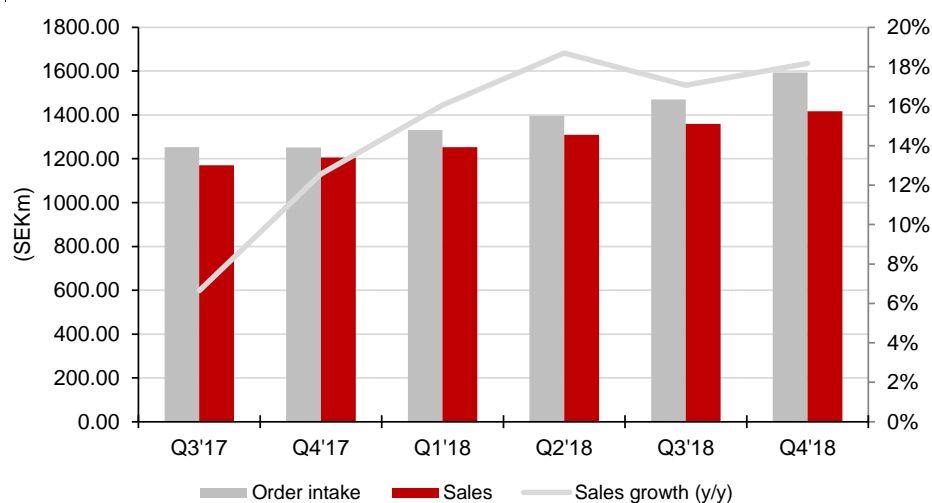
While its revenues are currently growing at a higher pace, there is still some work left to reach the profitability target. CEO Samuelsson has stated that BELE should be able to double its earnings with continued sales growth at an unchanged, or slightly improved, gross margin.

He has further mentioned that the group is considering updating its financial targets, which we believe can be expected once it has demonstrated improved profitability (likely within the next two years). Given its current R&D investments (>10% of sales) and the aim of becoming one of the leading IIoT companies, it is reasonable to expect somewhat more aggressive targets.

Financials and estimates

Beijer Electronics order intake reflects its sales during the coming 6-12 months while the order intake for Westermo and Korenix is the best indicator for their sales over the coming one to four years. Since Q4'16, the order backlog has changed for the positive. We believe that the exceptionally high order intake growth during 2017 and primarily 2018 (27%) illustrates that the group is back on track and that its entities have established good positions in their targeted segments.

Beijer Electronics Group: Order intake and sales (LTM)



Source: Redeye Research

Showing gross margin improvements

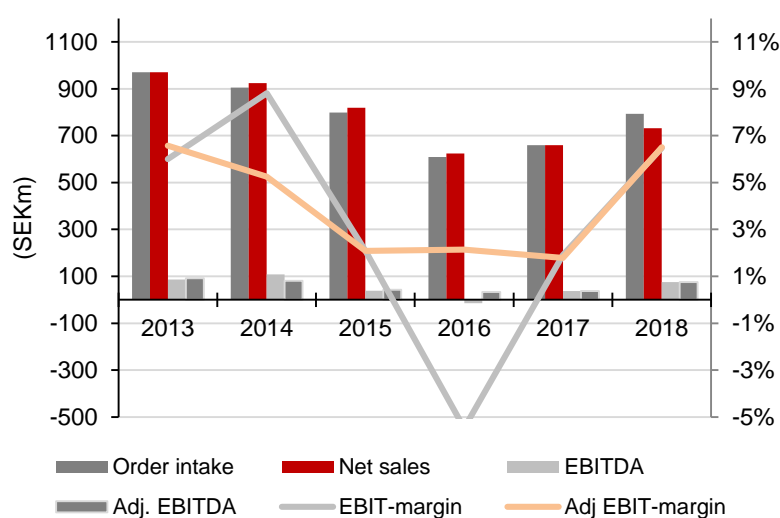
Thanks to new product launches and an improved share of internally produced products, BELE has increased the gross margin from 45% in 2015 to 49% in 2017. As the group only reports the cost distribution in its annual reports, the exact gross margin for 2018 has not yet been reported. The group has not communicated the distribution between the entities, but we believe that Westermo contributes the highest gross margin, at around 60%, whereas the gross margins for Beijer and Korenix are likely around 45% or lower.

Beijer Electronics

After ending the distribution agreement with Mitsubishi Electric and simultaneously facing a poorly performing oil and gas segment, 2016 was a year of crisis for Beijer Electronics. It remained profitable on an adjusted EBIT basis, however, with a margin of about 2%. The launch of new products and a new strategy led it to return to growth and increased profitability in 2017.

During 2018, the company grew order intake and sales by 20% and 11% respectively. In Q4 18, Beijer Electronics reported an EBIT margin of 9% which is higher than the margins achieved prior to the restructuring.

Beijer Electronics: Financials 2013-2018



Source: Redeye Research

The high order intake in Q4 18 is a strong indication of continued growth for 2019. A large part of the orders consists of older products, in our view implying somewhat lower gross margins during H1'19. From there, the gross margin should increase thanks to bolstered sales of X2 and IoT gateways. Thanks to its new products, an organization in shape, and evident digitalisation opportunities, we see good prospects for continued growth by Beijer Electronics and, in particular, improved profitability during the coming years.

We expect Beijer Electronics to continue growing at a rapid pace, especially over the next two years (11% and 8%, respectively). Cautiously, we do not extrapolate these extraordinary growth rates beyond 2020 given that it currently is rebounding from problematic levels under favourable market conditions. Between 2022 and 2027, we assume an average annual sales growth of 4%.

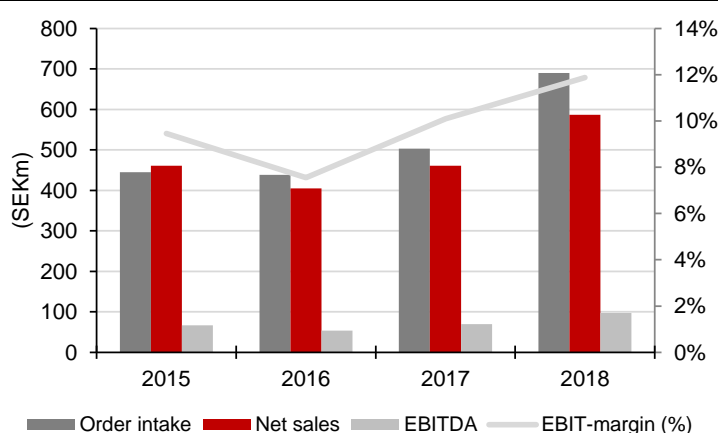
Its new cloud concept will be launched in 2019, but we do not expect any greater effects from this for the year, instead, we expect to see the results in 2021 and beyond. As sales of new products increase, and with the launch of its license-based software offering, we forecast improved margins over the coming years. In the long term, Beijer Electronics should be able to achieve an EBITDA-margin of around 15-17% and an EBIT margin of 12%, we estimate.

Westermo

Westermo has been the best performing entity in BELE since its acquisition, growing sales from SEK 225m in 2007 to SEK 586m in 2018 (corresponding to CAGR of 9%), with retained profitability. It still accounts for the largest share of the group's profitability with an EBIT margin of 12%. Westermo is currently experiencing high growth, as reflected in its order intake growth of 37% in 2018.

This growth has primarily been driven by the train networking segment, the area most prioritised during recent years. We still see room for it to grow in train networking, while the company is adding two additional focus markets. In particular, we expect the rail trackside segment to provide great growth opportunities. We estimate Westermo's sales will grow at a CAGR of 11% during 2019-21, resulting in sales of SEK 810m by 2021. From that point, we assume an average growth rate of 6% until 2027.

Westermo: Financials 2015-2018



Source: Redeye Research

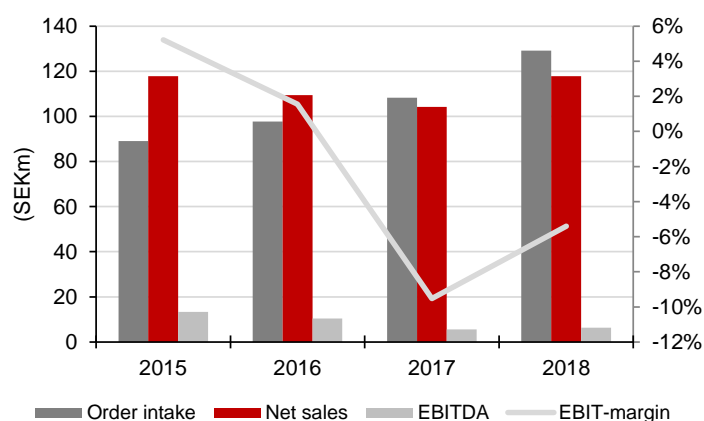
Although Westermo has undertaken measures to improve its production and supply chain efficiencies, it was difficult for the company to keep up with the high growth during 2018. In Q4 18, the company mentioned that its operating result was negatively affected by SEK 8m owing to supply chain problems that led to extraordinary costs (adj. EBIT margin of 13% in Q4).

There is consequently room for profitability improvements. Some manual production processes could potentially be semi- or fully automated, and the undertaken supply chain measures should also bring positive effects in 2019. Even though staff costs will continue to increase, we expect the company to expand margins by leveraging on volumes.

Given continued high growth and a gross margin of around 60%, Westermo should be able to reach an EBITDA margin of around 20%, we believe. In the short term, we still expect its profitability to be somewhat negatively impacted by the capacity problems mentioned in H2'18. The problems should, however, be solved during the year. We thus, estimate that Westermo can reach an EBITDA margin of 17% during 2019, and subsequently improve this further during the coming years.

Korenix

Korenix ended 2018 with very high order intake growth (51%) and has large deliveries for H1'19 according to the company. The strong order intake during 2018 indicates that the company has found its niche in transportation and we believe that it should be able to grow sales by about 10% annually during the coming three years.

Korenix: Financials 2015-2018

Source: Redeye Research

However, we take a somewhat more cautious stance on Korenix ability to rapidly increase its profitability and its long-term contributions to the group's net profit. We believe that Korenix should be able to achieve an EBITDA margin of about 10% during 2019, before increasing this towards 14% by 2021.

BEIJER GROUP

As a result of these forecasts, we expect the group to continue growing at a high pace during the coming three years. In particular, we forecast profitability improvements stemming from slightly better gross margin but primarily by it leveraging on greater sales volumes. It is important to bear in mind that the group currently is rebounding from levels during a problematic period and so we are careful not to extrapolate its current growth rate over a longer period. Beyond 2021, we assume a sales CAGR of 4% until 2027 and terminal growth of 2%.

| Group estimates | | | | | | | | |
|-------------------------|-------------|--------------|--------------|--------------|--------------|-------------|-------------|-------------|
| (SEKm) | 2018 | Q1'19 | Q2'19 | Q3'19 | Q4'19 | 2019 | 2020 | 2021 |
| Sales | 1417 | 403 | 412 | 368 | 419 | 1602 | 1767 | 1921 |
| Beijer Electronics | 731 | 205 | 210 | 185 | 210 | 810 | 883 | 949 |
| Westermo | 586 | 165 | 168 | 152 | 175 | 660 | 739 | 813 |
| Korenix | 118 | 33 | 34 | 31 | 34 | 132 | 145 | 158 |
| Group adjustments | -19 | | | | | | | |
| Total costs (excl. D&A) | -1268 | -357 | -363 | -320 | -360 | -1400 | -1504 | -1613 |
| EBITDA | 151 | 47 | 49 | 48 | 59 | 202 | 263 | 307 |
| Margin (%) | 11% | 12% | 12% | 13% | 14% | 13% | 15% | 16% |
| Beijer Electronics | 75 | 27 | 25 | 24 | 29 | 105 | 137 | 158 |
| Margin (%) | 10% | 13% | 12% | 13% | 14% | 13% | 16% | 17% |
| Westermo | 97 | 24 | 28 | 26 | 32 | 110 | 137 | 158 |
| Margin (%) | 17% | 15% | 17% | 17% | 18% | 17% | 19% | 19% |
| Korenix | 6 | 3.5 | 4 | 3 | 5 | 15 | 19 | 22 |
| Margin (%) | 5% | 11% | 12% | 10% | 13% | 11% | 13% | 14% |
| D&A | -77 | -21 | -21 | -22 | -22 | -85 | -87 | -88 |
| EBIT | 74 | 26 | 29 | 26 | 36 | 117 | 177 | 219 |
| PTP | 63 | 23 | 26 | 24 | 33 | 106 | 166 | 211 |
| EPS, SEK | 1.52 | 0.62 | 0.70 | 0.65 | 0.91 | 2.88 | 4.53 | 5.75 |
| Sales growth (%) | 18% | 20% | 14% | 9% | 10% | 13% | 10% | 9% |
| EBIT margin (%) | 5% | 6% | 7% | 7% | 9% | 7% | 10% | 11% |
| Net margin (%) | 3% | 4% | 5% | 5% | 6% | 5% | 7% | 9% |

Source: Redeye Research

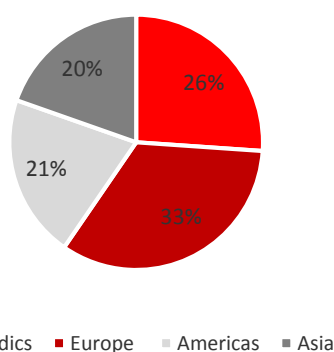
Over time, we estimate the group achieves a gross margin that exceeds 50%, with EBITDA improvements in all entities. Our EBITDA margin estimate averages out at 14.5% during 2019-2021 and at 17% beyond 2021.

The company's investments currently exceed its D&A, which we expect to increase in the wake of amortisation of the capitalised development costs. We expect continued EBIT improvements over the coming years, forecasting the EBIT margin to increase from the current level of around 5% towards 10% by 2020. Beyond 2021, we assume an average EBIT-margin of around 13%. Financial costs are based on interest rates averaging 2%. Together with a tax rate of 22%, this ultimately explains our net margin estimate averaging 9% beyond 2022.

Seasonality and FX exposure

In general, summer holidays have historically affected Beijer Electronics' and Korenix's Q3 financials. Beyond this, we see no clear seasonal variations. The group's largest FX exposures are to the USD, EUR and SEK. In 2017, 89% of the group's sales were in foreign currencies. BELE benefits when the SEK is weak, and this has boosted its financials during 2018 and should provide further tailwinds during early 2019.

Beijer Group: Sales by region



Source: Beijer Electronics Group

IFRS 16 effects

The introduction of IFRS 16 will affect the group's reporting during 2019, with its leasing contracts expanding the balance sheet. In the Q4 18 report, BELE estimated that its assets will increase by SEK 111m and its debt by approximately SEK 115m. Its income statement will be affected by lower external costs, meaning higher EBITDA. D&A should also rise following the increase in leased assets, but not enough to leave EBIT unaffected. This will be slightly boosted by the adoption of IFRS 16.

Balance sheet, investments and returns

The balance sheet was strengthened in 2017 through an equity issue used to repay about SEK 200m of debt. Its current debt is now healthier: net debt/EBITDA at 2.8x. Goodwill amounts to approximately SEK 500m, corresponding to 33% of total assets.

The group is investing heavily in R&D (SEK 160m), of which approximately 1/3 is capitalised. We expect CAPEX to remain in line with current levels during the next two years, amounting to SEK 100m. Although we expect gradual CAPEX increases, CAPEX/Sales should fall as sales volume rise.

| Debt, investments and returns | | | | | | |
|--------------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|
| (SEKm) | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
| Cash | 147.9 | 156.8 | 116.6 | 107.2 | 89.3 | 94.5 |
| Interest bearing debt | 707.8 | 655.6 | 609.5 | 689.1 | 506.7 | 512.5 |
| Net debt | 559.9 | 498.8 | 492.8 | 581.9 | 417.4 | 418.1 |
| ND/EBITDA | 3.70 | 2.79 | 4.27 | 25.28 | 4.62 | 2.78 |
| NWC/Sales | 12% | 11% | 12% | 14% | 13% | na |
| CAPEX intangibles | -24.4 | -28.5 | -45.4 | -61.2 | -61.1 | na |
| CAPEX tangibles | -15.9 | -17.3 | -17.3 | -16.5 | -17.8 | na |
| CAPEX/sales (%) | -8.3% | -3.3% | -4.8% | -6.9% | -6.6% | -6.6% |
| FCF/sales (%) | 7% | 6% | 1% | -6% | -3% | 1% |
| ROCE (%) | 8.8% | 10.3% | 4.8% | -3.2% | 1.7% | 6.7% |
| ROIC (%) | 8.7% | 10.7% | 3.9% | -5.3% | 1.6% | 5.5% |

Source: Redeye Research, Beijer Electronics, Bloomberg

BELE's working capital/sales has been stable over time, and we believe the group will maintain a stable ratio of around 13% going forward. We expect to see FCF improvements as operating cash flows improve, while CAPEX should remain relatively stable in absolute terms. With increased profitability, ROIC should also improve substantially from current levels.

Dividends

BELE paid dividends until it hit difficulties in 2016. In 2017, the board stated an ambition to resume dividend payments in 2018, and this was echoed in the Q4 18 report. The board proposed a dividend of SEK 0.5 per share, corresponding to SEK 14m, based on the policy of distributing earnings to shareholders if it sees no better potential returns on investment.

Although we consider the dividend payment symbolic, given that it represent a relatively small amount, we believe the group could have postponed resuming the payout dividend policy for a year owing to the total cash flow in 2018 (SEK 1.3m) and the possibility of future acquisitions.

Valuation

For valuation purposes, we apply a discount rate (WACC) of 10.5% based on our Redeye Rating. Our valuation is based on a DCF analysis for three scenarios - a base case plus an optimistic bull case and pessimistic bear case. No acquisitions are considered.

Base case

Sales should grow at a CAGR of 11% between 2019 and 2021. Beyond 2021, we assume a sales CAGR of 4.5% until 2027 and terminal growth of 2%. We forecast substantially improved profitability on the back of increased sales and new products.

Over time, we expect the company to achieve a gross margin above 50% and EBITDA improvements in all units. We anticipate an average EBITDA margin of 14.5% during 2019-21 and 17% beyond 2021. We forecast continued EBIT improvements in the coming years, with the EBIT margin increasing from its current level around 5% towards 10% by 2021. Beyond 2021, we assume an average EBIT margin of 13%. These assumptions give a **fair value of SEK 56 per share in our base case.**

| Valuation: Base case | | |
|-----------------------------|---------------------------------|--------------|
| Assumptions | 2019-27 DCF-value | |
| CAGR Sales | 6.3% WACC | 10.5% |
| EBIT-margin (avg) | 12.0% NPV FCF | 1 086 |
| ROIC (avg) | 18% NPV Terminal value | 939 |
| | Sum NPV | 2 025 |
| Terminal | Net debt | 416 |
| Terminal FCF growth | 2% DCF-value | 1 601 |
| Terminal EBIT-margin | 11% Fair value per share | 56 |
| | Current share price | 56 |
| | Potential/risk | 0% |

Source: Redeye Research

Bull case

Our optimistic bull case factors in higher growth in each part of the business, with sales growing at a CAGR of 13% until 2021. Beyond 2021, we assume an average annual growth rate of 5.4%. We also assume a more successful launch of Beijer Electronics' software offering, leading to higher gross margins in 2020-21 and beyond. We expect the improved gross margin to result in Beijer Electronics reaching an EBITDA margin of 17-18%.

This case also incorporates higher sales growth for Westermo following successful penetration and greater market shares in both of its new focus segments. Furthermore, we factor in increased profitability following increased sales. Our estimates have Westermo achieving an EBITDA margin of 21% in the long run.

| Valuation: Bull case | | |
|-----------------------------|---------------------------------|--------------|
| Assumptions | 2019-27 DCF-value | |
| CAGR Sales | 7.7% WACC | 10.5% |
| EBIT-margin (avg) | 13.0% NPV FCF | 1 285 |
| ROIC (avg) | 21% NPV Terminal value | 1 252 |
| | Sum NPV | 2 536 |
| Terminal | Net debt | 416 |
| Terminal FCF growth | 2% DCF-value | 2 121 |
| Terminal EBIT-margin | 13% Fair value per share | 74 |
| | Current share price | 56 |
| | Potential/risk | 32% |

Source: Redeye Research

We forecast an average EBITDA margin of 14.9% between 2019 and 2021 before increasing towards 18% in the long run. At the same time, we estimate somewhat higher investments to sustain the high growth. The bull case foresees an average EBIT margin amounting to 13% in our forecast period and a terminal margin of 13%. Our **bull case ultimately gives a fair value of SEK 74 per share**, around 32% above current levels.

Bear case

Our bear case takes a more cautious stance on the company's ability to keep growing at a double-digit rate over the next two years. It incorporates lower returns on the commercial launch of its software offering, less successful penetration of Westermo's new target markets and an extended turnaround in Korenix – ultimately resulting in lower sales and earnings in both the near term and long run.

We assume lower growth rates than in the two other scenarios, with annual growth of 7% to 2021 and 4% during the remaining forecast period. We also incorporate lower profitability gains as a result of lower sales growth and weaker returns from new offerings. This is captured by an average EBITDA margin of 13% over our forecast period.

We assume an average EBIT margin of 8%, which would mean that the company failed to reach its profitability targets. In the terminal period we assume an EBIT margin of 8%. Overall, our **bear case gives a fair value of SEK 33 per share**.

Case summary

| (SEKm) | 2019 | 2022 | 2025 |
|--------------|------|------|------|
| Sales | | | |
| Base | 1602 | 2054 | 2375 |
| Bull | 1669 | 2221 | 2686 |
| Bear | 1529 | 1809 | 2048 |
| EBIT | | | |
| Base | 117 | 249 | 327 |
| Bull | 132 | 332 | 395 |
| Bear | 98 | 145 | 188 |

Source: Redeye Research

Valuation: Bear case

| Assumptions | 2019-27 | DCF-value | |
|----------------------|---------|-----------------------------|-------------|
| CAGR Sales | 4.8% | WACC | 10.5% |
| EBIT-margin (avg) | 8.0% | NPV FCF | 646 |
| ROIC (avg) | 11% | NPV Terminal value | 726 |
| | | Sum NPV | 1 372 |
| Terminal | | Net debt | 416 |
| Terminal FCF growth | 2% | DCF-value | 956 |
| Terminal EBIT-margin | 8% | Fair value per share | 33 |
| | | Current share price | 56 |
| | | Potential/risk | -41% |

Source: Redeye Research

WACC sensitivity

Our DCF analysis is very sensitive to the discount rate (WACC). In this case, we apply a discount rate of 10.5%, based on its historical profitability among other things. Once the company manages to show improved EBIT over a prolonged period there should be room to lower WACC, which would ultimately raise fair value.

| Case | 9.5% | 10.0% | 10.5% | 11.0% | 11.5% |
|------|------|-------|-----------|-------|-------|
| Base | 65 | 60 | 56 | 52 | 48 |
| Bull | 86 | 80 | 74 | 68 | 64 |
| Bear | 40 | 36 | 33 | 30 | 27 |

Source: Redeye Research

Above we illustrate how the discount rate affects fair value in each scenario. A 50bp lowering of WACC would raise our base case valuation by SEK 4.

Peer valuation

BELE is traded below international peers on both forward-looking sales and 2020E EV/EBIT. However, the company is by far the smallest in its peer group and furthermore has the group's lowest margins. Compared to actors such as Belden and Spectris, multiples suggest that the share is fairly priced despite its higher forecast growth.

| Company | Enterprise Value | EV/Sales | | EV/EBIT | | Sales CAGR | EBIT-margin | | |
|---------------------------------|------------------|------------|------------|-------------|-------------|------------|-------------|------------|------------|
| | (SEK bn) | 19E | 20E | 19E | 20E | 2018-20E | 18 | 19E | 20E |
| HMS Network | 8.1 | 5.0 | 4.4 | 26.3 | 21.4 | 16% | 18% | 19% | 21% |
| Advantech | 51.9 | 3.2 | 3.1 | 19.8 | 17.5 | 11% | 15% | 16% | 18% |
| Belden | 29.0 | 1.2 | 1.2 | 7.7 | 7.4 | 5% | 12% | 15% | 16% |
| Spectris PLC | 40.6 | 2.0 | 2.0 | 13.1 | 12.2 | 7% | 13% | 15% | 16% |
| Rockwell Automation | 199.6 | 3.1 | 3.0 | 15.6 | 14.3 | 6% | 19% | 20% | 21% |
| Siemens AG | 1039.9 | 1.2 | 1.1 | 13.2 | 11.7 | 5% | 7% | 9% | 9% |
| Emerson | 424.8 | 2.4 | 2.3 | 13.7 | 12.6 | 11% | 16% | 18% | 18% |
| Shanghai Moons Electric Co | 7.3 | 2.4 | 2.0 | 20.5 | 15.7 | 21% | 11% | 12% | 13% |
| WuXi Xinjie Electric Co Ltd | 5.5 | 5.3 | 4.1 | 19.6 | 15.4 | 31% | 27% | 27% | 27% |
| Average | 201 | 2.9 | 2.6 | 16.6 | 14.3 | 13% | 15% | 17% | 18% |
| Median | 41 | 2.4 | 2.3 | 15.6 | 14.3 | 11% | 15% | 16% | 18% |
| Beijer Electronics Group | 2.0 | 1.3 | 1.1 | 17.3 | 11.4 | 14% | 5% | 7% | 10% |

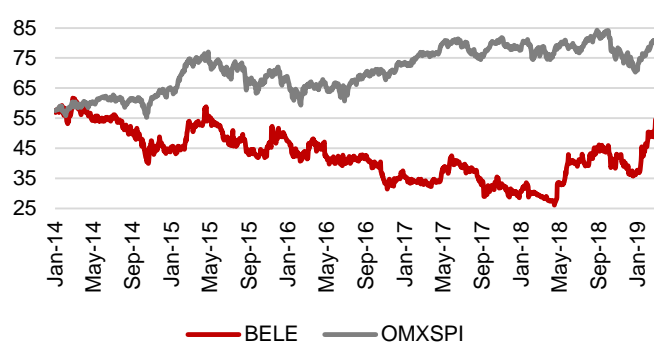
Source: Bloomberg, Redeye Research

Advantech is also a relevant competitor providing both HMIs and network equipment but it is significantly larger and has a much broader offering. An increased digitalization offering and positioning would justify higher multiples going forward. However, our conclusion is that the company is fairly priced for now in relation to international peers.

Fairly priced after share price surge

As a result of delivering several strong reports in 2018, sentiment around the share has shifted. After strong Q1 18 and, in particular, the Q4 18 reports, the share is up 115% since the bottom in April 2018 (SEK 26 per share). This year it is now up 55%, indicating that the report convinced investors that the turnaround should be deemed complete.

Share price history (2014-2019)



Source: Bloomberg

With the company better positioned than ever, we argue that the share price increase is justified since BELE has demonstrated that the turnaround is completed. Its restructuring efforts, launch of new products and Westermo's focus on train networking have clearly had a positive impact. Order intake is now at an all-time high, it has returned to profitability, the balance sheet is stronger and continued R&D investments are paving the way for continued growth and substantially improved profitability.

Westermo alone justifies a substantial element of the current valuation. It is truly the company's golden nugget, accounting for a significant share of its profitability and we find it unlikely that it will be spun off despite some investors' hopes. We see management as strongly opposed to the idea of splitting off the business.

Our base case valuation suggests that the share is fairly priced and that short-term upside potential is limited, which relative valuation also supports. However, continued growth and profitability improvements in the coming years would justify a higher valuation, we argue. Accordingly, long-term investors seeking exposure to the trend towards industrial digitalization should keep BELE on their radar.

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.

Management: 7.0

Relevant industry experience characterizes BELE's management and board of directors. Management shows a good understanding of its target markets, is focused on the long-term and nuanced in its communication. The average tenure is short, however, as all senior management was appointed in 2015 and beyond. BELE has, however, shown solid progress with current management, which we judge to have completed the company's turnaround.

Ownership: 8.0

We have a positive view of BELE's top shareholders, who comprise a large number of institutional investors. Several of the largest owners have been invested for over 10 years, indicating a long-term interest in the company. The shareholders also have the capital needed to support the company if required, which they have done previously. Principal owner Stena Sessan, holding about 30% of the votes, is represented on the board of directors.

Profit Outlook: 5.0

The company operates in large fragmented growth markets, primarily related to the digitalization trend. Long customer relationships characterize its business, where products are designed into customers' systems - laying the ground for potentially durable competitive advantages (switching costs). Continued profitability improvements are expected following recent gross margin improvements and by leveraging volume.

Profitability: 3.0

Although showing solid progress in the past year, BELE's profitability rating is burdened by a couple of years of negative results and free cash flow. As additional profitability improvements are expected, we see room for an increased rating going forward.

Financial Strength: 6.5

The company has a solid capital structure, the business is diversified, and we see no risk of needing to raise external capital going forward. On the negative side, the business is cyclical, implying that there is a risk of negative growth in a period of economic downturn.

| INCOME STATEMENT | 2017 | 2018 | 2019E | 2020E | 2021E |
|-----------------------|--------|--------|--------|--------|--------|
| Net sales | 1,206 | 1,417 | 1,602 | 1,767 | 1,921 |
| Total operating costs | -1,116 | -1,267 | -1,400 | -1,504 | -1,613 |
| EBITDA | 90 | 151 | 202 | 263 | 307 |
| Depreciation | -17 | -18 | -20 | -20 | -20 |
| Amortization | -55 | -58 | -66 | -67 | -68 |
| Impairment charges | 0 | 0 | 0 | 0 | 0 |
| EBIT | 18 | 74 | 117 | 177 | 219 |
| Share in profits | 0 | 0 | 0 | 0 | 0 |
| Net financial items | -22 | -11 | -11 | -11 | -8 |
| Exchange rate dif. | 0 | 0 | 0 | 0 | 0 |
| Pre-tax profit | -4 | 63 | 106 | 166 | 211 |
| Tax | -2 | -20 | -23 | -37 | -46 |
| Net earnings | -5 | 44 | 82 | 130 | 165 |

| BALANCE SHEET | 2017 | 2018 | 2019E | 2020E | 2021E |
|-----------------------------|-------|-------|-------|-------|-------|
| Assets | | | | | |
| <i>Current assets</i> | | | | | |
| Cash in banks | 89 | 94 | 156 | 253 | 354 |
| Receivables | 198 | 213 | 240 | 265 | 288 |
| Inventories | 169 | 206 | 232 | 247 | 269 |
| Other current assets | 68 | 68 | 68 | 68 | 68 |
| Current assets | 525 | 582 | 696 | 834 | 979 |
| <i>Fixed assets</i> | | | | | |
| Tangible assets | 85 | 91 | 92 | 94 | 97 |
| Associated comp. | 1 | 1 | 1 | 1 | 1 |
| Investments | 0 | 0 | 0 | 0 | 0 |
| Goodwill | 503 | 503 | 503 | 503 | 503 |
| Cap. exp. for dev. | 0 | 0 | 0 | 0 | 0 |
| Intangible rights | 251 | 286 | 290 | 296 | 301 |
| Other non-current assets | 2 | 2 | 2 | 2 | 2 |
| Total fixed assets | 843 | 883 | 889 | 896 | 904 |
| Deferred tax assets | 52 | 51 | 51 | 51 | 51 |
| Total (assets) | 1,419 | 1,515 | 1,636 | 1,780 | 1,933 |
| Liabilities | | | | | |
| <i>Current liabilities</i> | | | | | |
| Short-term debt | 47 | 50 | 50 | 50 | 50 |
| Accounts payable | 270 | 300 | 352 | 389 | 423 |
| Other current liabilities | 0 | 0 | 0 | 0 | 0 |
| Current liabilities | 317 | 350 | 402 | 439 | 473 |
| Long-term debt | 459 | 460 | 460 | 460 | 460 |
| Other long-term liabilities | 3 | 0 | 0 | 0 | 0 |
| Convertibles | 0 | 0 | 0 | 0 | 0 |
| Total Liabilities | 779 | 810 | 862 | 899 | 933 |
| Deferred tax liab | 49 | 49 | 49 | 49 | 49 |
| Provisions | 0 | 0 | 0 | 0 | 0 |
| Shareholders' equity | 585 | 653 | 721 | 829 | 948 |
| Minority interest (BS) | 6 | 4 | 4 | 4 | 4 |
| Minority & equity | 591 | 657 | 725 | 833 | 952 |
| Total liab & SE | 1,419 | 1,515 | 1,636 | 1,780 | 1,933 |

| FREE CASH FLOW | 2017 | 2018 | 2019E | 2020E | 2021E |
|-----------------------|--------|--------|--------|--------|--------|
| Net sales | 1,206 | 1,417 | 1,602 | 1,767 | 1,921 |
| Total operating costs | -1,116 | -1,267 | -1,400 | -1,504 | -1,613 |
| Depreciations total | -72 | -77 | -85 | -87 | -88 |
| EBIT | 18 | 74 | 117 | 177 | 219 |
| Taxes on EBIT | -4 | -23 | -26 | -39 | -48 |
| NOPLAT | 14 | 51 | 91 | 138 | 171 |
| Depreciation | 72 | 77 | 85 | 87 | 88 |
| Gross cash flow | 86 | 128 | 176 | 224 | 259 |
| Change in WC | 0 | -21 | -1 | -4 | -11 |
| Gross CAPEX | -62 | -117 | -91 | -94 | -96 |
| Free cash flow | 24 | -10 | 84 | 127 | 152 |

| CAPITAL STRUCTURE | 2017 | 2018 | 2019E | 2020E | 2021E |
|-----------------------|-------|-------|-------|-------|-------|
| Equity ratio | 42% | 43% | 44% | 47% | 49% |
| Debt/equity ratio | 87% | 78% | 71% | 62% | 54% |
| Net debt | 417 | 416 | 354 | 257 | 156 |
| Capital employed | 1,007 | 1,071 | 1,078 | 1,089 | 1,107 |
| Capital turnover rate | 0.9 | 0.9 | 1.0 | 1.0 | 1.0 |

| GROWTH | 2017 | 2018 | 2019E | 2020E | 2021E |
|------------------|------|-------|-------|-------|-------|
| Sales growth | 8% | 18% | 13% | 10% | 9% |
| EPS growth (adj) | -97% | -898% | 89% | 57% | 27% |

| DCF VALUATION | | CASH FLOW, MSEK | |
|---------------------------|--------|------------------------------|------|
| WACC (%) | 10.5 % | NPV FCF (2018-2020) | 300 |
| | | NPV FCF (2021-2027) | 786 |
| | | NPV FCF (2028-) | 939 |
| | | Non-operating assets | 86 |
| | | Interest-bearing debt | -510 |
| | | Fair value estimate MSEK | 1601 |
| Assumptions 2017-2023 (%) | | | |
| Average sales growth | 6.8 % | Fair value e. per share, SEK | 56.0 |
| EBIT margin | 11.7 % | Share price, SEK | 56.0 |

| PROFITABILITY | 2017 | 2018 | 2019E | 2020E | 2021E |
|---------------|------|------|-------|-------|-------|
| ROE | -1% | 7% | 12% | 17% | 19% |
| ROCE | 2% | 7% | 10% | 14% | 16% |
| ROIC | 1% | 5% | 8% | 13% | 16% |
| EBITDA margin | 7% | 11% | 13% | 15% | 16% |
| EBIT margin | 1% | 5% | 7% | 10% | 11% |
| Net margin | 0% | 3% | 5% | 7% | 9% |

| DATA PER SHARE | 2017 | 2018 | 2019E | 2020E | 2021E |
|----------------|-------|-------|-------|-------|-------|
| EPS | -0.19 | 1.52 | 2.88 | 4.53 | 5.75 |
| EPS adj | -0.19 | 1.52 | 2.88 | 4.53 | 5.75 |
| Dividend | 0.00 | 0.50 | 0.75 | 1.00 | 1.25 |
| Net debt | 14.58 | 14.51 | 12.37 | 8.97 | 5.46 |
| Total shares | 28.60 | 28.64 | 28.64 | 28.64 | 28.64 |

| VALUATION | 2017 | 2018 | 2019E | 2020E | 2021E |
|-------------|---------|---------|---------|---------|---------|
| EV | 1,284.2 | 1,458.2 | 1,966.4 | 1,868.0 | 1,766.4 |
| P/E | -157.3 | 23.8 | 19.5 | 12.4 | 9.7 |
| P/E diluted | -157.3 | 23.8 | 19.5 | 12.4 | 9.7 |
| P/Sales | 0.7 | 0.7 | 1.0 | 0.9 | 0.8 |
| EV/Sales | 1.1 | 1.0 | 1.2 | 1.1 | 0.9 |
| EV/EBITDA | 14.2 | 9.7 | 9.7 | 7.1 | 5.7 |
| EV/EBIT | 71.4 | 19.7 | 16.8 | 10.6 | 8.1 |
| P/BV | 1.5 | 1.6 | 2.2 | 1.9 | 1.7 |

| SHARE PERFORMANCE | | GROWTH/YEAR | 16/18E |
|-------------------------|--------|----------------------|---------|
| 1 month | 14.8 % | Net sales | 15.3 % |
| 3 month | 56.4 % | Operating profit adj | 154.7 % |
| 12 month | 93.8 % | EPS, just | ◆ |
| Since start of the year | 54.7 % | Equity | 10.7 % |

| SHAREHOLDER STRUCTURE % | CAPITAL | VOTES |
|----------------------------|---------|--------|
| Stena | 29.8 % | 29.8 % |
| SEB Fonder | 13.9 % | 13.9 % |
| Svalder | 11.1 % | 11.1 % |
| Nordea Fonder | 10.5 % | 10.5 % |
| Fjärde AP-fonden | 6.2 % | 6.2 % |
| Tredje AP-fonden | 2.5 % | 2.5 % |
| Torsten Bjurman | 2.1 % | 2.1 % |
| Nordnet Pensionsförsäkring | 1.7 % | 1.7 % |
| Nordea Funds (Lux) | 1.1 % | 1.1 % |
| Nicolas Hassbjer | 1.0 % | 1.0 % |

| SHARE INFORMATION | |
|-----------------------|-----------|
| Reuters code | BELE |
| List | Small Cap |
| Share price | 56.0 |
| Total shares, million | 28.6 |
| Market Cap, MSEK | 1603.6 |

| MANAGEMENT & BOARD | |
|--------------------|----------------|
| CEO | Per Samuelsson |
| CFO | Joakim Laurén |
| IR | |
| Chairman | Bo Elisson |

| FINANCIAL INFORMATION | |
|-----------------------|----------------|
| Q1 report | April 17, 2019 |
| Q2 report | July 12, 2019 |

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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

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Disclaimer

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Redeye Rating (2019-03-24)

| Rating | Management | Ownership | Profit outlook | Profitability | Financial Strength |
|--------------|------------|-----------|----------------|---------------|--------------------|
| 7,5p - 10,0p | 49 | 46 | 20 | 11 | 20 |
| 3,5p - 7,0p | 91 | 89 | 121 | 42 | 56 |
| 0,0p - 3,0p | 13 | 18 | 12 | 100 | 77 |
| Company N | 153 | 153 | 153 | 153 | 153 |

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CONFLICT OF INTERESTS

Dennis Berggren owns shares in the company : No

Henrik Alveskog owns shares in the company : No

Redeye performs/have performed services for the Company and receives/have received compensation from the Company in connection with this.