Railcare Group

Sector: Industrial Goods & Services

Steady Progress

Redeye's view on the case remains intact and we have only made minor changes to our forecasts following the Q2 report. Railcare showed continued good growth and stable margins during the quarter. Given the circumstances, with problems relating to the Swedish Transport Administration's new MPK planning system, we find this particularly encouraging. A testimony to Railcare's agility and corporate culture. Overall, market demand remains firm. However, the very near-term outlook is unpredictable due to the planning issues mentioned. Our valuation is unchanged with a Base case fair value around SEK29 per share suggesting significant upside to current share price levels.

Another solid quarter

Net sales of SEK145m in Q2 is 14% higher Y/Y and a little higher than our forecast. Transport Scandinavia and Contracting Sweden both recorded higher sales than we expected. EBIT of SEK15m was however right on our estimate and margins are unchanged, just above 10%. Cost increases are partly due to inflation, but Railcare is confident that it is able to raise prices to make up for higher operating costs. Earnings in the four business segments were mainly as expected. Transport Scandinavia slightly higher, while Contracting Abroad a bit lower.

Near-term challenges, long-term opportunities

The introduction of the Swedish Transport Administration's (Trafikverket) new MPK planning system has been a challenge, as track timetables are being announced at very short notice. Railcare's dynamic organization appears to have handled the situation well, and hopefully these issues will be resolved by 2024. Market demand and outlook for Railcare's main operations within Transportation Scandinavia and Contracting Sweden remains firm. And with less "friction" in the system we see good opportunities for profitable growth ahead.

Forecasts and valuation unchanged

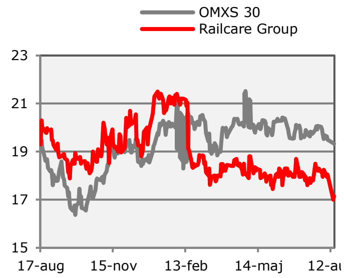
We have again raised our sales forecast somewhat, while earnings 2023-25e are virtually unchanged. Impact on our valuation is negligible and Base case fair value around SEK29 per share. The potential in the share is supported by attractive earnings multiples. It is currently trading at 8x EV/EBIT on our 2023e (probably an all-time-low).

Key Financials (SEKm)	2021	2022	2023e	2024e	2025e
Net sales	438	497	562	618	680
Sales growth	9%	13%	13%	10%	10%
EBITDA	108	95	112	128	140
EBIT	56	52	67	76	83
EBIT Margin (%)	13%	11%	12%	12%	12%
Net Income	40	37	47	52	57
EV/Sales	1.5	1.2	1.0	0.9	0.8
EV/EBITDA	6.1	6.5	4.9	4.4	4.0
EV/EBIT	11.9	11.7	8.2	7.4	6.8

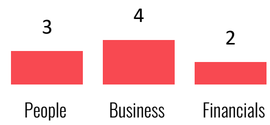
FAIR VALUE RANGE

BEAR	BASE	BULL
17.0	**29.0**	37.0

RAIL.ST VERSUS OMXS30



REDEYE RATING



KEY STATS

Ticker	RAIL.ST
Market	Nasdaq
Share Price (SEK)	17.6
Market Cap (MSEK)	425
Net Debt 23E (MSEK)	130
Free Float	60%
Avg. daily volume ('000)	11

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Q2 highlights

Railcare: Actual vs. Expectations

SEKm	Q2 2022	Q2 2023 Actual	Q2 2023e	Diff
Net sales	127.2	144.7	135.0	7%
EBIT	13.0	14.9	15.0	-1%
Pre Tax Profit	11.9	12.6	13.3	-5%
Sales growth Y/Y	40%	14%	6%	
EBIT margin	10.2%	10.3%	11.1%	

Source: Railcare, Redeye Research

Contracting Sweden's showed higher sales Y/Y despite a later start of the contracting season due to cold weather. Margins are somewhat diluted from the new setup with operators being hired to the UK operations as well as less favorable sales mix within the relining business.

Contracting Abroad had very modest sales volumes, which is often the case in the UK in Q2 and Q3. Thanks to last year's reorganization, the Q2 loss is also rather modest.

Transport Scandinavia was again stronger than we expected, despite some headwinds in the market. Resumed transports for LKAB was delayed due to access to locomotives, but is up to speed as of Q3. Also, the upgrade of TB locomotives to Infranord was postponed until Q4 due to sourcing issues. The locomotive workshop sees good demand for its services but is probably working close to full capacity.

Machines and Technology continued to focus on the construction of the new MPV. Tests are planned for H2 2023 and full production in Railcare's contracting operations in 2024.

On group level sales grew by 14% Y/Y and EBIT margins remained just above 10%. Trailing 12 months, top-line growth has now slowed down to 10% from the very high levels a year ago.

Segments by quarter

SEKm	Q1'22	Q2'22	Q3'22	Q4'22	Q1'23	Q2'23
Contracting Sweden						
Net sales	37	52	49	48	41	58
PTP	5	5	6	5	2	5
PTP margin	13%	10%	13%	10%	4%	8%
Contracting Abroad						
Net sales	11	5	10	10	13	5
PTP	-1	-5	0	-3.3 *	2	-1
Profit margin	-7%	-100%	-1%	n.m.	12%	-19%
Transport Scandinavia						
Net sales	43	73	88	75	68	82
PTP	0	11	14	4	7	9
Profit margin	0%	15%	15%	5%	10%	11%
Machines and Technology						
Net sales	22	23	24	19	18	18
PTP	3	2	3	1	1	1
Profit margin	13%	7%	11%	3%	5%	8%
Group sales:	**95**	**127**	**146**	**128**	**111**	**145**
Growth Y/Y	7%	40%	16%	-3%	17%	14%
Growth, TTM	16%	30%	25%	13%	15%	10%
EBIT	**9**	**13**	**24**	**7**	**13**	**15**
EBIT-margin	9%	10%	16%	5%	12%	10%
EBIT margin TTM	13%	15%	14%	11%	11%	11%

* Including one-off costs of SEK3m in Q4 2022.

Source: Railcare, Redeye Research

Financial forecasts

Earnings forecasts unchanged

On group level, our earnings forecasts 2023-25e are unchanged, while we have raised our growth expectations, mainly for business segment Transport Scandinavia. We anticipate a significant improvement in earnings 2023 vs 2022, driven by the turn-around in Contracting Abroad and expansion within Transport Scandinavia. As mentioned earlier, issues relating to the MPK planning system is however a near-term concern.

Good project pipeline

Contracting Sweden's pipeline for 2023 is promising with more maintenance projects planned vs 2022. The main hurdle for some of these projects to be completed as planned is access to the tracks. Since the beginning of this year, the segment also includes the pool of machine operators, where some are leased to the UK (Contracting Abroad), see table below. Hence, net sales will be higher while margins slightly diluted going forward.

Contracting Abroad has a more flexible cost structure after the reorganization, with a lower break-even point. And hopefully the new approach with railway partners in the UK will help bring in more business. The UK market has been very unpredictable and following promising Q1 numbers, Q2 was again quite weak. We still have a rather cautious view on this segment.

Transport Scandinavia is one of the cornerstones in Railcare's growth strategy with an ambition to expand significantly in the coming years. This includes transports as well as services offered by the locomotive workshop. We believe the main challenge will be to balance capacity along with the expansion. The segment showed exceptionally high margins of 13-14% in 2020-21. Going forward, we believe around 10% is probably more realistic. Transporting services are typically not a very high margin business and capacity utilization will not always be optimized.

Machines and Technology is the segment with the greatest long-term potential we believe. Railcare has a unique and very attractive product range mainly based on the Railvac systems and soon also the new electric MPV. The MPVe will be tested in H2'23 and in full production in 2024. There is a wide range of business opportunities here and we hope to see the first order and sales of an MPVe in 2024. Admittedly, this is still very unpredictable and our forecasts for the next few years include rather modest success at this point.

Forecasts per segment

SEKm	2020	2021	2022	2023e	2024e	2025e
Contracting Sweden						
Net sales	159	131	186	220	226	233
Wherof leasing operators to UK	-	-	-	28	30	33
PTP	18	8	21	19	23	23
Margin	11%	6%	11%	9%	10%	10%
Contracting Abroad						
Net sales	60	48	36	38	42	46
PTP	2	4	-9	2	3	3
Margin	3%	8%	-25%	4%	7%	7%
Transport Scandinavia						
Net sales	184	274	279	319	344	372
PTP	24	39	28	33	34	35
Margin	13%	14%	10%	10%	10%	10%
Machines and Technology						
Net sales	83	37	88	81	110	140
PTP	11	1	8	6	9	14
Margin	14%	2%	9%	7%	8%	10%
Group net sales	**401**	**438**	**497**	**562**	**618**	**680**
EBIT	**61**	**56**	**52**	**67**	**76**	**83**
Sales growth, Y/Y	8%	9%	13%	13%	10%	10%
EBIT margin	15.1%	12.8%	10.5%	11.9%	12.3%	12.1%

Source: Railcare, Redeye Research

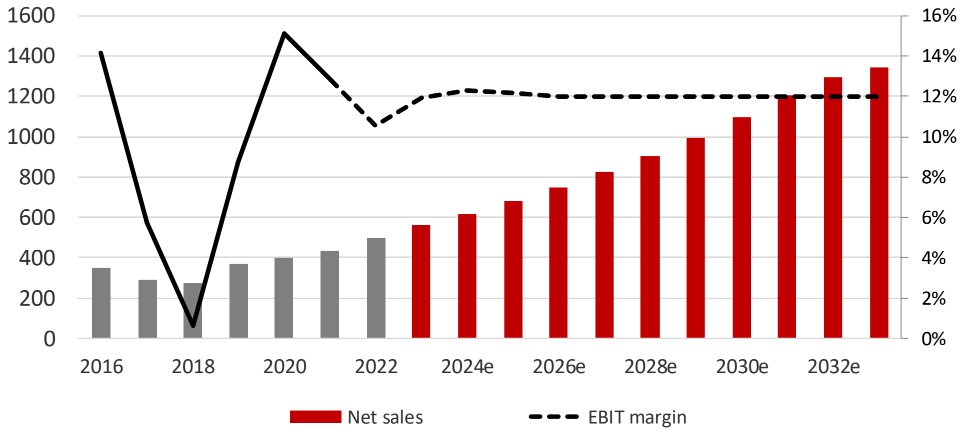
Long-term assumptions, years 2026-33

No changes have been made to our long-term assumptions. Railcare's target of reaching sales of SEK800m by 2027 coincides with our forecasts. As for EBIT margins we believe an average of 12% is attainable, vs company target of 10%. Redeye assumptions include:

- 10% annual growth
- 12% EBIT margin
- From 2033 (Terminal year): 12% EBIT margin and 2% annual growth

In the period up until 2033 we find it highly likely that Railcare will expand into new geographic markets. In our view, probably countries in northern Europe. And with machine exports to the global market. The future progression will certainly not be linear, like our model suggests. But a CAGR of 10% should be attainable, given the significant expansion opportunities available. If so, annual sales in 2033 will reach around SEK1.3bn.

Net sales and EBIT margins



Source: Railcare, Redeye Research

Valuation

Fair value: ~SEK 29 per share

Our cash flow model indicates a fair enterprise value around SEK 845m. After deducting net debt, we arrive at a fair equity value of SEK 700m, or SEK ~29 per share (unchanged vs previously). This suggests a rather appealing potential of more than 60% from current share price level. Assumptions for our Base case scenario and valuation are summarized in the table below.

Railcare: Base case

Assumptions	**2026-32e**	**DCF-value**	
CAGR	10%	WACC	10.0%
EBIT margin	12%	NPV FCF 2022-32	283
ROIC (avg)	17%	NPV FCF Terminal	562
		Total (EV)	845
Terminal		Net debt	145
Net sales 2033 (SEKm)	1 342		
Growth FCF	2%	Fair value	700
EBIT margin	12%	Fair value per share	29.0
EV/S Exit multiple	1.1	Share price	17.5
EV/EBIT Exit multiple	9.4	**Potential**	**66%**

Source: Redeye Research

Still trading at attractive multiples

Based on our estimates Railcare is trading at more attractive multiples than we have seen historically. With a rather stable business and continued good outlook, we find this unjustified and a bit surprising. EV/EBIT is in our view the most relevant multiple since it also takes net debt into account. We are not including leasing debt in our EV/EBIT. It is however included in our EV/EBITDA multiple.

Valuation multiples

	2020	**2021**	**2022**	**2023e**	**2024e**	**2025e**
P/E	12.9	13.3	13.1	8.9	7.8	7.2
EV/EBIT	11.6	11.8	11.7	8.2	7.3	6.7
EV/EBITDA	6.7	6.6	7.1	6.3	5.0	4.5
P/S	1.4	1.2	1.2	1.0	0.9	0.8
Share price	23.3	22.4	20.5	17.5	17.5	17.5

Source: Railcare, Redeye Research

Scenarios

For a company like Railcare there are of course a variety of possible scenarios. We do not see any specific binary events that would cause a significantly different development than the one outlined in our main scenario, Base case. Business operations are stable and the balance between different segments offer some diversification in terms of risks. However, two other possible scenarios are outlined below: Bull- and Bear-case. Both are quite possible, but in our view rather optimistic and pessimistic, respectively.

Bull-case

Railcare certainly could grow faster than we anticipate for an extended period of time. If they, e.g. establish operations in a new country or if machine sales really start taking off. The Railvac, Minevac, Tubevac and MPV, all have significant market potential globally. These machines have a potential for very good gross margins and with higher volumes Rilcare can improve its manufacturing process. Growth driven by machine sales should also drive margins. Assumptions for our Bull case:

- CAGR 2023-32: ~13%, taking sales to SEK1.6bn in 2033.
- Sustainable EBIT margins of 12%.
- Bull case fair value around SEK 37 per share.

Bear-case

Although the near-term outlook is bright, market conditions could deteriorate later on. New competitors, that we don't see today could emerge and impact profitability. State budgets could see major cuts or Railcare itself could run into internal problems. Bear case assumptions:

- CAGR 2023-32: 5% taking sales to ~SEK800m in 2033.
- Sustainable EBIT margins of 10%.
- Bear case fair value around SEK 17 per share.

Investment Thesis

Unique position in attractive market segment

Railcare has established a solid position in the railway maintenance market, with an offer based on its own unique proprietary vacuum technology. The company has developed efficient systems to handle ballast replacement that standard excavators are unable to perform. This means maintenance work can be done at a lower cost and with less interruptions in railroad traffic. The global market potential is huge and if executed well, Railcare has decades of major growth opportunities ahead.

Successfully validated

The Railvac systems have been operating successfully in Sweden and the UK for many years and been exported to several markets overseas. It has become a well-known concept, validated by partners and clients. With the new all-electric MPV (emission-free and low noise), Railcare is adding features very appealing to niche applications like maintenance in subways, tunnels and populated areas.

Challenges

Limited progress lately

In recent years, export sales of Railvac systems have been quite few and far apart. This is reason for some concern, as we believe the company's ambition has been higher. We don't really know the reasons behind this. When it comes to Railcares' overall growth ambitions, our sense is that they have been somewhat defensive and not too eager. This may be changing considering the new financial sales target of SEK800m by 2027, corresponding to a CAGR ~10%.

Political risk

A significant part of the group's operations is exposed to public utilities and government budgets. Currently there is good support for railroad maintenance, but there is always a risk associated with political involvement. This can certainly be applied to Railcare's own contracting business, but also to some extent when it comes to exports of machinery and equipment.

Summary Redeye Rating

The rating consists of three valuation keys, each constituting an overall assessment of several factors that are rated on a scale of 0 to 1 points. The maximum score for a valuation key is 5 points.

Rating changes in the report: No changes.

People: 3

Management is very active in daily operations and have extensive experience from the railroad industry. However, Mattias Remahl is still rather new as CEO and we really cannot evaluate him in this capacity yet. Communication and financial reports are relevant and transparent and Railcare is ticking most boxes in the People category. Furthermore, the two dominant owners are represented on the Board of directors, which also has some independent members. So a good mix on the Board.

Business: 4

Revenues and profitability have been quite volatile in the last few years, due to fluctuating demand. The customer offer based on the unique Railvac machines is a competitive advantage that should give good prospects for growth and profitability. There are still no head-on competitors in this niche segment, as far as we know. For some of Railcare's other service offerings, there is more competition. Management appears to be committed on innovation of new products and services and we also believe that Railcare will expand geographically, in due course.

Financials: 2

Profitability was poor in 2017-18, due to declining volumes, but has improved remarkably since then. Railcare decided not to make any drastic reductions in personnel during 2017-18, as they anticipated better times and need skilled staff. EBIT margins have been well over the company's own target of 10% lately and we would not be surprised if Railcare decides to raise this target. However, there is limited leverage in the major part of the company's business offering. Hence, there are also limitations in terms of what they can score in our Financial rating. Financial gearing (debt/equity) is on a reasonable level given stable and profitable operations. But there is probably limited room for major acquisitions or significant expansions into new markets.

	2022	2023e	2024e	2025e
INCOME STATEMENT				
Net sales	497	562	618	680
Cost of Revenues	193	213	225	248
Gross Profit	304	349	393	433
Operating Expenses	209	236	264	292
EBITDA	95	112	128	140
Depreciation & Amortization	43	45	52	58
EBIT	52	67	76	83
Net Financial Items	-5	-9	-9	-9
EBT	47	58	67	74
Income Tax Expenses	10	11	14	16
Non-Controlling Interest	0	0	0	0
Net Income	37	47	52	57
BALANCE SHEET				
Assets				
Current assets				
Cash & Equivalents	32	24	12	17
Inventories	32	39	43	48
Accounts Receivable	41	51	56	61
Other Current Assets	37	39	43	48
Total Current Assets	142	154	154	174
Non-current assets				
Property, Plant & Equipment, Net	383	410	459	506
Goodwill	6	6	6	6
Intangible Assets	2	0	-1	-3
Right-of-Use Assets	55	50	44	23
Shares in Associates	0	0	0	0
Other Long-Term Assets	5	5	5	5
Total Non-Current Assets	451	472	513	537
Total Assets	593	626	667	711
Liabilities				
Current liabilities				
Short-Term Debt	64	54	54	54
Short-Term Lease Liabilities	11	11	11	11
Accounts Payable	34	39	43	48
Other Current Liabilities	42	47	48	49
Total Current Liabilities	151	151	156	161
Non-current liabilities				
Long-Term Debt	101	101	101	101
Long-Term Lease Liabilities	43	43	43	43
Other Long-Term Liabilities	55	55	55	55
Total Non-current Liabilities	198	198	198	198
Non-Controlling Interest	0	0	0	0
Shareholder's Equity	244	277	313	352
Total Liabilities & Equity	593	626	667	711
CASH FLOW				
NOPAT	64	80	92	101
Change in Working Capital	-19	-9	-8	-9
Operating Cash Flow	68	83	97	106
Capital Expenditures	-53	-50	-75	-76
Investment in Intangible Assets	0	-4	-6	-7
Investing Cash Flow	-65	-66	-93	-83
Financing Cash Flow	-8	-24	-16	-18
Free Cash Flow	15	29	16	24

DCF Valuation Metrics	Sum FCF (SEKm)
Initial Period (2023–2025)	40
Momentum Period (2026–2028)	243
Stable Period (2029–)	562
Firm Value	845
Net Debt (last quarter)	145
Equity Value	700
Fair Value per Share	29.0

	2022	2023e	2024e	2025e
CAPITAL STRUCTURE				
Equity Ratio	0.4	0.4	0.5	0.5
Debt to equity	0.7	0.6	0.5	0.4
Net Debt	133	130	143	137
Capital Employed	442	475	511	550
Working Capital Turnover	21.3	17.3	15.3	13.9
GROWTH				
Revenue Growth	13%	13%	10%	10%
Basic EPS Growth	-9%	28%	12%	9%
Adjusted Basic EPS Growth	-9%	28%	12%	9%
PROFITABILITY				
ROE	16%	18%	18%	17%
ROCE	12%	14%	15%	15%
ROIC	16%	18%	19%	19%
EBITDA Margin (%)	19%	20%	21%	21%
EBIT Margin (%)	11%	12%	12%	12%
Net Income Margin (%)	7%	8%	8%	8%
VALUATION				
Basic EPS	1.5	1.9	2.2	2.4
Adjusted Basic EPS	1.5	1.9	2.2	2.4
P/E	13.1	9.0	8.0	7.3
EV/Revenue	1.2	1.0	0.9	0.8
EV/EBITDA	6.5	4.9	4.4	4.0
EV/EBIT	11.7	8.2	7.4	6.8
P/B	2.0	1.5	1.3	1.2

SHAREHOLDER STRUCTURE	CAPITAL %	VOTES %
Norra Västerbotten Fastighets AB	29.5%	29.5%
TREAC Aktiebolag	9.9%	9.9%
Ålandsbanken AB	5.1%	5.1%
Försäkringsbolaget Avanza Pension	3.4%	3.4%
Bernt Larsson	3.1%	3.1%

SHARE INFORMATION	
Reuters code	RAIL.ST
List	Nasdaq Smallcap
Share price	17.5
Total shares, million	24.1

MANAGEMENT & BOARD	
CEO	Mattias Remahl
CFO	Lisa Borgs
Chairman	Anders Westermark

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Redeye Rating and Background Definitions

Company Quality

Company Quality is based on a set of quality checks across three categories: PEOPLE, BUSINESS, FINANCE. These are the building blocks that enable a company to deliver sustained operational outperformance and attractive long-term earnings growth.

Each category is grouped into multiple sub-categories assessed by five checks. These are based on widely accepted and tested investment criteria and used by demonstrably successful investors and investment firms. Each sub-category may also include a complementary check that provides additional information to assist with investment decision-making.

If a check is successful, it is assigned a score of one point; the total successful checks are added to give a score for each sub-category. The overall score for a category is the average of all sub-category scores, based on a scale that ranges from 0 to 5 rounded up to the nearest whole number. The overall score for each category is then used to generate the size of the bar in the Company Quality graphic.

People

At the end of the day, people drive profits. Not numbers. Understanding the motivations of people behind a business is a significant part of understanding the long-term drive of the company. It all comes down to doing business with people you trust, or at least avoiding dealing with people of questionable character.

The People rating is based on quantitative scores in seven categories:

- Passion, Execution, Capital Allocation, Communication, Compensation, Ownership, and Board.

Business

If you don't understand the competitive environment and don't have a clear sense of how the business will engage customers, create value and consistently deliver that value at a profit, you won't succeed as an investor. Knowing the business model inside out will provide you some level of certainty and reduce the risk when you buy a stock.

The Business rating is based on quantitative scores grouped into five sub-categories:

- Business Scalability, Market Structure, Value Proposition, Economic Moat, and Operational Risks.

Financials

Investing is part art, part science. Financial ratios make up most of the science. Ratios are used to evaluate the financial soundness of a business. Also, these ratios are key factors that will impact a company's financial performance and valuation. However, you only need a few to determine whether a company is financially strong or weak.

The Financial rating is based on quantitative scores that are grouped into five separate categories:

- Earnings Power, Profit Margin, Growth Rate, Financial Health, and Earnings Quality.

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CONFLICT OF INTERESTS

Henrik Alveskog owns shares in the company : No

Fredrik Nilsson 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.