

Railcare Group

Sector: Industrial Goods & Services

New record sales level

Redeye remains confident on the case as Railcare showed surprisingly strong sales growth of 24% in Q2. Earnings only saw a modest improvement due to losses in the UK, which is running at unsustainably poor levels. Swedish operations continue to look very promising and with the new leasing company AC Finance, Railcare is in a better position to gain further large business deals. We have raised our top-line estimates somewhat and our valuation is inching a little higher with a Base case fair value ~SEK34 per share (previously: SEK33).

Q2 – Sweden 👍 while UK 🙄

Net sales amounted to SEK180m, which is 24% higher Y/Y and clearly above our forecast. EBIT of SEK16m is a little higher Y/Y but we expected more. The main deviation is within the UK operations which posted a SEK4m loss due to very low sales. The two large business units, Contracting Sweden and Transport Scandinavia, both showed strong growth and solid margins around 10%. And the outlook for Railcare's core businesses in Sweden remains bright. Contracting Sweden was particularly encouraging as it had a record quarter in terms of sales and earnings. In Q2 Railcare carried out a major assignment involving several subcontractors which was highly successful. And the ambition is to continue on this path, when conditions allow.

Securing access to locomotives

Railcare recently announced its plan to be a 40% owner and copartner in AC Finance AB, a newly started locomotive leasing company. The companies have signed a lease agreement for nine locomotives that will enable Railcare to deliver on the large contract with Trafikverket, for standby locomotives (revenues ~SEK400m over five years). For Railcare this is a strategically important move. Short term, it will secure access to locomotives that meet Trafikverket's requirements. And in the longer term, it will improve the chances to win new assignments.

Valuation inching higher

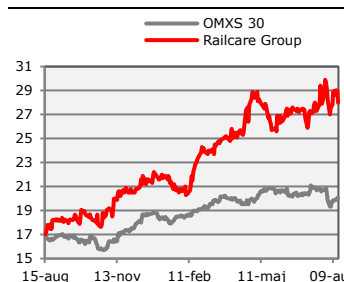
Following the Q2 report we are again raising our growth forecasts for 2024-26e. We expect margins just over 12% but a little lower in 2024 due to losses in the UK. Our valuation is inching up, supported by a higher growth trajectory. With a Base case fair value ~SEK34 per share, we still see a decent potential from current share price levels.

Key Financials (SEKm)	2022	2023	2024e	2025e	2026e
Net sales	497	564	659	773	899
Sales growth	13%	14%	17%	17%	16%
EBITDA	95	112	123	154	171
EBIT	52	68	72	97	112
EBIT Margin (%)	11%	12%	11%	13%	12%
Net Income	37	44	48	70	83
EV/Sales	1.2	1.1	1.2	1.0	0.9
EV/EBITDA	6.5	5.9	6.5	5.2	4.7
EV/EBIT	11.7	9.7	11.1	8.3	7.1

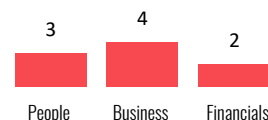
FAIR VALUE RANGE

BEAR	BASE	BULL
21.0	34.0	43.0

RAIL.ST VERSUS OMXS30



REDEYE RATING



KEY STATS

Ticker	RAIL.ST
Market	Nasdaq
Share Price (SEK)	27.2
Market Cap (MSEK)	656
Net Debt 24E (MSEK)	124
Free Float	60%
Avg. daily volume ('000)	15

ANALYSTS

Henrik Alveskog
henrik.alveskog@redeye.se
 Fredrik Nilsson
fredrik.nilsson@redeye.se

Q2 in brief

Railcare: Actual vs. Expectations

SEKm	Q2 2023	Q2 2024 Actual	Q2 2024e	Diff
Net sales	144.7	179.8	160.0	12%
EBIT	14.9	15.8	19.8	-20%
Pre Tax Profit	12.7	12.6	17.4	-28%
Sales growth Y/Y	14%	24%	11%	
EBIT margin	10.3%	8.8%	12.4%	

Source: Railcare, Redeye Research

Contracting Sweden had a record quarter in terms of sales and earnings. This is to a large extent thanks to the successful completion of a major assignment where Railcare engaged subcontractors. Hence somewhat diluted margins, but still at 10%.

Contracting Abroad's sales hit a new low point resulting in a sizeable deficit. The new control period in the UK started in April and assignments in Q2 were obviously very few. Railcare is in discussions with Network Rail as the current situation is clearly not sustainable.

Transport Scandinavia posted sales growth of 16% and some improvement in profits Y/Y. We expect a strong H2'24 as the majority of track replacements are scheduled for Q3 and the locomotive workshop has a good pipeline of new assignments.

Machines and Technology remains on plan to commission the MPV2 and get it operational during 2024, following approval from The Swedish Transport Agency. No external sales were recorded in Q2, but according to management, the company is stepping up its sales efforts regarding the MPV as well as Railvacs.

On group level sales grew by an astounding 24% Y/Y with EBIT margins around 9%. Trailing 12 months, top-line has grown 16% with EBIT margins just above 11%.

Segments by quarter

SEKm	Q1'23	Q2'23	Q3'23	Q4'23	Q1'24	Q2'24
Contracting Sweden						
Net sales	41	58	58	60	47	89
PTP	2	5	6	5	1	9
PTP margin	4%	8%	10%	9%	1%	10%
Contracting Abroad						
Net sales	13	5	6	8	9	2
PTP	2	-1	-1	-2	1	-4
Profit margin	neg	neg	neg	neg	8%	neg
Transport Scandinavia						
Net sales	68	82	97	92	82	96
PTP	7	9	18	13	10	10
Profit margin	10%	11%	18%	14%	12%	10%
Machines and Technology						
Net sales	18	18	24	21	24	13
PTP	1	1	1	-2	1	-1
Profit margin	5%	8%	3%	neg	3%	neg
Group sales:	111	145	159	149	129	180
Growth Y/Y	17%	14%	9%	17%	17%	24%
Growth, TTM	15%	10%	8%	14%	14%	16%
EBIT	13	15	27	13	14	16
EBIT-margin	12%	10%	17%	9%	11%	9%
EBIT margin TTM	11.1%	11.1%	11.3%	12.1%	11.8%	11.3%

Source: Railcare, Redeye Research

Financial forecasts

Raising our top-line forecasts

Following the Q2 report and other recent events we are again raising our growth forecasts for 2024-26e. We expect margins just over 12% but a little lower in 2024 due to losses in the UK.

Railcare: Estimate changes			
SEKm	2024e	2025e	2026e
Net sales			
Old	636	741	854
New	659	773	899
% change	4%	4%	5%
EBIT			
Old	79	93	109
New	72	97	112
margin	10.9%	12.5%	12.5%

Source: Redeye Research

Contracting Sweden has a solid market position and demand for contracting services as well as relining remain high. With the new ambition of taking on larger projects and involving subcontractors, top-line forecasts are now more unpredictable. We have raised our sales forecasts and expect margins ~10%, which is a little lower than previously.

Contracting Abroad (UK) is still facing major near-term uncertainty and our expectations remain quite low. We are not ruling out a termination of UK operations, but it would not have any material impact on our valuation.

Transport Scandinavia is the segment with the most obvious growth opportunities within transports as well as locomotive workshop services. With the leasing company AC Finance in place, we see good prospects for long-term growth. 2025-26 will be highly supported by the new contract for standby locomotives. We expect margins to remain just over 10%.

Machines and Technology has the potential to offer significant leverage to the groups' margins from machine and system sales to external customers. Our forecasts include some, but still rather modest success, in 2025 and forward.

Forecasts per segment						
SEKm	2021	2022	2023	2024e	2025e	2026e
<u>Contracting Sweden</u>						
Net sales	131	186	217	266	279	293
Wherof leasing operators to UK	-	-	23	23	23	24
PTP	8	21	17	23	26	28
Margin (net of UK leasing revenues)	6%	11%	9%	10%	10%	10%
<u>Contracting Abroad</u>						
Net sales	48	36	32	25	28	31
PTP	4	-9	-3	-6	0	2
Margin	8%	-25%	-8%	-24%	0%	5%
<u>Transport Scandinavia</u>						
Net sales	274	279	340	390	456	525
PTP	39	28	46	44	50	58
Margin	14%	10%	14%	11%	11%	11%
<u>Machines and Technology</u>						
Net sales	37	88	81	80	120	160
PTP	1	8	1	1	12	19
Margin	2%	9%	1%	2%	10%	12%
Group net sales	438	497	564	659	773	899
EBIT	56	52	68	72	97	112
Sales growth, Y/Y	9%	13%	14%	17%	17%	16%
EBIT margin	12.8%	10.5%	12.0%	10.9%	12.5%	12.5%

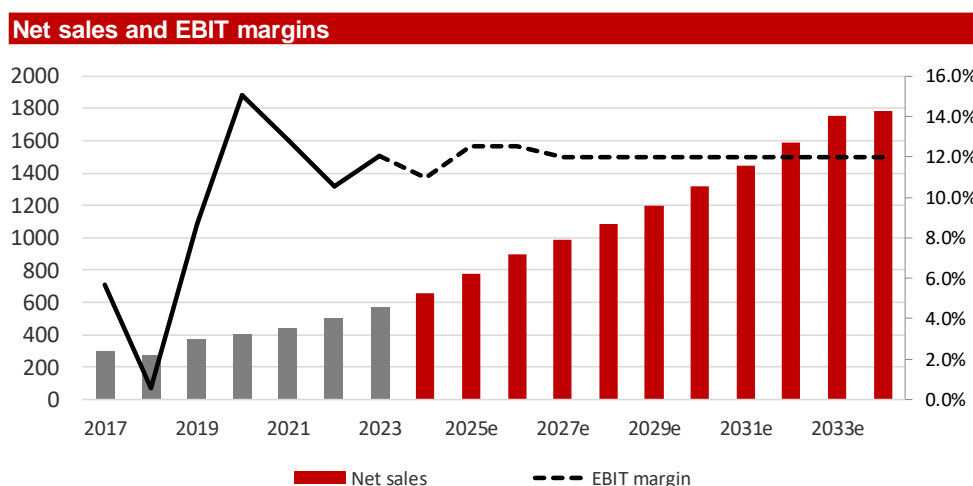
Source: Railcare, Redeye Research

Long-term assumptions, years 2027-33

No changes have been made to our long-term assumptions in terms of growth and EBIT margins. Railcare's target is to reach sales of SEK 1 billion by 2027, which concurs with our forecasts. As for EBIT margins we believe the 13% target is fair, but we are still slightly more cautious at this point. Our long-term assumptions are:

- 10% annual growth
- 12% EBIT margins
- 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 close to SEK1.8bn.



Source: Railcare, Redeye Research

Railcare presented new and more ambitious financial targets in February this year. They now target SEK 1 billion in sales and at least 13% EBIT margin by 2027. Previous targets for 2027 were SEK 800 million in sales and over 10% EBIT margin. So, the bar has been raised quite significantly and signals a higher ambition and confidence in their growth strategy. Although the new targets are challenging, we think they are backed by good market opportunities and not least, Railcare's own track record of profitable growth. New long-term transportation contracts are likely required in order to meet the new growth target. And as for the margin target, a revival of machine sales would be highly supportive. We expect to see progress in both areas.

Valuation

Fair value:
~SEK 34 per share

Our cash flow model indicates a fair enterprise value just below SEK 1 billion. After deducting net debt, we arrive at a fair equity value just above SEK 800m, or ~SEK 34 per share (SEK 33 previously). Assumptions for our Base case scenario and valuation remain the same and are summarized in the table below.

Railcare: Base case			
Assumptions	2027-33e	DCF-value	
CAGR	10%	WACC	10.0%
EBIT margin	12%	NPV FCF 2024-32	298
ROIC (avg)	17%	NPV FCF Terminal	697
		Total (EV)	995
		Net debt	168
Terminal			
Net sales 2034 (SEKm)	1 786		
Growth FCF	2%	Fair value	827
EBIT margin	12%	Fair value per share	34.3
EV/S Exit multiple	1.0	Share price	27.2
EV/EBIT Exit multiple	8.3	Potential	26%

Source: Redeye Research

Forward looking multiples remain attractive

Based on our estimates, 2024e multiples are quite in line with previous years. With a rather stable business and continued good outlook, we still find forward looking multiples rather attractive. 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.

Railcare: Valuation multiples						
	2021	2022	2023	2024e	2025e	2026e
P/E	13.3	13.1	12.3	14.1	9.8	10.1
EV/EBIT	11.8	11.7	9.7	11.1	8.4	7.2
EV/EBITDA	6.6	7.1	7.4	7.1	5.7	5.1
P/S	1.2	1.2	1.1	1.2	1.0	0.8
Share price	22.4	20.5	21.8	27.2	27.2	27.2

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 Railcare can improve its manufacturing process. Growth driven by machine sales should also drive margins. Assumptions for our Bull case:

- CAGR 2023-33: ~13%, taking sales to ~SEK 2 billion in 2033.
- Sustainable EBIT margins of 13%.
- Bull case fair value around **SEK 43 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 2024-33: ~6% taking sales to ~SEK 1 billion in 2033.
- Sustainable EBIT margins of 10%.
- Bear case fair value around **SEK 21 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 in export sales 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 SEK1000m by 2027, corresponding to a CAGR ~15%.

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 improved since and we were encouraged to see the company raising its own target from 10% to 13%. 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.

	2023	2024e	2025e	2026e
INCOME STATEMENT				
Net sales	564	659	773	899
Cost of Revenues	230	279	294	341
Gross Profit	352	391	479	557
Operating Expenses	240	268	326	386
EBITDA	112	123	154	171
Depreciation & Amortization	44	51	57	62
EBIT	68	72	97	112
Net Financial Items	-11	-12	-10	-8
EBT	57	60	87	104
Income Tax Expenses	14	12	17	21
Non-Controlling Interest	0	0	0	0
Net Income	44	48	70	83

BALANCE SHEET

Assets				
Current assets				
Cash & Equivalents	39	45	41	47
Inventories	36	40	54	63
Accounts Receivable	57	66	70	72
Other Current Assets	36	40	46	72
Total Current Assets	168	190	211	254
Non-current assets				
Property, Plant & Equipment, Net	405	440	486	545
Goodwill	6	6	6	6
Intangible Assets	4	1	-3	-8
Right-of-Use Assets	55	51	51	33
Shares in Associates	0	0	0	0
Other Long-Term Assets	5	5	5	5
Total Non-Current Assets	475	502	544	580
Total Assets	643	692	755	834
Liabilities				
Current liabilities				
Short-Term Debt	85	95	95	95
Short-Term Lease Liabilities	12	12	12	12
Accounts Payable	48	46	54	63
Other Current Liabilities	54	63	65	77
Total Current Liabilities	198	216	226	247
Non-current liabilities				
Long-Term Debt	74	74	74	74
Long-Term Lease Liabilities	37	37	37	37
Other Long-Term Liabilities	60	60	60	60
Total Non-current Liabilities	171	171	171	171
Non-Controlling Interest	0	0	0	0
Shareholder's Equity	274	305	358	417
Total Liabilities & Equity	643	692	755	834

CASH FLOW

NOPAT	84	87	116	135
Change in Working Capital	8	-8	-15	-16
Operating Cash Flow	102	91	112	128
Capital Expenditures	-57	-61	-77	-90
Investment in Intangible Assets	-3	-3	-7	-8
Investing Cash Flow	-61	-79	-99	-97
Financing Cash Flow	-34	-7	-17	-24
Free Cash Flow	41	27	28	31

DCF Valuation Metrics	Sum FCF (SEKm)			
Initial Period (2024–2026)	41			
Momentum period (2026-32)	258			
Stable period (2033-)	697			
Firm Value	996			
Net Debt (last quarter)	168			
Equity Value	828			
Fair Value per Share	34.3			

	2023	2024e	2025e	2026e
CAPITAL STRUCTURE				
Equity Ratio	0.4	0.4	0.5	0.5
Debt to equity	0.6	0.6	0.5	0.4
Net Debt	120	124	128	122
Capital Employed	445	476	529	587
Working Capital Turnover	36.2	27.8	20.1	16.4

GROWTH				
Revenue Growth	14%	15%	15%	16%
Basic EPS Growth	18%	10%	45%	19%
Adjusted Basic EPS Growth	18%	10%	45%	19%

PROFITABILITY				
ROE	17%	17%	21%	21%
ROCE	15%	15%	18%	19%
ROIC	20%	19%	23%	24%
EBITDA Margin (%)	20%	19%	20%	19%
EBIT Margin (%)	12%	11%	13%	12%
Net Income Margin (%)	8%	7%	9%	9%

VALUATION				
Basic EPS	1.8	2.0	2.9	3.4
Adjusted Basic EPS	1.8	2.0	2.9	3.4
P/E	12.3	14.1	9.7	8.1
EV/Revenue	1.1	1.2	1.0	0.9
EV/EBITDA	5.9	6.5	5.2	4.7
EV/EBIT	9.7	11.1	8.3	7.1
P/B	2.0	2.2	1.9	1.6

SHAREHOLDER STRUCTURE	CAPITAL %	VOTES %
Norman Invest AB	29.5%	29.5%
TREAC Aktiebolag	9.9%	9.9%
Avanza Pension	3.3%	3.3%
Bernt Larsson	3.1%	3.1%
Canaccord Genuity Wealth Management	2.5%	2.5%

SHARE INFORMATION	
Reuters code	RAIL.ST
List	Nasdaq Smallcap
Share price	27.2
Total shares, million	24.1

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

ANALYSTS	
Henrik Alveskog	Redeye AB
Fredrik Nilsson	Mäster Samuelsgatan 42, 10tr 111 57 Stockholm

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.

Redeye Equity Research team

Management

Björn Fahlén

bjorn.fahlen@redeye.se

Tomas Otterbeck

tomas.otterbeck@redeye.se

Technology Team

Hjalmar Ahlberg

hjalmar.ahlberg@redeye.se

Henrik Alveskog

henrik.alveskog@redeye.se

Jessica Grünwald

jessica.grunwald@redeye.se

Jesper von Koch

jesper.vonkoch@redeye.se

Anton Hoof

anton.hoof@redeye.se

Rasmus Jacobsson

rasmus.jacobsson@redeye.se

Fredrik Nilsson

fredrik.nilsson@redeye.se

Mattias Ehrenborg

mattias.ehrenborg@redeye.se

Niklas Sävås

niklas.savas@redeye.se

Fredrik Reuterhäll

fredrik.reuterhall@redeye.se

Life Science Team

Oscar Bergman

oscar.bergman@redeye.se

Christian Binder

christian.binder@redeye.se

Filip Einarsson

filip.einarsson@redeye.se

Mats Hyttinge

mats.hyttinge@redeye.se

Martin Wahlström

martin.wahlstrom@redeye.se

John Westborg

john.westborg@redeye.se

Gustaf Meyer

gustaf.meyer@redeye.se

Richard Ramanius

richard.ramanius@redeye.se

Kevin Sule

kevin.sule@redeye.se

Fredrik Thor

fredrik.thor@redeye.se

Johan Unnerus

johan.unnerus@redeye.se

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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 services for the Company and receives compensation from the Company in connection with this.