

Railcare Group

Sector: Industrial Goods & Services

Targeting double digit grow rate

Redeye was hoping for a stronger finish to 2022 in terms of earnings. The dip in Q4 is however most likely very temporary. We find Railcare's new financial sales target to be ambitious and realistic and quite in line with our mid-term assumptions. Our forecasts and valuation remain virtually unchanged.

Air pocket in Q4

Net sales of SEK128m was on par with last year and in line with our estimates. EBIT of SEK7m was however significantly lower, particularly within Transport Scandinavia. The rapid cost increases last fall weighed on Q4 earnings. Price cost adjustments in the Kaunis contract are made each year, so margins should recover quickly.

Contracting Sweden had a solid quarter, supported by exceptional growth within business unit reling, which is looking increasingly promising.

Contracting Abroad has reorganized its UK operations. It now has a more flexible cost structure with a lower break-even point. This resulted in one-off costs of SEK3m in Q4.

New financial target: sales SEK800m by 2027

Railcare's new sales target is 60% higher than 2022 and corresponds to ~10% CAGR in the next five years. Annual growth in the past five years has been around 10% and we find the new target to be very realistic. In fact, it's very close to Redeye's forecasts.

Railcare has ambitions to grow within all its segments. The new green industries being established in northern Sweden, will be a major driver for expansion, particularly within transport services. More stringent requirements authorities and customers to reduce emissions will also offer new business opportunities, not least related to the MPVe.

Railcare's 10% EBIT margin target is unchanged and looks a bit defensive to us. We believe the reason is that high margin machine export sales are unpredictable and Railcare doesn't want to rely on these to achieve its targets. In our view this is fair, while we still expect average EBIT margins around 12%.

Minor changes to forecasts and valuation

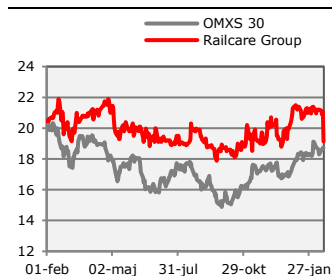
We are only making very small adjustments to our forecasts and valuation. Our valuation range: SEK17-37 and Base case fair value ~SEK28 per share are virtually unchanged.

Key Financials (SEKm)	2021	2022	2023e	2024e	2025e
Net sales	438	497	525	592	651
Sales growth	9%	13%	6%	13%	10%
EBITDA	108	95	114	124	137
EBIT	56	52	65	72	80
EBIT Margin (%)	13%	11%	12%	12%	12%
Net Income	40	37	46	52	60
EV/Sales	1.5	1.2	1.1	1.0	0.9
EV/EBITDA	6.1	6.5	5.2	4.9	4.3
EV/EBIT	11.9	11.8	9.2	8.4	7.4

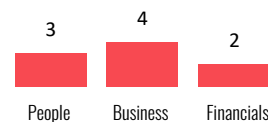
FAIR VALUE RANGE

BEAR	BASE	BULL
17.0	28.0	37.0

RAIL.ST VERSUS OMXS30



REDEYE RATING



KEY STATS

Ticker	RAIL.ST
Market	Nasdaq
Share Price (SEK)	19.0
Market Cap (MSEK)	458
Net Debt 23E (MSEK)	123
Free Float	60%
Avg. daily volume ('000)	15

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Q4 highlights

Railcare: Actual vs. Expectations

SEKm	Q4 2021	Q4 2022	Q4 2022e	Diff
		Actual		
Net sales	131.8	128.0	127.0	1%
EBIT *	22.1	9.7	19.5	-51%
EBIT	24.7	6.7	16.5	-60%
Pre Tax Profit	23.2	4.8	15.0	-68%
Sales growth Y/Y	38%	-3%	-4%	
EBIT *	17%	8%	15%	
EBIT margin	19%	5%	13%	

* Adjusted for one-off items

Source: Railcare, Redeye Research

Contracting Sweden's volumes were a bit lower in construction work related to Railvac services. Relining of culverts on the other hand, was exceptionally strong. 2022 was a new record level for relining and the future looks very promising.

Contracting Abroad had a rather slow quarter, while earnings were charged with SEK3m related to the reorganization. Railcare now has a more flexible set-up with lower fixed costs. Volumes still need to improve, and the company is seeking better traction through selected railway partners in the UK.

Transport Scandinavia posted rather weak earnings which is the main reason for the Q4 deviation on group level. High cost inflation during 2022 has squeezed margins in the Kaunis contract which is subject to cost adjustments annually. Activity and order intake for the locomotive workshop remained high with several large projects ongoing.

Machines and Technology recorded no major deliveries of machines during the quarter.

Segments by quarter

SEKm	Q2'21	Q3'21	Q4'21	Q1'22	Q2'22	Q3'22	Q4'22
Contracting Sweden							
Net sales	24	36	40	37	52	49	48
PTP	-7	7	7	5	5	6	5
PTP margin	-30%	19%	16%	13%	10%	13%	10%
Contracting Abroad							
Net sales	10	6	14	11	5	10	10
PTP	-2	-3	5 *	-1	-5	0	-3.3 *
Profit margin	-24%	-47%	n.m.	-7%	-100%	-1%	n.m.
Transport Scandinavia							
Net sales	52	89	85	43	73	88	75
PTP	5	17	14	0	11	14	4
Profit margin	9%	19%	16%	0%	15%	15%	5%
Machines and Technology							
Net sales	20	6	7	22	23	24	19
PTP	3	0	-1	3	2	3	1
Profit margin	14%	-1%	-13%	13%	7%	11%	3%
Group sales:	91	126	132	95	127	146	128
Growth Y/Y	-14%	34%	38%	7%	40%	16%	-3%
Growth, TTM	-9%	1%	9%	16%	30%	25%	13%
EBIT	-2	25	25	9	13	24	7
EBIT-margin	-3%	20%	19%	9%	10%	16%	5%
EBIT margin TTM	9%	11%	13%	13%	15%	14%	11%

* Including capital gains of SEK2.6m in Q4 2021 and one-off costs of SEK3m in Q4 2022.

Source: Railcare, Redeye Research

Financial forecasts

New sales target:
SEK800m by 2027

On group level we are now only making minor adjustments to our forecasts. Declining profitability in Q4 is mainly due to cost increases that will be compensated for going forward. Railcare's new sales target for 2027 corresponds to ~10% CAGR, which is in line with the last three years. The company's EBIT margin target of 10% is unchanged and doesn't look to challenging or ambitious, considering the 2020-22 average EBIT margins of 13%. Railcare sees future growth to a large extent coming from the transport business. Long-term contracts give predictable revenues but probably slightly dilutive margins. We are still assuming future EBIT margins around 12%, as we include a fair amount of success from sales of MPVs and Railvac systems where margins should be significantly higher.

Contracting Sweden's market outlook seems stable with extensive maintenance projects planned for the Swedish railway. Also, the relining business looks very promising and is now making meaningful contributions to sales and earnings. Relining still has a large untapped market potential and as far as we understand good margins. Our forecasts assume further growth and EBIT margins ~12%, which is in line with five-year average since 2017.

Contracting Abroad has been struggling with declining volumes in the last few years. At least it now has a more flexible cost structure, with a lower break-even point. Hopefully the new approach with railway partners in the UK will help bring in more business. We think chances for a turnaround are quite good, but we are not totally convinced.

Transport Scandinavia will certainly continue to grow as Railcare's ambition is to be an active partner to the new green industries in northern Sweden. This includes transports as well as services offered by the locomotive workshop. EBIT margins of 13-14% in 2020-21 were rather impressive showing the potential in really good times. Last year's 10% is maybe more realistic going forward, even if margins were squeezed by the exceptionally high cost increases. The LKAB contract expired by year-end, but we expect it to be renewed in 2023.

Machines and Technology is the segment we believe has the greatest future potential, given a strong and unique product range. Our forecasts include some but rather modest success in the next few years as the orderbook is still empty and the track record in recent years is weak.

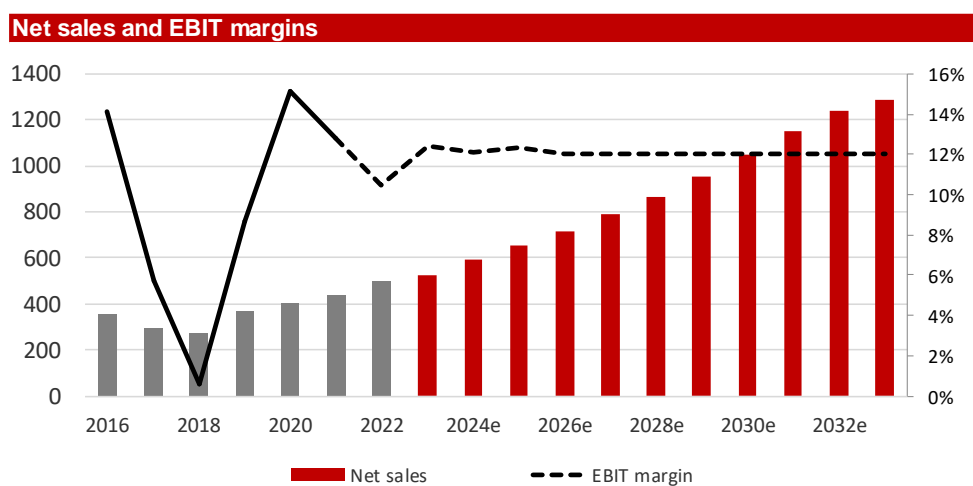
Forecasts per segment						
SEKm	2020	2021	2022	2023e	2024e	2025e
Contracting Sweden						
Net sales	159	131	186	194	203	213
PTP	18	8	21	23	24	26
Margin	11%	6%	11%	12%	12%	12%
Contracting Abroad						
Net sales	60	48	36	44	48	53
PTP	2	4	-9	0	1	2
Margin	3%	8%	-25%	0%	3%	3%
Transport Scandinavia						
Net sales	184	274	279	288	311	342
PTP	24	39	28	29	31	34
Margin	13%	14%	10%	10%	10%	10%
Machines and Technology						
Net sales	83	37	88	100	130	160
PTP	11	1	8	8	10	16
Margin	14%	2%	9%	8%	8%	10%
Group net sales	401	438	497	525	592	651
EBIT	61	56	52	65	72	80
Sales growth, Y/Y	8%	9%	13%	6%	13%	10%
EBIT margin	15%	13%	11%	12%	12%	12%

Source: Railcare, Redeye Research

Long-term assumptions, years 2026-32:

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

In the period up until 2032 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 a little over SEK1.2bn.



Source: Railcare, Redeye Research

Valuation

Fair value:
~SEK 28 per share

Our cash flow model indicates a fair enterprise value around SEK 800m. After deducting net debt, we arrive at a fair equity value of SEK 666m, or **SEK ~28 per share** (basically unchanged vs previously). This suggests a rather appealing potential of almost 50% 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	281
ROIC (avg)	17%	NPV FCF Terminal	519
		Total (EV)	799
		Net debt	133
Terminal			
Net sales 2033 (SEKm)	1 285		
Growth FCF	2%	Fair value	666
EBIT margin	12%	Fair value per share	27.6
EV/S Exit multiple	1.1	Share price	19
EV/EBIT Exit multiple	9.5	Potential	45%

Source: Redeye Research

Multiples increasingly attractive

Based on our estimates Railcare is still 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	13.2	10.0	8.9	7.6
EV/EBIT	11.6	11.8	11.8	9.2	8.4	7.4
EV/EBITDA	6.7	6.6	6.8	5.6	5.2	4.7
P/S	1.4	1.2	1.2	1.1	1.0	0.9
Share price	23.3	22.4	19.0	19.0	19.0	19.0

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 2023-32: ~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: A general update of our rating model has caused minor changes.

People: 3

Management is very active in daily operations and have extensive experience from the railroad industry. However, Mattias Remahl is newly appointed 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.

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	525	592	651
Cost of Revenues	193	194	213	234
Gross Profit	304	331	379	417
Operating Expenses	209	216	255	280
EBITDA	95	114	124	137
Depreciation & Amortization	43	48	52	57
EBIT	52	65	72	80
Net Financial Items	-5	-6	-5	-4
EBT	47	59	66	76
Income Tax Expenses	10	13	14	16
Non-Controlling Interest	0	0	0	0
Net Income	37	46	52	60

BALANCE SHEET

Assets				
Current assets				
Cash & Equivalents	32	21	13	22
Inventories	32	37	41	46
Accounts Receivable	41	47	53	59
Other Current Assets	37	37	41	46
Total Current Assets	142	141	149	171
Non-current assets				
Property, Plant & Equipment, Net	383	419	459	503
Goodwill	6	6	6	6
Intangible Assets	2	5	8	11
Right-of-Use Assets	55	46	37	14
Shares in Associates	0	0	0	0
Other Long-Term Assets	5	5	5	5
Total Non-Current Assets	451	480	515	540
Total Assets	593	622	664	711
Liabilities				
Current liabilities				
Short-Term Debt	64	54	54	54
Short-Term Lease Liabilities	11	11	11	11
Accounts Payable	34	37	41	46
Other Current Liabilities	42	46	47	49
Total Current Liabilities	151	147	153	159
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	276	312	354
Total Liabilities & Equity	593	622	664	711

CASH FLOW

NOPAT	64	79	87	97
Change in Working Capital	-19	-4	-9	-8
Operating Cash Flow	68	91	94	109
Capital Expenditures	-50	-58	-65	-72
Investment in Intangible Assets	-5	-8	-9	-10
Investing Cash Flow	-67	-78	-86	-81
Financing Cash Flow	-8	-24	-16	-18
Free Cash Flow	13	25	20	27

DCF Valuation Metrics

	Sum FCF (SEKm)			
Initial Period (2023–2025)	44			
Momentum Period (2026–2028)	237			
Stable Period (2029–)	519			
Firm Value	800			
Net Debt (last quarter)	133			
Equity Value	667			
Fair Value per Share	27.7			

	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	134	142	133
Capital Employed	442	474	510	552
Working Capital Turnover	21.3	19.2	16.1	14.5

GROWTH

Revenue Growth	13%	6%	13%	10%
Basic EPS Growth	-10%	27%	12%	16%
Adjusted Basic EPS Growth	-10%	27%	12%	16%

PROFITABILITY

ROE	16%	18%	18%	18%
ROIC	12%	14%	14%	15%
ROCE	16%	18%	18%	18%
EBITDA Margin (%)	19%	22%	21%	21%
EBIT Margin (%)	11%	12%	12%	12%
Net Income Margin (%)	7%	9%	9%	9%

VALUATION

Basic EPS	1.5	1.9	2.2	2.5
Adjusted Basic EPS	1.5	1.9	2.2	2.5
P/E	13.2	10.0	8.9	7.6
EV/Revenue	1.2	1.1	1.0	0.9
EV/EBITDA	6.5	5.2	4.9	4.3
EV/EBIT	11.8	9.2	8.4	7.4
P/B	2.0	1.7	1.5	1.3

SHAREHOLDER STRUCTURE

	CAPITAL %	VOTES %
Norra Västerbotten Fastighets AB	29.5%	29.5%
TREAC Aktieföretag	10.0%	10.0%
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	19.0
Total shares, million	24.1

MANAGEMENT & BOARD

CEO	Mattias Remahl
CFO	Mattias Remahl
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.