REDEYE

Update

Equity Research

27 December 2019

Sensys Gatso Group

Sector: Information Technology

Good things come to those who wait

Fortifying the long-term TRaaS position …

Sensys Gatso continues to fortify its long-term TRaaS (traffic enforcement as-a-service) position, in a strategic manner. The vast majority of the recent contracts consists of recurring TRaaS revenue, as we will outline in more detail below. About two thirds of all announced contracts YTD and their combined order values (~SEK 280m) have been related to TRaaS. This will eventually create a strong, lower risk business, with stable, high margins, resulting in a higher stock multiple.

… But weaker short-term earnings

On the flipside, however, short-term figures have taken, and will take, a hit, as service transformations are hammock shaped (tail heavy) by nature. Hence, our headline. Our major EBIT miss (SEK -18m vs. estimated +13m) is due to slower delivery than expected for several larger programs. These contracts have not been cancelled, meaning the large order book is still fully intact. Moreover, we believe there is a strong product/market fit for several of the newer areas, e.g. enforcement of uninsured vehicles, school zones, distracted driving and stationery in-vehicle systems. Consequently, we see solid potential for additional orders.

The market is speculating around another rights issue

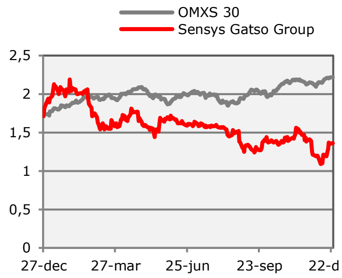
In essence, we have overestimated the short term and underestimated the long term. Thus, we need to lower our short-term estimates, but since we are more positive in the longer run, given the solid TRaaS order intake, our base case only drops from SEK 1.8 to 1.7. The rest of our fair value range is unchanged, i.e. our bear and bull case are SEK 1.0 and 3.4. Shares have traded down after each report in 2019 and are now down -25% YTD. Q3 is the fourth quarter in a row where we had too high expectations and the third quarter in the losing streak, summing the YTD operating loss to SEK -38m. We think there is a lot of speculation around capital raising, where the market extrapolates the YTD 2019 losses into the future. The speculations are understandable as cash are down to 34m, incl. 46m used from the credit facilities. We have not included any new capital raising in our estimates. However, in order for the company to avoid another rights issue, we believe it needs to speed up the deliveries from the order book and win some larger system orders that can feed the company while the TRaaS programs ramp.

KEY FINANCIALS (SEKm)	2017	2018	2019E	2020E	2021E	2022E
Net sales	293	383	364	464	580	635
EBITDA	-16	37	10	37	103	135
EBIT	-55	1	-44	-1	68	99
EPS (adj.)	-0.1	0.0	0.0	0.0	0.1	0.1
EV/Sales	4.5	4.0	3.3	2.6	2.0	1.7
EV/EBITDA	-83.0	41.3	124.6	32.2	11.2	8.0
EV/EBIT	-24.0	2627.4	-27.0	-1244.7	17.0	10.9
P/E	-23.5	-341.2	-29.1	-417.7	23.2	15.4

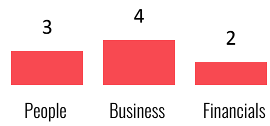
FAIR VALUE RANGE

BEAR	BASE	BULL
1.0	1.7	3.4

SENS.ST VERSUS OMXS30



REDEYE RATING



KEY STATS

Ticker	SENS.ST
Market	Small Cap
Share Price (SEK)	1.4
Market Cap (MSEK)	1170
Net Debt 19E (MSEK)	24
Free Float	82 %
Avg. daily volume ('000)	1000

ANALYSTS

Viktor Westman
viktor.westman@redeye.se
Eddie Palmgren
eddie.palmgren@redeye.se

Important information: All information regarding limitation of liability and potential conflicts of interest can be found at the end of the report
Redeye, Mäster Samuelsgatan 42, 10tr, Box 7141, 103 87 Stockholm. Tel. +46 8-545 013 30, E-post: info@redeye.se

Good things come to those who wait

As described above, the TRaaS strategy is playing out better than expected, which comes at the cost of lower short-term earnings. In essence, this means that we have overestimated the short term and underestimated the long term. Moreover, the three entirely new programs mentioned in Q2 (Australia, Netherlands & Oklahoma) are still in ramp-up phase. In our view, there seems to be delays here, in relation to the timeline in the respective press release. One important piece of information in Q3 was the average development, delivery and deployment of 20 months for these kinds of brand-new solutions, (e.g. Oklahoma or the Dutch point-to-point program).

For "Repeat Solutions", like adding speed and red light contracts in new US cities, the average implementation time is 10 months. When the Oklahoma solution is sold in another state it becomes a Repeat Solution. As mentioned in our last update, the first program with a new solution is costly, but when it is up and running, it can basically be copied to other customers. Sensys Gatso says it is able to handle one new kind of program without negative earnings effects, but three simultaneous ones, like in Q3, is in general a bit too much. In other words, several new programs at the same time will suppress margins. By the same logic, a period of fewer new programs, like in 2017, will lead to higher margins.

TRaaS has become a significant majority of new business

The TRaaS strategy has worked out well, as TRaaS is a significant part of the new contracts of 2019 (see the table below). About two thirds of all contracts and the order value YTD (~SEK 280m) have been related to TRaaS.

Announced new contracts in 2019: TRaaS & non-TRaaS

Geography	Type of appl.	TRaaS	Value (SEKm)	Exp. delivery*
TRaaS				
Austalia	Maint. of in-vehicle	Yes	22	6 yrs
New York, US	Red light	Yes, Man.Serv.	12	5 yrs
Iowa, US	Speed	Yes, Man.Serv.	6	5 yrs
Maryland, US	Red light, school, parking	Yes, Man.Serv.	44	5 yrs
Iowa, US	Red light & speed	Yes, Man.Serv.	19	3 yrs
Colombia	Red light, speed & bus	Yes, 30% of 9m	3	5 yrs
Colombia	Red light & speed	Yes, 30% of 10m	3	5 yrs
New York,US	School zone	Yes, Man.Serv.	30	3 yrs
Iowa, US	Speed	Yes, Man.Serv.	20	5 yrs
Iowa, US	Speed	Yes, Man.Serv.	6	5 yrs
Australia	Maint. of in-vehicle	Yes, 100%	55	6 yrs
Australia	Maint. of fixed systems	Yes, 100%	60	3 yrs
Total			**280**	**5 yrs**
non-TRaaS				
Australia	ANPR	No	7	Q4'19
Australia	In-vehicle	Yes (separate TRaaS order)	46	Q4'19
Colombia	Red light, speed & bus	Yes, 70% non-TRaaS of 9m	6	H2'19
Colombia	Red light & speed	Yes, 70% non-TRaaS of 10m	7	H2'19
France	In-vehicle	No	16	H2'19
UAE	Red light & speed	No	12	Q1'20
UAE	Red light & speed	No	8	Q1'20
Australia	In-vehicle	Yes (separate TRaaS order)	52	Until Q1'21
Total			**154**	

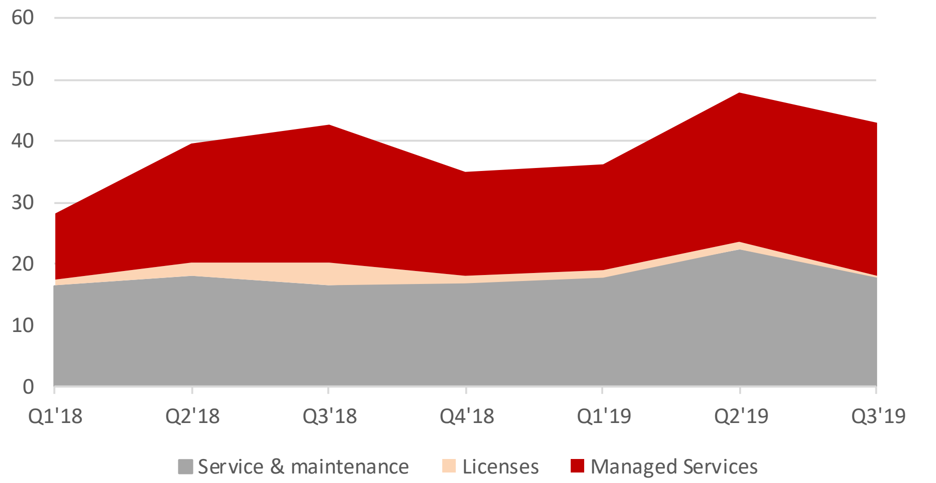
Source: Redeye Research, Sensys Gatso

* = delivery periods stated in the respective press releases, subject to eventual changes or delays

There are several positive aspects here, as described above. Most notably, there will be recurring revenue over many years to come. The average contract period for the 12 new TRaaS agreements is ~5 years. The flipside is that the revenue and profits are split over several years, while systems sales result in a rather immediate one-time profit boost. We have seen a couple of examples of companies transforming to recurring revenue. Initially there is a negative effect when profits are delayed, as increased costs precede growth.

In the graph below, we have summarized the TRaaS related System Sales for the past seven quarters. Q3 was a bit weaker sequentially, but there is a positive trend of growing TRaaS sales, which should be enhanced by all new contracts that are yet to ramp.

TRaaS Sales (SEKm)



Source: Redeye Research & Sensys Gatso

Slightly lower order intake in Q3

The order intake was down -21% in Q3 to SEK 79m, but it is important to look at the rolling 12 month, which is steady, although still down somewhat YTD on a y/y basis (SEK 321 vs. 336m). 49% of the YTD order intake is TRaaS. During Q3, the smaller, non-announced orders amounted to SEK 24m, in total, which is in line with previous quarters.

Strong value proposition for the Oklahoma solution

We believe the roll-out of cameras in Oklahoma is now finished, and that the program could soon start to generate positive cash flows. According to Sensys Gatso, Oklahoma is already considered a success. Over 10 000 citations is good, in our opinion, since Oklahoma is such a small state, as described in our previous reports. The company says Oklahoma is currently growing quarter-over-quarter, which surprised us a bit as we had expected an initial peak followed by growth from lower levels. One possible explanation is that license fees are renewed by the month, and that some people forget to renew their licenses, which could mean offenders with multiple violations. However, it is hard for the company to foresee what the pattern will look like.

We believe the market conditions for the uninsured vehicle market is extra interesting as the support in favor of enforcement in this area is higher among the public and the authorities. This is because the incentives for the states are not only to decrease the direct social costs from uninsured vehicles (people who get hit by uninsured drivers bear much of the costs), but also to collect the insurance premium tax revenue, that it would else miss out on.

Several orders in Australia for a total of SEK 167m

Sensys has strong traction in Australia, with orders of in total SEK 167m during the past weeks. Most of the ordered solutions are related to stationary in-vehicle systems. All orders are from the Victoria region. Authorities have noted the so-called Halo effect, where people brake before the cameras and then speed up afterwards, creating dangerous irregularities in the traffic flow. Similar to the moving in-vehicle systems, the technology is very advanced, according to the company. The cameras are mounted inside the back of an ordinary car, and take pictures through the windows, meaning the cars are unrecognizable. These solutions are not new for Sensys Gatso, but we assume the performance; 80-meter detection over six lanes, etc., has been improved. Sensys Gatso believes these solutions will have a significant effect on traffic behavior and fatal accidents over the next quarters, and if so, they could likely be sold in other parts of Australia, and the World as well.

The most recent Australian order is a TRaaS order for fixed systems of SEK 60m. The two other Australian orders from December 12 of SEK 55m and 52m are for in-vehicle systems. We would like to highlight that these were two separate pieces of news, albeit reported in immediate sequence, something the market may not have noted. The 52m order is for system sales with delivery during 2021 and the 55m order is a TRaaS order for a period of six years. In our view, these contracts, together with the earlier Australian orders, suggest there is a substantial TRaaS potential in Australia – roughly 50% of the total order values. One reason is that the in-vehicle cameras need to be recalibrated each year. Last, we note that all these orders came in competitor Redflex's backyard.

Strong demand for school zone systems in the US

Here are a few comments on the most important new orders, besides Australia:

Sensys Gatso has continued to strengthen its position in Iowa, US, with two new five-year contracts of SEK 20m (LeClaire) and 6m (Independence). The Independence order is a good indication of the total market potential, as it is a small city with 6 000 residents, meaning a contract value of SEK ~200 per resident per year. We assume the order is not related to the city itself, but to heavy traffic from the U.S. 20 that intersects with Iowa Highway 150 at Independence.

The company has also received another school system contract, in Buffalo, New York, following previous school contracts in Rhode Island and Maryland. The three-year contract is related to fixed poles at 20 school zone locations, around Buffalo. It has a relatively large value of SEK 10m per year, in total SEK 30m. We assume Sensys Gatso has increased its focus in school system applications, as this is an easier sell. The regulation in the different states varies a lot, but speed enforcement is, in general, a tough sell in republican states. However, very few are against school systems and protecting children. Thus, school systems can be a good base to expand from, in our view. This is particularly interesting for Sensys Gatso, given its scalable FLUX architecture. In the future we expect to see update orders, for e.g. adding distracted driving functionality and whatnot to the FLUX platforms.

There is considerable activity in the Middle East as well. Sensys Gatso recently received two orders for red light and speed enforcement from the United Arab Emirates (UAE) of SEK 12m and 8m, respectively. There is no TRaaS revenue in these contracts, but we still view them as important, as it has been a long time since the last order from the Middle East, excluding in-vehicle systems. The two orders are proof that Sensys Gatso still has relevant products for fixed speed and red light enforcement in the Middle East.

In France, there were no new orders, but the customer can continue to buy under the existing contract.

Q3 sales: Delayed deliveries

As described in our report comment, we grossly miscalculated the Q3 sales of SEK 73m (expected SEK 150m), as we failed to guess how much of the order book that would be delivered. Consequently, the operating loss came in at SEK -18m, compared to our expected SEK +13m.

Outcome vs. estimates

SEKm	Q3'18	Q3'19E	Q3'19A	Dif.
Sales	96	150	73	-51%
EBITDA	18	26	-3	-111%
EBITA	**15**	**19**	**-12**	**-163%**
EBIT	9	13	-18	-241%
EPS (SEK)	0.00	0.01	-0.02	
Sales growth(YoY)	35%	57%	-24%	
Gross margin	49%	38%	34%	
EBIT margin	9%	8%	-24%	
EPS growth (YoY)	n/a	n/a	n/a	

Source: Redeye Research, Sensys Gatso

Overall, however, the company performs good (and in line with internal expectations), winning many TRaaS contracts, as described above. Redeye's estimates are based on the timelines of the press releases, which could sometimes change. Our belief is that very little, if any, of the large point-to-point project in Netherlands has been delivered. Second, we expected more sales in Sweden ahead of the winter and ground frost. Moreover, given the recent type approval in Australia for mobile systems, we believe there were no third quarter revenue from the associated Australian program (the March 2019 order of SEK 46m). We had expected delivery of a large part of this order in our Q3 estimates. We did not know that this order was dependent on a future type approval (moreover, we do not know if the Australian type approval was an isolated thing or if there is a need for this in e.g. the Netherlands as well). Normally, type approval is won before the orders. Nevertheless, as the type approval has now been received, Sensys Gatso should be able to start delivery for the Australian contracts. In conclusion, we had expected substantial revenue from both Australia and the Netherlands, that did not come. It is worth mentioning that these orders are not forfeited, but still in the order book.

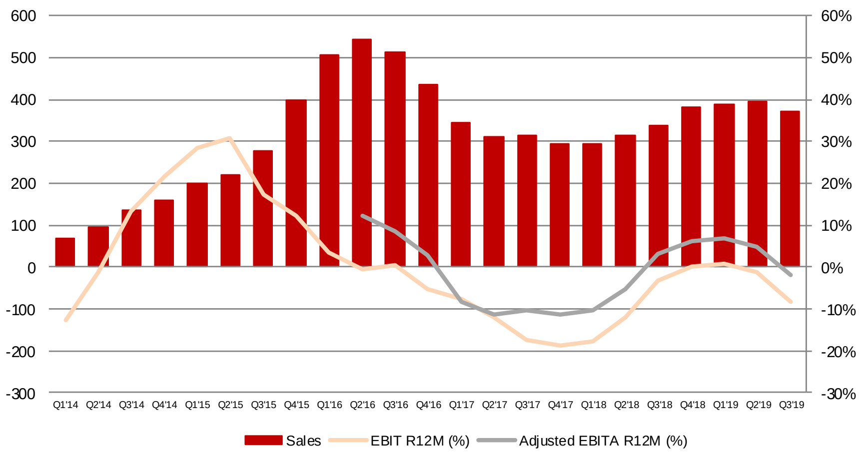
We have also looked at the competitors, in order to understand if the stock price movement is trying to tell us something. We do not see any tendencies that competitors are pulling the rug out from underneath Sensys Gatso's feet. On the contrary, we believe the company has a good win ratio. It is still a small contender on the US market, but it is winning increasingly larger contracts. We especially note that Sensys Gatso still has not lost any US contracts, which should help increase the customers trust in Sensys Gatso being able to handle larger contracts.

Lower margins from starting up the new programs

The gross margin of 34% were four percentage points lower than we had expected. We assume there could be temporary upstart costs that negatively affected the gross margin in both business areas. Ramping up programs in entirely new areas is costly, at first. Similar to our reasoning above, managing one such project at a time is fine, while three at the same time will significantly weigh on margins.

The margin trend is pointing towards the record low levels (in modern times) seen three years ago, as indicated in the graph below. However, one important difference today, compared to back then, is that Sensys Gatso has a solid, filled order book this time.

R12M Sales (SEKm), EBIT & adjusted EBITA* (%)



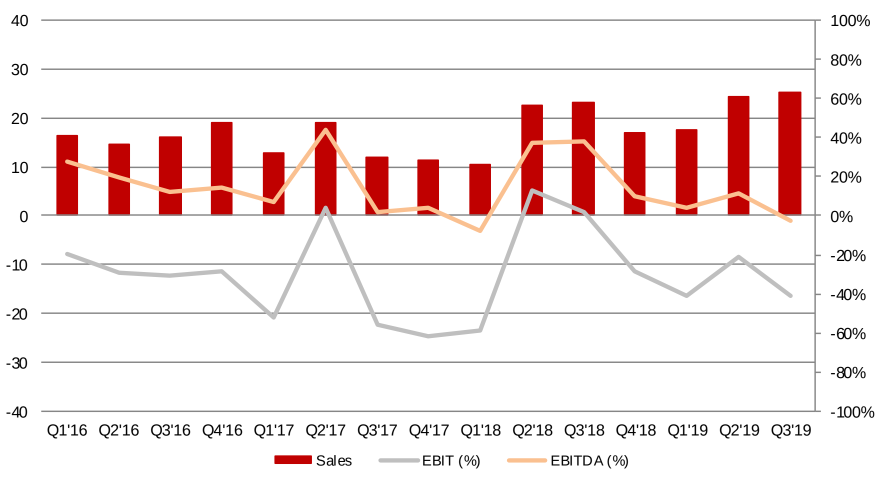
* = EBITA adjusted for acquisition costs of SEKm 7.4 in Q3'15 and for the cost reduction program and additional Gatso consideration

Source: Redeye Research, Sensys Gatso

There is quarterly volatility. Thus, in the graph above, we look at sales and margins on a rolling 12-month basis, to better capture the underlying movement. One can note that sales easy and steady have trended upwards, with the exception of Q3'19. We believe the downward trend in the margins during the past three quarters is related to higher costs from new TRaaS programs, while sales have temporarily stopped growing.

Looking at the different business areas, costs in Managed Services increased by about SEK 6m q/q, leading to lower margins (see the graph below). We guess this is mostly related to temporarily higher variable costs (cost of revenue) from starting up new programs.

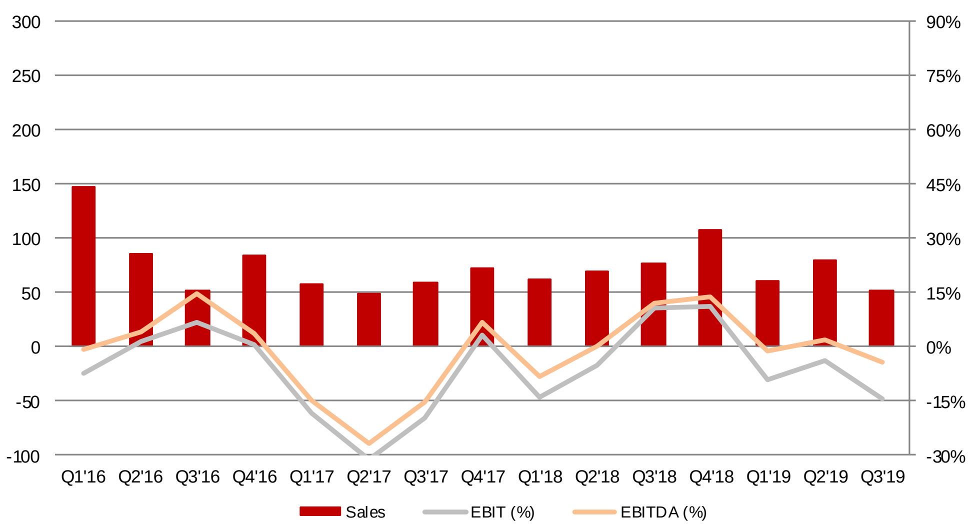
Managed Services: Revenue (SEKm) & margins (%)



Source: Redeye Research, Sensys Gatso

The revenue in business area System Sales was on record low levels in Q3, as indicated in the graph below, meaning margins fell to the lowest level since Q1'18. We also believe there could be an increased cost effect from delayed programs.

System Sales: Revenue (SEKm) & margins (%)

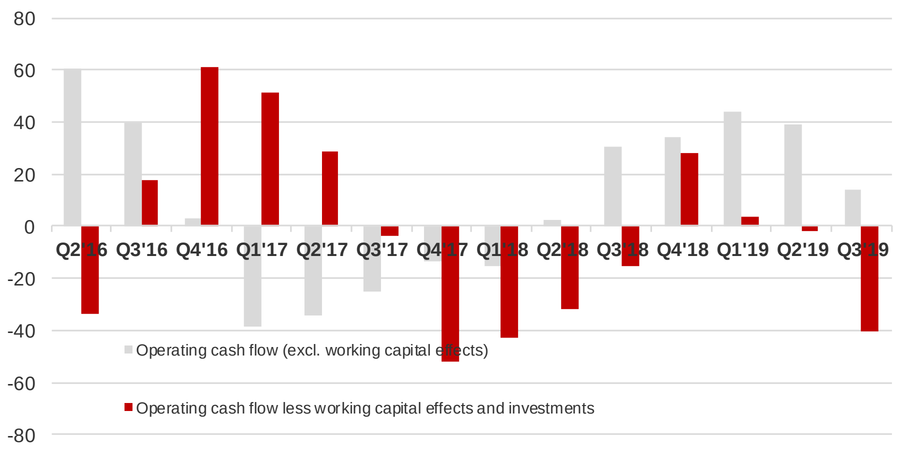


Source: Redeye Research, Sensys Gatso

Cash has eroded (but the two coming quarters should be solid)

The important operating cash flow amounted to SEK -16m including a -8m working capital effect, as both receivables and inventory continued to increase ahead of delivery of larger orders, leading to rolling-12 month figures in line with the bottom in Q4'17 and Q1'18 (see the graph below). According to Sensys Gatso, the increased working capital is related to the large orders in e.g. Australia and the Netherlands, and will be converted to cash in H1'20.

Operating cash flow on a rolling 12-month basis (SEKm)



Source: Redeye Research, Sensys Gatso

The cash amounted to SEK 34m at the end of the period, but it must be noted that the company so far this year has used SEK 46m from the credit facilities, i.e. without the credit line, cash would be below zero. Sensys Gatso did not fulfill the covenants and received a waiver from its bank. However, we note that the company repaid SEK 10m on the vendor loan (instead of converting the debt to shares/equity), during the period, which we believe it would perhaps not have done if it had been in a precarious situation, in terms of cash. We expect the cash situation to improve in Q4'19 and Q1'20, from deliveries of larger system orders. In our view, Sensys Gatso seems confident about cash being enough. The voluntary repayment of the vendor loan adds support to this assessment. On the stock market though, we believe there is speculation around a new offering. In our view, the stock price reaction following the report is primarily related to worries around the cash position together with an extrapolation of the YTD cash flow trend.

Financial estimates

In our last update we lowered our estimates due to underestimation of the time and costs (e.g. subcontractors) needed to start up the TRaaS programs, but not enough though, as we see a need to cut our 2019-2021 estimates again (see the table below). In short, we have overestimated the short term and underestimated the long term. The average solution development, delivery and deployment period for new type of programs is 20 months, which is longer than we would have expected. In our view, most of the current order book of systems will be delivered in 2020 or 2021, i.e. we expect delays in relation to the timelines in the press releases. We also, as a margin of safety, postpone much of the deliveries in our expected H2'20 orders to 2021. Last, we assume that meaningful revenues from the Managed Services contracts come about one quarter after the contracts become operational.

Changes in Redeye's estimates

SEKm		2019E	2020E	2021E
Sales	Old	491	589	700
	New	*364*	*464*	*580*
	change (%)	-26%	-21%	-17%
EBITDA	Old	61	122	179
	New	10	37	103
	change (%)	-84%	-70%	-42%
EBIT	Old	-44	76	137
	New	-44	-1	68
	change (%)	0%	-101%	-50%
EPS	Old	0.01	0.07	0.12
	New	-0.05	0.00	0.06
	change (%)	-567%	-105%	-51%

Source: Redeye Research, Sensys Gatso

Our expected sales growth for 2020 is 27%, but we only estimate EBIT to SEK -1m, since we have lowered our short-term gross margin assumptions due to delays. As for fixed costs, however, Sensys Gatso continues to surprise us on the positive side.

Quarterly estimates

In our last update we expected a lot of the order book the be delivered in H2'19, but we now postpone those deliveries to 2020.

Sensys Gatso: Quarterly estimates (SEKm)

(SEKm)	2018	Q1'19	Q2'19	Q3'19	Q4'19	2019	Q1'20	Q2'20	Q3'20	Q4'20	2020
Sales	380	78	97	73	116	364	109	99	130	126	464
Growth (%)	*30%*	*9%*	*9%*	*-24%*	*-7%*	*-4%*	*39%*	*2%*	*78%*	*9%*	*27%*
Gross margin (%)	42%	37%	38%	34%	35%	36%	37%	40%	39%	40%	39%
System sales	317	61	79	52	91	284	85	72	102	98	357
Growth (%)	33%	-11%	2%	-51%	-15%	-10%	7%	37%	12%	8%	26%
whereof TRaaS	76	19	23	18	20	80	22	21	27	31	100
Growth (%)	n/a	9%	17%	-10%	8%	6%	15%	-11%	49%	58%	25%
Managed Services	74	18	25	25	25	92	24	27	28	28	106
Growth (%)	33%	65%	8%	8%	45%	25%	38%	10%	10%	12%	16%
EBITDA	37	0	4	-3	8	10	9	8	23	17	37
EBITA	**23**	**-6**	**-2**	**-12**	**0**	**-20**	**1**	**0**	**14**	**9**	**23**
EBITA (%)	***6%***	***-8%***	***-2%***	***-16%***	***0%***	***-5%***	***0%***	***0%***	***11%***	***7%***	***5%***
EBIT	1	-12	-8	-18	-6	-44	-5	-6	8	3	-1
EBIT (%)	*0%*	*-16%*	*-9%*	*-24%*	*-5%*	*-12%*	*-5%*	*-6%*	*6%*	*2%*	*0%*
EPS	-0.01	-0.01	-0.01	-0.02	-0.01	-0.05	-0.01	-0.01	0.01	0.00	0.00

Source: Redeye Research, Sensys Gatso

Investment Case

Growing recurring revenue from Managed Services
Large potential in new adjacent areas
Share price normally driven by big deals

Growing recurring revenue from Managed Services

The Managed Services business with its high margins, long contracts and repeat revenue, is a critical factor in securing a sustainable growth and will therefore determine the long-term performance of the shares. The Gatso part of Sensys Gatso has during the past decade committed a lot of hard work and investments in building a strong foothold in the US. Moreover, the Managed Services model is easy and steady spreading across the World. The Company has so far never lost a Managed Services contract but it has taken over a few contracts from competitors. We have previously been a bit hesitant towards the US market following the Trump election but the market has not deteriorated thus far.

Large potential in new adjacent areas

During the fall of 2017, Sensys Gatso won an important ANPR contract for uninsured vehicle enforcement in Oklahoma - a brand new area for the company as well as the very first program of its kind. In Oklahoma, Sensys Gatso takes full responsibility for administration of tickets and therefore receives about 40-50% of every citation during the contract period. In all of the US states where Sensys Gatso is present there are substantially more uninsured vehicles than in Oklahoma. Thus, there is a major upside if Sensys Gatso can get others of its customers on board for programs similar to Oklahoma. Using ANPR for uninsured vehicles is one good illustration of how the company can leverages its expertise and competitive advantages (securing an unbroken chain of evidence) in other adjacent areas, but there are other possibilities as well, e.g. school zones, distracted driving, environmental zones, etc. Besides the evidence integrity issues there are two other important barriers to entry for smaller, local players: The size and stability requirements of customers in order for them to assure reliable long-term delivery and the unique type approval procedures in each country.

Share price driven by big deals

The shares have always been driven by announcements of major deals, such as the skyrocketing of about 360 % in the fall of 2015, which was largely related to the gigantic North African order worth SEK 165 million. The business and the stock will remain volatile. Larger System Sales orders will remain important catalysts, although the most significant event would be a new, major Managed Services contract.

Valuation

Bear Case 1.0 SEK

Our bear case has two key differences compared to base case, related to Managed Services and uninsured vehicles. In Managed Services we expect a status quo in the US market with no improvement but also no deteriorated market conditions. We estimate that Sensys Gatso will continue to have stable growth in line with the market, meaning a CAGR revenue growth of about 9 percent (excl. uninsured vehicles). This would yield Managed Services revenue of close to SEK ~150m in 2024, i.e. around twice today's levels but less than half of our base case levels. In our bear case we expect a tough competition within ANPR solutions for uninsured vehicles related to the major US players, meaning a failure in growing in other states with programs similar to Oklahoma. We do however expect Oklahoma to deliver annual sales of about SEK 20m. With the solid growth from Managed Services and Oklahoma Sensys Gatso should be able to put up a decent CAGR growth in recurring revenue of 16% during 2018-2024, meaning recurring revenue of about 50 percent. The gross margin in our bear case averages 42%, despite the pressure on the gross margin on the systems side, thanks to the company's focus on recurring revenue. The fixed costs average 32% of sales, slightly higher than the base case, which is of course explained by the lower sales level. In the bear case, and with the above estimates, revenue would grow by 8% in 2018-2024 while the EBIT margin would rise to 8 percent on average, with a long-term sustainable EBIT margin of 12 percent.

Base Case 1.7 SEK

All our scenarios use a required rate of return of 11.5% and a 2% terminal growth. Our base case makes the following assumptions: System revenue growth is flat during 2018-2024, due to the transformation to Managed Services and recurring TRaaS revenue. Our base case expects a CAGR of 62% within uninsured vehicles, meaning annual revenus reaching SEK ~80m in 2024 as customers in other shates outside Oklahoma join in. The CAGR for Managed Services revenue (incl. uninsured vehicles) and recurring revenue (i.e. software and service as well as operator revenue) amounts to 30% and 22%, respectively, which represents a share of on average about 60% recurring revenue, reaching 66% in 2024. The average gross margin for the group is 45 percent in 2018-2024 due to gradual growth in Managed Services and TRaaS revenues. The fixed costs average 35 percent of sales in 2018-2024. With our assumptions above, average annual revenue growth totals 14% in the period 2018-2024 and then 8% until 2027. During the same period, the EBIT margin is approximately 13% on average (due to initial losses) but rises to an average of 16% in 2020-2024 and subsequently to 20 percent in the long term, following peak margins of 26 % during years 2024-2027.

Bull Case 3.4 SEK

Similar to our bear case our bull scenario is based on different assumptions for Managed Services and uninsured vehicles compared to our base case. In our bull case we see a chance for an improved US Managed Services market in which it should be possible for Sensys Gatso to have a higher growth meaning about 25 percent higher revenue than our base case and a 46% Managed Services CAGR growth during (including uninsured vehicles). As for uninsured vehicles we expect Sensys to win several other programs, meaning on average 25 000 citations more every year than in our base case, leading up to almost 200 000 citations in total during year 2024. While this might not seem that much an average fee for Sensys Gatso of USD 74 means sales of about SEK 460m in 2024. We expect that Sensys Gatso in bull case reaches recurring revenues of about 75% in 2024. This will also imply higher gross margins of on average 50 percent. Fixed costs average 28 percent of sales in 2018-2024. We assume that the company will invest in addressing increasingly interesting opportunities in areas such as smart cities, and that the growth journey is therefore extended. Sales will in our optimistic scenario grow by an average of 20% annually in 2018-2024, before gradually starting to decrease towards the level of market growth. The EBIT margin averages 21% in 2018-2024 driven by an increased proportion of Managed Services revenues, which we believe is in line with the TRaaS strategy. With a successful execution of such a high-margin strategy, it would not be unlikely to have a long-term EBIT margin of 30 percent.

Catalysts

Large Managed Services contracts

The most important catalyst for the stock is large Managed Services orders, given the margin profile and the recurring revenue. We especially look forward to orders from new adjacent areas, like the uninsured vehicles enforcement program in Oklahoma.

Large system orders

The share price is largely driven by the announcement of major orders. For the next quarters we see larger orders from several geographies, especially related to the competitive offering within in-vehicle solutions

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.

People: 3

The Gatso acquisition in summer 2015 was a logical acquisition of stability in the form of a high proportion of much-needed recurring revenue, but the order intake has not been convincing until recently. Sensys Gatso's new CEO has worked in entirely different industries, but parts of the management team have extensive experience from working a long time for Gatso, although the old Sensys management team has left. Communication and transparency are on the path to improvement but, in many respects, there is still a black box. The incentive scheme is reserved for the CEO only, which is not ideal, according to us. In conjunction with the acquisition, Sensys Gatso gained an industrial principal shareholder. The former Gatso management holds ~19% of the shares in all, and has committed operationally to the management. Shareholdings among the rest of the management are still too low, in our opinion. All members of the board own shares, but the size of the board member holdings generally are too small.

Business: 4

Gatso brings significant recurring revenues from Managed Services as well as other service and maintenance sales. However, competition remains intense even after the Gatso acquisition. The European market appears to be in need of consolidation, and the company has an interesting position as a market leader on the system side. The size and stability after the Gatso acquisition should provide greater credibility with customers and an opportunity for the company to capitalise in a market where fatal road accidents are taken increasingly seriously. It should be noted though that the market conditions are largely affected by the volatile political climate.

Financials: 2

Gatso's historical earnings stability has so far not broken through to the combined total sales of Sensys and Gatso. The operating profit peaked at SEK 49 million in 2015 and has mostly been negative since then. However, it should be noted that market conditions and the order intake have improved significantly. Despite some tough years the company has had a relatively strong cash flow, which is not seen on the EBIT level due to high depreciation and amortisation, although EBITDA has also trended downward. A higher profitability rating requires not only uninterrupted profitability but also higher profitability. Despite several weak quarterly bottom lines, net debt has been reduced with the help of good cash flows. Following having repaid a large part of the debt the balance sheet now looks solid. However, current sales levels are not quite enough to cover much more than the current costs. The company therefore relies on its credit facility remaining in place, alternatively improved revenues. The dependence on individual large deals can be significant from time to time, but at present the order intake, procurement awards and the order book are all to a large extent more or less related to multiannual contracts or recurring revenue.

INCOME STATEMENT	2017	2018	2019E	2020E	2021E
Net sales	293	383	364	464	580
Total operating costs	-309	-346	-354	-427	-477
EBITDA	-16	37	10	37	103
Depreciation	-14	-11	-22	-15	-16
Amortization	-25	-26	-32	-23	-19
Impairment charges	0	0	0	0	0
EBIT	-55	1	-44	-1	68
Share in profits	0	0	0	0	0
Net financial items	-4	-4	-4	-3	-2
Exchange rate dif.	0	0	0	0	0
Pre-tax profit	-59	-3	-48	-4	66
Tax	3	-1	8	1	-15
Net earnings	-55	-5	-40	-3	51

BALANCE SHEET	2017	2018	2019E	2020E	2021E
Assets					
Current assets					
Cash in banks	59	77	27	23	53
Receivables	99	79	78	97	119
Inventories	63	72	69	84	102
Other current assets	0	0	0	0	0
Current assets	221	228	175	204	273
Fixed assets					
Tangible assets	35	42	59	65	73
Associated comp.	0	0	0	0	0
Investments	0	0	0	0	0
Goodwill	239	251	256	256	256
Cap. exp. for dev.	88	63	39	23	14
O intangible rights	3	10	13	16	20
O non-current assets	0	0	0	0	0
Total fixed assets	365	367	367	361	363
Deferred tax assets	38	37	37	37	37
Total (assets)	624	632	580	602	673
Liabilities					
Current liabilities					
Short-term debt	26	10	11	12	10
Accounts payable	95	95	91	116	145
O current liabilities	0	0	0	0	0
Current liabilities	121	106	102	128	155
Long-term debt	56	49	41	36	29
O long-term liabilities	0	0	0	0	0
Convertibles	0	0	0	0	0
Total Liabilities	177	154	143	164	184
Deferred tax liab	23	17	17	17	17
Provisions	4	7	7	7	7
Shareholders' equity	420	454	414	414	465
Minority interest (BS)	0	0	0	0	0
Minority & equity	420	454	414	414	465
Total liab & SE	624	632	580	602	673

FREE CASH FLOW	2017	2018	2019E	2020E	2021E
Net sales	293	383	364	464	580
Total operating costs	-309	-346	-354	-427	-477
Depreciations total	-39	-37	-54	-38	-35
EBIT	-55	1	-44	-1	68
Taxes on EBIT	3	0	7	0	-16
NOPLAT	-52	0	-37	-1	52
Depreciation	39	37	54	38	35
Gross cash flow	-13	37	17	37	88
Change in WC	-17	11	-1	-8	-10
Gross CAPEX	-6	-38	-54	-32	-37
Free cash flow	-36	10	-39	-2	40

CAPITAL STRUCTURE	2017	2018	2019E	2020E	2021E
Equity ratio	67%	72%	71%	69%	69%
Debt/equity ratio	20%	13%	13%	12%	8%
Net debt	23	-18	24	25	-13
Capital employed	444	436	438	440	452
Capital turnover rate	0.5	0.6	0.6	0.8	0.9

GROWTH	2017	2018	2019E	2020E	2021E
Sales growth	-33%	31%	-5%	27%	25%
EPS growth (adj)	76%	-92%	775%	-93%	-

DCF VALUATION	
WACC (%)	11.5 %

Assumptions 2017-2023 (%)	
Average sales growth	16.8 %
EBIT margin	12.0 %

PROFITABILITY	2017	2018	2019E	2020E	2021E
ROE	-14%	-1%	-9%	-1%	12%
ROCE	-11%	0%	-9%	0%	14%
ROIC	-11%	0%	-8%	0%	12%
EBITDA margin	-5%	10%	3%	8%	18%
EBIT margin	-19%	0%	-12%	0%	12%
Net margin	-19%	-1%	-11%	-1%	9%

DATA PER SHARE	2017	2018	2019E	2020E	2021E
EPS	-0.07	-0.01	-0.05	0.00	0.06
EPS adj	-0.07	-0.01	-0.05	0.00	0.06
Dividend	0.00	0.00	0.00	0.00	0.01
Net debt	0.03	-0.02	0.03	0.03	-0.02
Total shares	844.91	860.02	860.02	866.02	866.02

VALUATION	2017	2018	2019E	2020E	2021E
EV	1,316.1	1,547.5	1,194.1	1,195.1	1,156.4
P/E	-23.5	-341.2	-29.1	-417.7	23.2
P/E diluted	-23.5	-341.2	-29.1	-417.7	23.2
P/Sales	4.4	4.1	3.2	2.5	2.0
EV/Sales	4.5	4.0	3.3	2.6	2.0
EV/EBITDA	-83.0	41.3	124.6	32.2	11.2
EV/EBIT	-24.0	2,627.4	-27.0	-1,244.7	17.0
P/BV	3.1	3.5	2.8	2.8	2.5

SHARE PERFORMANCE		GROWTH/YEAR	16/18E
1 month	-2.9 %	Net sales	11.4 %
3 month	4.6 %	Operating profit adj	-10.1 %
12 month	-21.8 %	EPS, just	-15.4 %
Since start of the year	-25.3 %	Equity	-0.8 %

SHAREHOLDER STRUCTURE %	CAPITAL	VOTES
Gatso Special Products B.V.	19.0 %	19.0 %
Avanza Pension	4.2 %	4.2 %
Per Wall	2.7 %	2.7 %
Inger Bergstrand	2.4 %	2.4 %
Nordnet Pensionsförsäkring	1.4 %	1.4 %
State Street Bank And Trust co	1.1 %	1.1 %
Swedbank Försäkring	1.0 %	1.0 %
AXA	0.9 %	0.9 %
Danica Pension	0.9 %	0.9 %

SHARE INFORMATION	
Reuters code	SENS.ST
List	Small Cap
Share price	1.4
Total shares, million	860.0
Market Cap, MSEK	1169.6

MANAGEMENT & BOARD	
CEO	Ivo Mönnink
CFO	Simon Mulder
IR	n/a
Chairman	Claes Ödman

ANALYSTS	Redeye AB
Viktor Westman	Mäster Samuelsgatan 42, 10tr
viktor.westman@redeye.se	111 57 Stockholm
Eddie Palmgren	
eddie.palmgren@redeye.se	

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

Håkan Östling
hakan.ostling@redeye.se

Technology Team

Jonas Amnesten
jonas.amnesten@redeye.se

Henrik Alveskog
henrik.alveskog@redeye.se

Havan Hanna
havan.hanna@redeye.se

Kristoffer Lindström
kristoffer.lindstrom@redeye.se

Erika Madebrink
erika.madebrink@redeye.se

Fredrik Nilsson
fredrik.nilsson@redeye.se

Tomas Otterbeck
tomas.otterbeck@redeye.se

Eddie Palmgren
eddie.palmgren@redeye.se

Magnus Skog
magnus.skog@redeye.se

Oskar Vilhelmsson
oskar.vilhelmsson@redeye.se

Viktor Westman
viktor.westman@redeye.se

Linus Sigurdsson (Trainee)
linus.sigurdsson@redeye.se

Editorial

Eddie Palmgren
eddie.palmgren@redeye.se

Mark Siöstedt
mark.siostedt@redeye.se

John Hintze
john.hintze@redeye.se

Johan Kårestedt (Trainee)
johan.karestedt@redeye.se

Life Science Team

Gergana Almquist
gergana.almquist@redeye.se

Oscar Bergman
oscar.bergman@redeye.se

Anders Hedlund
anders.hedlund@redeye.se

Arvid Necander
arvid.necander@redeye.se

Erik Nordström
erik.nordstrom@redeye.se

Klas Palin
klas.palin@redeye.se

Jakob Svensson
jakob.svensson@redeye.se

Ludvig Svensson
ludvig.svensson@redeye.se

Disclaimer

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Redeye Rating (2019-12-27)

Rating	People	Business	Financials
5p	11	11	2
3p - 4p	88	68	28
0p - 2p	9	29	78
Company N	108	108	108

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Westman owns shares in the company : No
Palmgren 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.