REDEYE

Update

Equity Research

5 September 2018

Sensys Gatso Group

Sector: Information Technology

The market is speeding up

Improved market: Q2 orders of SEK 183m & procurement awards of SEK 380m

The Q3 order intake of SEK 183m was a bit higher than our estimates. Second, the Company has during H1'18 won procurement awards of SEK 236m, related to Finland, Belgium and Saudi Arabia (SEK 30m, 27m & 100m respectively). The existing procurement awards as of the end of Q4'17 was SEK 144m. In addition, Sensys Gatso has after Q2 announced orders of SEK 75m and an in-vehicle contract in Australia worth an additional SEK 70m. Altogether these orders and contracts create a strong foundation for future growth. This is what we mean by "high quality order intake" in our Q2 comment. The competitors seem slightly more optimistic as well, supporting the Company's statement that market conditions have indeed improved.

US & in-vehicle should continue to drive growth

The strong Q2 sales of SEK 89m (est. SEK 70m) is due to Managed Services despite Oklahoma and the Ohio takeover contracts coming online no earlier than H2'18. The Q2-growth was also not at all affected by the strong order intake, suggesting solid sequential growth during H2'18.The SEK 9m EBITDA (est. SEK -6m) is fully related to Managed Services' EBITDA margin of 37 percent. Sensys Gatso is not yet ready to share its growth strategy though but from its communication we derive that recurring revenue and growing with existing customers seem to be key components. Thus, we believe the company tries to "bloom where it is planted", e.g. focusing on using its expertise in securing a so called unbroken chain of evidence for new adjacent ANPR solutions, as in Oklahoma. We also expect the company to continue leveraging its success in France to close new in-vehicle deals, like in Qatar, Saudi Arabia and Australia. In the US, where Sensys Gatso still never has lost a contract, there could also be more to come, although one should note that the total number of cities allowing traffic enforcement has in essence not changed during the 20 month tenure of the Trump administration.

We raise our rating and our fair value range substantially

Having confidence in Sensys Gatso has paid of big time during the past months and our assumptions proved way too conservative as well as inaccurate in the light of the recent news flow. Aside of higher estimates, the solid order intake also decreases the risk and allows for a higher Management and financial stability rating. Thus, we raise our valuation scenarios substantially by 54-100 percent. Our base case jumps to SEK 1.7 (1.1) while the new bear and bull case is SEK 1.0 (0.5) and 3.4 (1.9).

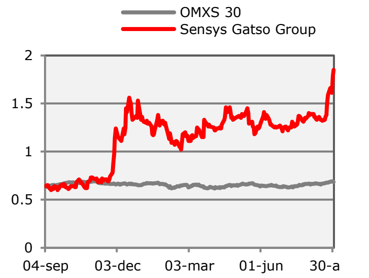
KEY FINANCIALS (MSEK)	2016	2017	2018E	2019E	2020E	2021E
Net sales	437	293	386	539	615	715
EBIT	-23	-55	-8	68	105	149
EBITDA	25	-16	29	102	140	181
EPS (adj.)(SEK)	0.0	-0.1	0.0	0.1	0.1	0.1
EV/Sales	2.3	4.5	4.4	3.1	2.6	2.0
EV/EBIT	-43.2	-24.0	-224.5	24.4	15.0	9.8
EV/EBITDA	39.6	-83.0	59.0	16.3	11.2	8.1
P/E	-38.0	-23.5	-167.2	26.8	20.6	14.9

Source: Redeye Research

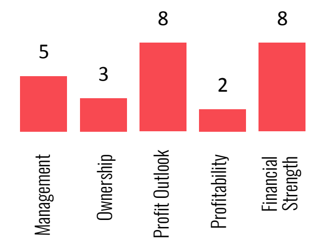
FAIR VALUE RANGE

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)	2.0
Market Cap (MSEK)	1698
Net Debt 18E (MSEK)	12
Free Float	82 %
Avg. daily volume ('000)	7

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The market is speeding up for Sensys Gatso

In the report, we especially note that Sensys Gatso writes that the market conditions have improved. We can also see that recurring revenue is a very important mission for all areas, not only for Managed Services but also from maintenance and software licenses. The recurring part of the business was basically flat from 2016 to 2017, at SEK 130m, but as the size of the recurring part of the System Sales per quarter is not reported we do not know what it looks like for 2018. Also, even though Sensys Gatso pursues recurring revenue and up-sell it says it will still come across larger programs like the one in MENA of SEK 165m in 2015-2016 and then it will fight vigorously to win those tenders as well, meaning the volatility in sales will remain for the foreseeable future.

Besides the recurring revenue focus Sensys Gatso is not yet fully ready to discuss the growth path in more detail, although there seems to be no lack of opportunities on the existing markets, judging from the news flow alone. As for the regional focus, we would expect Sensys Gatso to concentrate on the homologated markets, i.e. markets where type approval is required. Asian markets have a rapid expected market growth but the customers' hardware to a large extent is based on cheap Chinese commodity. The downtimes for those cameras are clearly higher than Sensys Gatso's more reliable cameras but nevertheless we do not expect the company to make any major efforts in winning business in these markets (although there could of course be opportunities in selected Asian markets).

We believe one relevant subject for a future Capital Markets Day, or equivalent, will be the M&A potential among smaller, local traffic enforcement players in the fragmented European market. One common trend among the competitors, reflected also in M&A, is to focus more on tolling and Automatic Number Plate Recognition (ANPR) cameras[1] but we do not expect Sensys Gatso to go into tolling. Even though the tolling applications are similar to the Oklahoma ANPR solution from a technology perspective these segments are very different from a customer and market perspective, according to the company.

We instead expect Sensys Gatso to focus eventual new business around its competitive advantages in managing data and integrity (i.e. securing a so called unbroken chain of evidence for eventual court cases). Sensys Gatso takes pride in never having failed as technological evidence in a court case, which is related to deep knowledge in these areas. This is a very valuable and essential asset for the customers. Customers do not want to go to court and they certainly do not want the bad publicity associated with going to court and losing the case.

Humongous order intake of SEK 183m – in line with expected

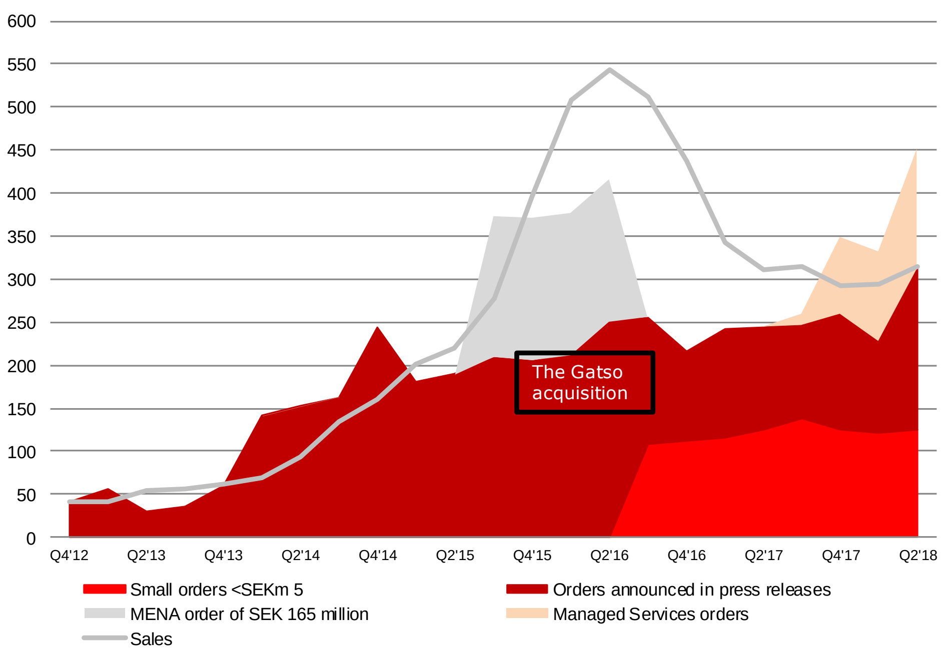
As we anticipated in our preview the order intake, coming in at SEK 183m (up almost 200 % from SEK 65m in Q2'17), was humongous. SEK 134m are related to system sales and SEK 49m came from Managed Services. The company highlights that out of the new Managed Services contract value, two thirds are related to new programs (Ohio).

The order intake includes the Netherlands contract of SEK 66m but it does not take the framework agreement in Finland of SEK 30m into account (as no orders have been received yet). This suggests that the underlying order intake of small orders should be around SEK 50m, whereof SEK 16m came from smaller, unannounced renewals in Managed Services, which is a good number, in our opinion.

[1] Redflex e.g. added 230 ANPR cameras addressed for parking solutions at major retailer shopping centers in Australia and now has 892 ANPR cameras in total.

In our preview we posed the question whether this order intake is related to a market release that will continue or more of a temporary nature. We could see a potential effect from more sales attention and a harder push against existing markets and upselling like e.g. the partner day on Intertraffic, which by the way was very successful, according to Sensys Gatso. Both Redflex and Jenoptik have reported ok sales and order intake figures as well as outlooks, supporting an improved market. We note that Redflex has a 300 million dollar pipeline and that about half of that is project based (system sales). Sensys Gatso does not want to comment on its own or Redflex's pipeline but looking at the size of the TAM figures that has previously been communicated the Redflex numbers do not look unreasonable to us.

Sales & order intake* R12M (SEKm)



* = Our assumptions, including orders received before consolidation in August 2015 but excluding a service contracts for Q3'15 (size unknown) & SEKm 30 of service in the Australia deal.
From Q3'16 we break out the small orders (less than SEKm 5) from the total order intake

Source: Redeye Research & Sensys Gatso

On the call, Sensys Gatso explained very clear that the procurement awards are against fixed conditions (such as e.g. the price levels) but without any purchase obligation. It is therefore important to distinguish between won purchase orders and procurement awards where the last mentioned does not necessarily mean that it will be an order. The values for the procurement awards are estimated based on assessments around the customer's needs and demands.

The company states that it has secured future, potential orders of an estimated SEK 236m during H1'18 and in addition that it had SEK 144m from procurement awards as of Q4, meaning SEK 380m in total. Following the end of the period, it has also in Q3 e.g. closed a framework agreement for an additional SEK 70m of in-vehicle systems in Australia (not included in the Q2 figures). Thus, in addition to the strong order intake in Q2 and Q3 the company as of Q2'18, according to our calculations, has potential orders of over SEK 400m in the bag and therefore a good base for future orders and sales growth.

Two thirds of the US Managed Services order intake related to new business

Sensys stated in the report that the US business is recovering and, more important, that increased sales opportunities are emerging. This is an interesting contrast compared to Verra (previously known as ATS) that are eyeing Europe as US is said to be slower. Redflex, however, seems more optimistic on US than before since it recently said that there is an opportunity for US market growth as some states pass positive legislative changes around road safety and traffic management solutions.

Iowa is being reinstated and is on track to begin again from October 1 as the hardware is fully intact and in position. As for Oklahoma, it remains delayed but Sensys Gatso said that the implementation is making good progress and that it still expects sales to start in Q4. The delays are due to the matching of different databases and related to the fact that this is a brand new type of program that has not been done before.

Looking at the total usage of red light cameras compared to one and a half year ago it is slightly down to 423 cities from 426 while two more cities, 144 in total, use speed cameras. The political climate has been described as volatile but when we compare the regulations in the different states to what it looked like 20 months ago, just after the Trump election, it is almost identic, the only difference being that Rhode Island has accepted speed cameras in addition to the red light cameras that already were allowed. Thus, we can now conclude that the US market has not deteriorated during the Trump administration, although it has not gotten better either. In Rhode Island, Charlestown by Sensys America is the only program in full compliance with the requirements[2].

In line with the above, Sensys Gatso says that the existing states are stable. Given the slow regulation processes, we assume that the new opportunities most likely come from additional cities in the existing states. Sensys Gatso are at the moment in eight US states: Ohio, Iowa, Florida, Maryland, Alabama, Oklahoma, Pennsylvania and Washington.

Sensys Gatso has still never lost a US contract but it has won contracts from competitors, like recently in Ohio. Thus, the company has a successful model for the US. The consistent feedback the company gets is that the support is great, which might make the difference in winning new contracts, or at least it provides a partial answer to why it has not lost any contracts yet.

As for the competitors, we note that ATS has announced that it is relaunching under the name “Verra Mobility” and will be listed on the stock market during Q3. As mentioned, Verra’s main focus seems to be on tolling. We therefore expect it to be a tough future competitor in ANPR based solutions. Redflex, in our opinion, has a surprisingly high retention rate of over 90 percent on the US market given the brand problems after the bribery scandals. We take this as a very clear proof of the industry’s high barriers to entry.

We now move over to analyse the different other regions outside of the US.

Strong order intake in Australia & from in-vehicle – more to come in the Nordics?

In Australia, we especially note the framework agreement, allowing the state of Victoria to buy in-vehicle systems for an additional SEK 70m during the next six years. The virus problem for the competitors’ software has had a positive impact on Sensys Gatso’s recent Australian wins in programs that were up for renewal, although not directly related. The windows based

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[2] It should be noted that Sensys America is an independent company and there is no relation to Sensys Gatso except that it has the right to use Sensys as a brand name, in the US.

virus infected hundreds of systems for Redflex and Jenoptik but not a single one of Sensys Gatso's as these run on Linux.

Sensys Gatso is pursuing potential other in-vehicle contracts as well. Crossing the political barriers takes time but the successful implementation in France during the past years has helped winning orders in Qatar, Saudi and Australia. We were a bit worried when we learned that the Saudi in-vehicle deal included customer specific software as we feared that it could be related to a weak software architecture with a large need for patches. However, Sensys Gatso says that this is a specific customer request and that it does not need to modify the software for all other, future in-vehicle contracts. The software integration is actually very similar to the big MENA-order of SEK 165m, according to the Company.

Aside of the big Saudi contract for in-vehicle the sales of the fixed systems has been slower though. Selma (previously known as Safran) has been aggressive and taken some market shares in the Middle East. Sensys Gatso says that this has been related to pricing pressure and that it does not want to dilute its margins. One important takeaway to us from this is that it is important that Sensys Gatso's next generation of products can come down in cost. For the next earnings report we hope to receive a timeline for the next generation of products.

No order has yet been received related to the Finish framework agreement of SEK 30m. Various sources have stated that Finland could favour a larger roll-out than the SEK 30m. Such an extension is not included in the Company's SEK 30m estimate but it is possible to make additional orders under the existing framework agreement, although there are no guarantees for such an event to happen.

In Sweden, The Swedish Transport Administration (Trafikverket) has traditionally been the customer but there is a large potential from municipalities ordering systems as well by implementing their own procurements and agreements with the police authority regarding investigation of speeding ticket cases. According to Trafikverket, there is no difference in technology requirements for the speed cameras between the state and the municipal road networks. The only differences are related to who has the main responsibility for the road maintenance. The municipalities could also, as an alternative to cameras, use speed bumps. Trafikverket says that it is in need of placing cameras in other environments than the rural roads where the vast majority of today's cameras are located. It is therefore conducting an investigation to research the requirements regarding legal certainty, the technology, service and maintenance etc. We expect this investigation to be finished within short but we do not yet know if it will negatively affect Trafikverket's ability or desire to place new orders. Last, Sensys Gatso's tunnel solutions work well. The solution is built with a technology using the same principles as the "moppestrut" to prevent insects from obscuring the cameras.

As mentioned in our preview, Sensys has an employee in Japan. With regards to barriers to entry it also states that the local competitor is not a new one.

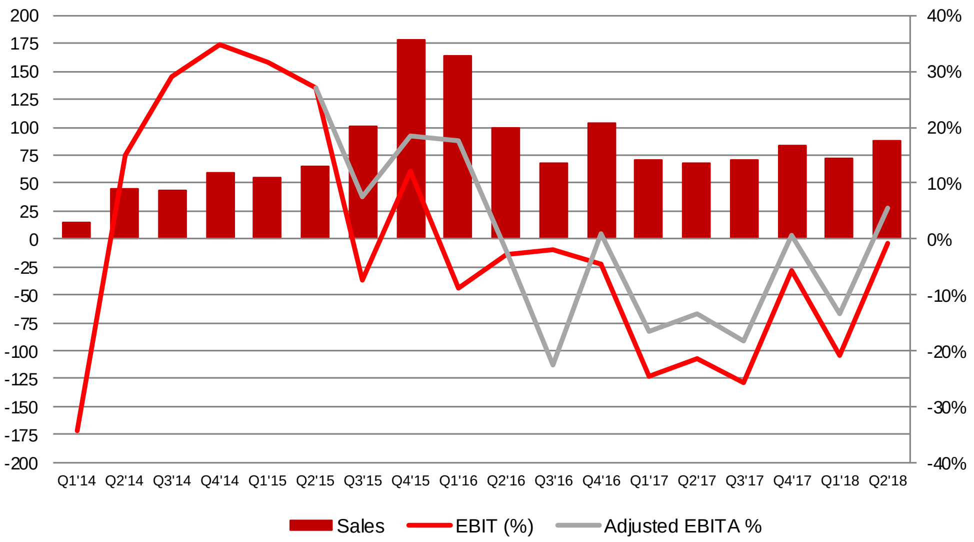
As for the Dutch tender, Sensys Gatso was one of the two winning companies (the contract specified dual sourcing). Sensys Gatso estimates the total contract value on its behalf to SEK 66m. The contract is for so called point-to-point systems that monitor and enforce the average speed of vehicles over a longer distance, typically on rural roads. Besides installation it includes invoicing, repair and maintenance. The contract is a labelled an operations contract but the difference from the US Managed Service contract is that the customer owns the equipment and that the back office solution for sending out tickets is not included. However, one should note that this does not mean that there cannot be a hefty portion of recurring revenue, albeit with lower margins than Managed Services. We estimate the recurring revenue part of this contract to about 50 percent. Remember, the service part of the system sales is substantial although it is not reported per quarter. The Netherlands is a good example of when Sensys Gatso takes a large service responsibility but many times in other countries the service is mostly executed by a partner.

Previously, Sensys Gatso has talked a lot about sustainable cities as a big future opportunity, although the exact offering, in our opinion, has been somewhat fuzzy. The Company states that a good example of sustainable cities is the project in Amsterdam where the ANPR technology (basically the same as in Oklahoma) is used to control heavy trucks. This is done by creating a blacklist of license plates. The camera and the ANPR technology can therefore capture and monitor heavy trucks that drive on lanes they are not supposed to, which would improve the environment of the cities.

Q2: Sensys Gatso is beginning to exceed our estimates

The sales and earnings improved in Q2 and reached levels not seen during the past 6 quarters (see the table below). One important reminder here is that nothing of the solid Q2 sales is related to the strong order intake, suggesting a strong sequential growth during H2'18.

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

As we noted in our first comment on the report, this was the third quarter in a row where the figures came in better or on levels around our estimates. The sales beat of SEK 18m (see the table on the next page) was primarily related to stronger Managed Services sales, which was partly due to a SEK 4m effect from collection of bad debt but Sensys Gatso also said there was an on-boarding effect from new programs. There is also a positive seasonal effect from people traveling more by car in Q2 compared to the winter in Q1.

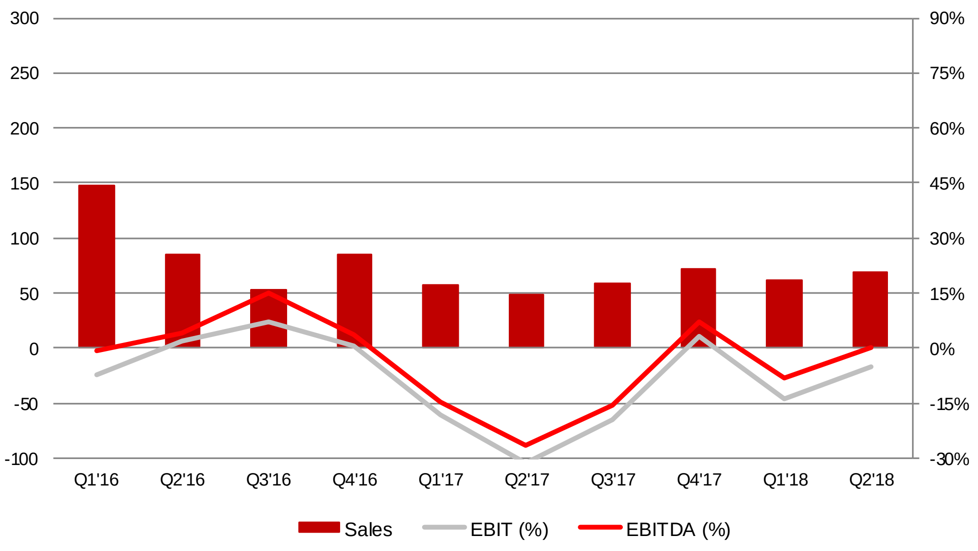
Outcome vs. estimates

SEKm	Q2'17	Q2'18E	Outcome	Dif.
Sales	68	70	89	18
EBITDA	-5	-6	9	14
EBITA	-9	**-10**	**5**	**15**
EBIT	-15	-15	-1	15
EPS (SEK)	-0.02	-0.02	0.00	
Sales growth(YoY)	-32%	3%	30%	
Gross margin	47%	36%	44%	
EBIT margin	-21%	-22%	-1%	
EPS growth (YoY)	1583%	n/a	n/a	

Source: Redeye Research, Sensys Gatso

Cost control and OPEX decreasing by 15 percent y/y led to a solid EBITDA of SEK 9m (expected SEK -6m). The lower OPEX levels were in line with our estimates but we believe they are still worth highlighting, especially given the increased focus on sales and trade shows like e.g. the Partner Day in conjunction with the Intertraffic event in Amsterdam. Looking at the different business areas System Sales reported improved earnings and a break-even EBITDA of SEK 0.1m (see the graph below).

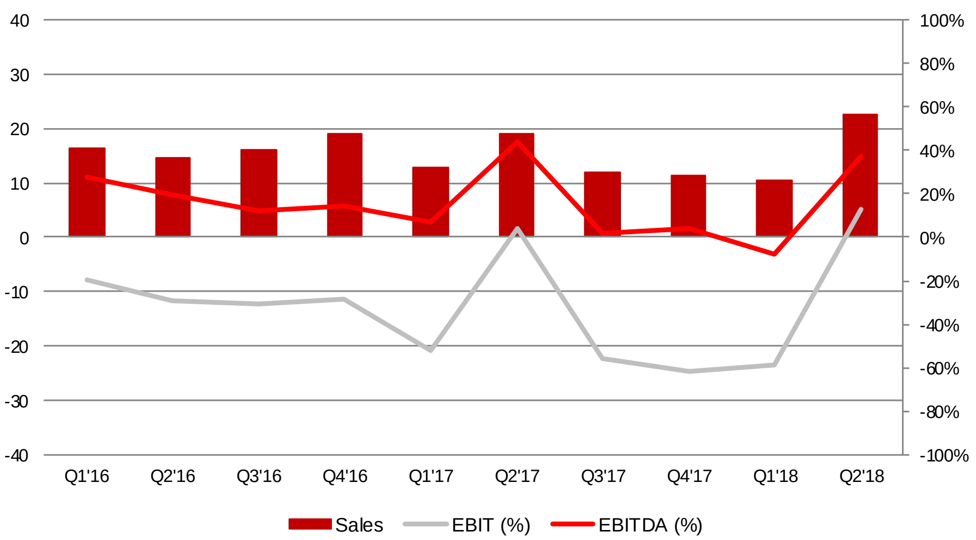
System Sales: Revenue (SEKm) & margins (%)



Source: Redeye Research, Sensys Gatso

Managed Services delivered an outstanding EBITDA margin of 37 percent (see the graph below on the next page) as costs decreased by about SEK 1m. During the coming quarters we expect increased costs though, related to the starting of the new programs in Ohio, although the payback period is normally very fast.

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

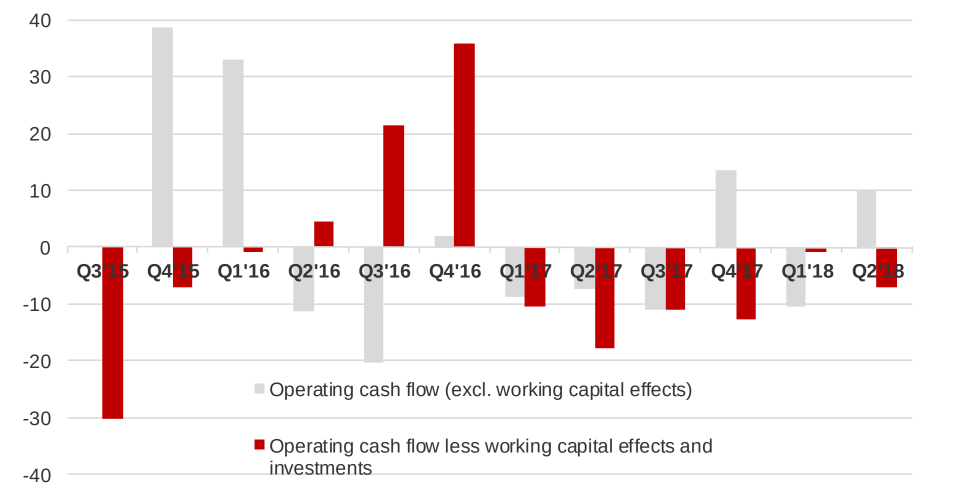


Source: Redeye Research, Sensys Gatso

SEK 64m in cash and a solid balance sheet

Increased working capital requirements led to an operating cash flow of SEK -5m (see the graph below) but the cash position of SEK 64m is solid. We expect the Ohio cost effect to be seen in the CAPEX as well during the next quarters but we have no good idea how large it could be.

Operating cash flow (SEKm)



Source: Redeye Research, Sensys Gatso

The CEO of Sensys Gatso Sweden leaves to pursue new career opportunities

One thing the new CEO has done is that he has decentralized and e.g. given the subsidiaries in the different regions more influence and their own P&Ls. However, the CEO of Sensys Gatso Sweden will leave the company to pursue a career as CFO at Garo. In terms of sales Garo is a three times larger company. Thus, we believe it does not look like she is escaping but more like she is climbing up the career ladder for an exciting new job opportunity.

Financial estimates

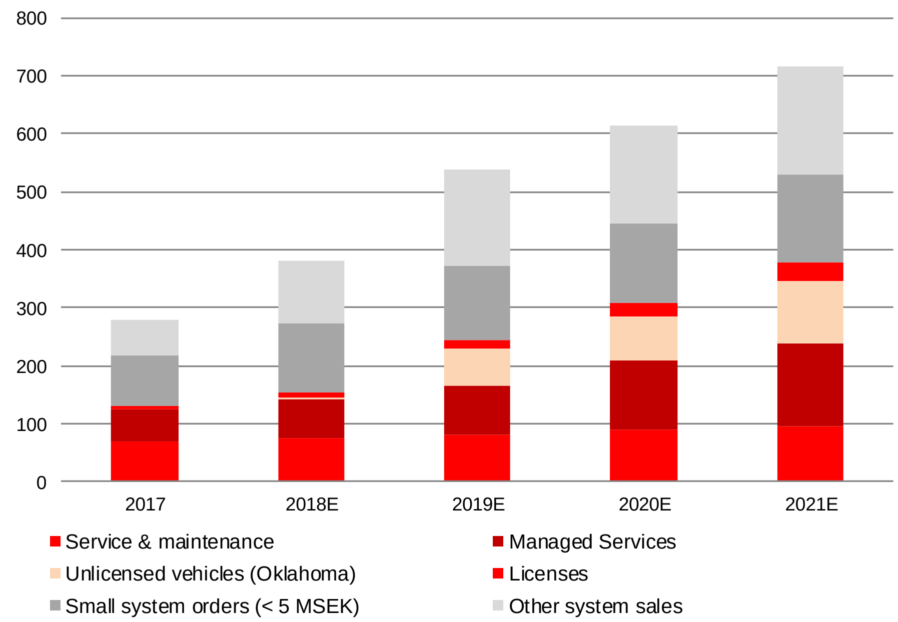
The massive order intake of course leads to changes in our estimates, as indicated in the table below:

Changes in Redeye's estimates					
SEKm		**2018E**	**2019E**	**2020E**	**2021E**
Sales	Old	360	462	586	673
	New	*386*	*539*	*615*	*715*
	change (%)	7%	17%	5%	6%
EBITDA	Old	16	87	135	182
	New	29	102	140	181
	change (%)	83%	17%	4%	-1%
EBIT	Old	-22	52	99	148
	New	-8	68	105	149
	change (%)	-65%	32%	5%	1%
EPS	Old	-0.02	0.06	0.09	0.13
	New	-0.01	0.08	0.10	0.14
	change (%)	-46%	33%	11%	3%

Source: Redeye Research, Sensys Gatso

As can be seen above, the revisions are larger on the top line but as for our cost assumptions the changes are rather small, which is due to the product mix where a large part of the order book is related to services and not hardware or software. The recurring revenue part of the order intake was SEK 104m and SEK 64m with and without the procurement awards. The four lower bars in the graph below are related to the important, faster growing recurring part while the gray bars represent system sales. By comparison, as can be seen in the graph, we expect only minor growth in system sales from 2019 and onward.

Sales assumptions (SEKm)



Source: Redeye Research & Sensys Gatso

The fact that Ohio is related to takeover contracts, as opposed to totally new programs, means that the cameras will be up and running faster, since there is already infrastructure like power, cables etc. plus the predecessor has usually thought a lot about the best positions for the cameras. We therefore expect the Ohio contracts (together with Maryland) to positively affect Managed Services from Q3. However, given the SEK 4m one-off in Q3 we expect revenues to come down slightly compared to Q2. Our cautious Oklahoma estimates for Q4 only include about SEK 4m.

Sensys Gatso: Quarterly estimates (SEKm)

(SEKm)	2016	Q1'17	Q2'17	Q3'17	Q4'17	2017	Q1'18	Q2'18	Q3'18	Q4'18	2018
Sales	437	71	68	71	83	293	72	89	99	123	383
Growth (%)	*10%*	*-57%*	*-32%*	*4%*	*-20%*	*-33%*	*1%*	*30%*	*40%*	*47%*	*31%*
Gross margin (%)	34%	35%	47%	32%	44%	40%	35%	44%	39%	40%	40%
System sales	370	58	49	59	72	238	62	69	80	98	310
Growth (%)	*n/a*	-61%	-42%	13%	-15%	-36%	7%	41%	36%	36%	30%
Managed Services	66	13	19	12	11	55	11	23	19	25	77
Growth (%)	*n/a*	-21%	30%	-26%	-40%	-16%	-17%	18%	62%	117%	40%
EBITDA	25	-8	-5	-9	5	-16	-6	9	9	17	29
EBITA	**-6**	**-12**	**-9**	**-13**	**1**	**-33**	**-10**	**5**	**6**	**13**	**14**
EBITA (%)	***-1%***	***-17%***	***-13%***	***-18%***	***1%***	***-11%***	***-13%***	***6%***	***6%***	***11%***	***4%***
EBIT	-23	-17	-15	-18	-5	-55	-15	-1	0	8	-8
EBIT (%)	*-5%*	*-24%*	*-21%*	*-26%*	*-6%*	*-19%*	*-21%*	*-1%*	*0%*	*6%*	*-2%*
EPS	-0.04	-0.02	-0.02	-0.02	-0.01	-0.07	-0.02	0.00	0.00	0.00	-0.01

Source: Redeye Research, Sensys Gatso

Investment Case

Growing recurring revenue from Managed Services

The US 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. 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 during the first 20 months of the Trump administration.

Large potential in growing with existing customers

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. Sensys Gatso takes full responsibility for administration of tickets and therefore the initial terms reward Sensys Gatso by as much as USD 80 for every citation. When we do the math and glance at statements from Gatso USA we note that the numbers could easily get huge, which is due to the fact that about 25 percent of all vehicles in Oklahoma lack insurance. In Florida, one of Sensys Gatso's other eight states, the proportions of uninsured vehicles are essentially the same as 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 a good example of leveraging the company's expertise and competitive advantages in securing a so called unbroken chain of evidence. 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 movement from SEK 1.3 to over SEK 5.5 in the fall of 2015, which was largely related to the gigantic North African order worth SEK 165 million. The business will remain volatile and larger System Sales orders should continue to be important catalysts, although the most significant event would be a new contract similar to Oklahoma.

Valuation

Bear Case 1.0 SEK

Our bear case has two key differences compared to base case, related to Managed Services and uninsured vehicles (Oklahoma) 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. Oklahoma). This would yield Managed Services revenue of close to SEK 130m in 2024, i.e. twice today's levels but only about 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 no new programs similar to Oklahoma. We do however expect Oklahoma to deliver sales of about SEK 60m on average, based on about 100 000 citations per year. 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 15 percent during 2018-2024, meaning recurring revenue of about 60 percent - not too far from our base case. The gross margin in our bear case averages 46 percent in 2018-2024 despite the pressure on the gross margin on the systems side, thanks to the company's focus on recurring revenue. The fixed costs average 33 percent of sales in 2018-2024, 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 13 percent in 2018-2024 while the EBIT margin would rise to 13 percent on average, close to a long-term sustainable EBIT margin of 12 percent.

Base Case 1.7 SEK

Our base case makes the following assumptions: System revenue grows by CAGR 25 percent in 2018-2024, largely driven by increased geographical expansion of the unique in-vehicle solution, which today only is sold in France, two countries in the Middle East and Australia. Our base case expects an average of 150,000 fines collected annually in Oklahoma and one other state which with an average cut of USD 74 (USD 80 for the first two years) for Sensys per fine means annual revenue in excess of about SEK 100 million. CAGR for Managed Services revenue (incl. Oklahoma) and recurring revenue (i.e. software and service as well as operator revenue) amounts to 25 percent and 23 percent respectively in the period 2018-2024, which represents a share of on average about two thirds recurring revenue. The average gross margin for the group is 47 percent in 2018-2024 due to gradual growth in Managed Services and software revenues. The fixed costs average 31 percent of sales in 2018-2024. With our assumptions above, average annual revenue growth totals 21 percent in the period 2018-2024. During the same period, the EBIT margin is approximately 16 percent on average (due to losses in 2018) but rises to an average of 20 percent in 2019-2024 and subsequently to 20 percent in the long term.

Bull Case 3.4 SEK

Similar to our bear case our bull scenario is based on different assumptions for Managed Services and uninsured vehicles (Oklahoma) 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 48 percent CAGR growth during 2018-2024 (including Oklahoma). As for Oklahoma and 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 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 500m in 2024. We expect that Sensys Gatso in bull case reaches recurring revenues of over 70 percent during 2023 and on average 68 percent during 2018-2024. 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, meaning only 3 percentage points lower OPEX than our base scenario. Sales will in our optimistic scenario grow by an average of 24 percent annually in 2018-2024, before gradually starting to decrease towards the level of market growth. The EBIT margin averages 22 percent in 2018-2024 driven by an increased proportion of software and operator revenues, which we believe is in line with the 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

New orders similar to Oklahoma

The uninsured vehicles enforcement program in Oklahoma is a new business area for Sensys, which looks very promising Sensys receives as much as 80 USD per citation in Oklahoma. About 25 percent of the cars in Oklahoma are uninsured and in other states these figures seems similar, meaning great potential for Sensys.

Large system orders

The share price is largely driven by the announcement of major orders. For the next quarters we especially see larger orders from Sweden, France, Japan and the Netherlands.

Summary Redeye Rating

The rating consists of five valuation keys, each constituting an overall assessment of several factors that are rated on a scale of 0 to 2 points. The maximum score for a valuation key is 10 points.

Rating changes in the report

Sensys Gatso has cleaned up its balance sheet significantly and it also now has a large order book that suggests profitability for coming quarters, meaning lower risk and a higher rating for financial stability of 8 (4) as well as profitability of 2 (1). We also raise our Management score to 5 (4) as we like Management's increased sales efforts like e.g. the partner day and focus on existing customers. The CEO may lack experience from the traffic enforcement industry but he is compensating that by decentralizing power to the local subsidiaries. Our new required rate of return following these changes is 11.3 percent (14.3 %).

Management: 5.0

The Gatso acquisition in summer 2015 seemed to be a well-timed, 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 experience from entirely other 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.

Ownership: 3.0

In conjunction with the acquisition, Sensys Gatso gained an industrial principal shareholder. The former Gatso management holds 18 percent 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 excluding the COB's holdings no one owns more than 100 000 shares on average.

Profit Outlook: 8.0

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.

Profitability: 2.0

Gatso's historical earnings stability has so far not broken through to the combined total sales of Sensys and Gatso. EBIT peaked at SEK 49 million in 2015 and now looks set to be negative for the third consecutive year. However, it should be noted that market conditions and the order intake have improved significantly during 2018. 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.

Financial Strength: 8.0

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 operating costs, interest expenses and amortisation. 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	2016	2017	2018E	2019E	2020E
Net sales	437	293	386	539	615
Total operating costs	-411	-309	-357	-437	-475
EBITDA	25	-16	29	102	140
Depreciation	-13	-14	-11	-13	-16
Amortization	-35	-25	-25	-21	-20
Impairment charges	0	0	0	0	0
EBIT	-23	-55	-8	68	105
Share in profits	0	0	0	0	0
Net financial items	-7	-4	-4	-1	-1
Exchange rate dif.	0	0	0	0	0
Pre-tax profit	-30	-59	-11	67	104
Tax	6	3	1	-3	-21
Net earnings	-24	-55	-10	63	83

BALANCE SHEET	2016	2017	2018E	2019E	2020E
Assets					
Current assets					
Cash in banks	22	59	19	53	137
Receivables	63	71	66	92	105
Inventories	47	63	66	92	102
Other current assets	28	28	34	40	44
Current assets	160	221	184	277	387
Fixed assets					
Tangible assets	43	35	39	54	62
Associated comp.	0	0	0	0	0
Investments	0	0	0	0	0
Goodwill	239	239	239	239	239
Cap. exp. for dev.	113	88	66	51	39
O intangible rights	2	3	5	6	7
O non-current assets	0	0	0	0	0
Total fixed assets	398	365	349	351	348
Deferred tax assets	52	38	38	38	38
Total (assets)	609	624	571	666	773
Liabilities					
Current liabilities					
Short-term debt	19	26	1	0	0
Accounts payable	21	31	39	55	62
O current liabilities	67	64	64	84	100
Current liabilities	107	121	104	139	162
Long-term debt	80	56	30	19	9
O long-term liabilities	0	0	0	0	0
Convertibles	0	0	0	0	0
Total Liabilities	187	177	134	158	171
Deferred tax liab	32	23	20	26	31
Provisions	4	4	7	9	11
Shareholders' equity	387	420	410	473	560
Minority interest (BS)	0	0	0	0	0
Minority & equity	387	420	410	473	560
Total liab & SE	609	624	571	666	773

FREE CASH FLOW	2016	2017	2018E	2019E	2020E
Net sales	437	293	386	539	615
Total operating costs	-411	-309	-357	-437	-475
Depreciations total	-49	-39	-37	-34	-36
EBIT	-23	-55	-8	68	105
Taxes on EBIT	4	3	1	-3	-21
NOPLAT	-19	-52	-7	65	84
Depreciation	49	39	37	34	36
Gross cash flow	30	-13	30	99	120
Change in WC	73	-17	5	-23	-4
Gross CAPEX	-10	-6	-20	-36	-33
Free cash flow	92	-36	15	40	83

CAPITAL STRUCTURE	2016	2017	2018E	2019E	2020E
Equity ratio	63%	67%	72%	71%	72%
Debt/equity ratio	26%	20%	8%	4%	2%
Net debt	77	23	12	-35	-127
Capital employed	463	444	422	439	433
Capital turnover rate	0.7	0.5	0.7	0.8	0.8

GROWTH	2016	2017	2018E	2019E	2020E
Sales growth	10%	-33%	32%	40%	14%
EPS growth (adj)	-153%	76%	-82%	-725%	30%

DCF VALUATION		CASH FLOW, MSEK	
WACC (%)	11.3 %	NPV FCF (2018-2020)	126
		NPV FCF (2021-2027)	594
		NPV FCF (2028-)	756
		Non-operating assets	59
		Interest-bearing debt	-82
		Fair value estimate MSEK	1453
Assumptions 2017-2023 (%)			
Average sales growth	16.0 %	Fair value e. per share, SEK	1.7
EBIT margin	17.0 %	Share price, SEK	2.0

PROFITABILITY	2016	2017	2018E	2019E	2020E
ROE	-6%	-14%	-2%	14%	16%
ROCE	-4%	-11%	-2%	15%	20%
ROIC	-4%	-11%	-2%	15%	19%
EBITDA margin	6%	-5%	8%	19%	23%
EBIT margin	-5%	-19%	-2%	13%	17%
Net margin	-6%	-19%	-3%	12%	13%

DATA PER SHARE	2016	2017	2018E	2019E	2020E
EPS	-0.04	-0.07	-0.01	0.08	0.10
EPS adj	-0.04	-0.07	-0.01	0.08	0.10
Dividend	0.00	0.00	0.00	0.00	0.00
Net debt	0.12	0.03	0.01	-0.04	-0.15
Total shares	657.16	844.91	844.91	844.91	850.91

VALUATION	2016	2017	2018E	2019E	2020E
EV	1,003.4	1,316.1	1,710.1	1,663.7	1,571.0
P/E	-38.0	-23.5	-167.2	26.8	20.6
P/E diluted	-38.0	-23.5	-167.2	26.8	20.6
P/Sales	2.1	4.4	4.4	3.1	2.8
EV/Sales	2.3	4.5	4.4	3.1	2.6
EV/EBITDA	39.6	-83.0	59.0	16.3	11.2
EV/EBIT	-43.2	-24.0	-224.5	24.4	15.0
P/BV	2.4	3.1	4.1	3.6	3.0

SHARE PERFORMANCE		GROWTH/YEAR	16/18E
1 month	44.6 %	Net sales	-6.0 %
3 month	46.7 %	Operating profit adj	-42.8 %
12 month	214.1 %	EPS, just	-43.1 %
Since start of the year	31.4 %	Equity	3.0 %

SHAREHOLDER STRUCTURE %	CAPITAL	VOTES
Gatso Special Products B.V.	17.6 %	17.6 %
Avanza Pension	4.5 %	4.5 %
Per Wall	2.7 %	2.7 %
Inger Bergstrand	2.6 %	2.6 %
Nordnet Pensionsförsäkring	2.0 %	2.0 %
AXA	1.4 %	1.4 %
Swedbank Försäkring	1.1 %	1.1 %
Per Hamberg	0.9 %	0.9 %
Livförsäkringsbolaget Skandia	0.8 %	0.8 %
Dimensional Fund Advisors	0.8 %	0.8 %

SHARE INFORMATION	
Reuters code	SENS.ST
List	Small Cap
Share price	2.0
Total shares, million	844.9
Market Cap, MSEK	1698.3

MANAGEMENT & BOARD	
CEO	Ivo Mönnink
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IR	n/a
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Redeye Rating and Background Definitions

The aim of a Redeye Rating is to help investors identify high-quality companies with attractive valuation.

Company Qualities

The aim of Company Qualities is to provide a well-structured and clear profile of a company's qualities (or operating risk) – its chances of surviving and its potential for achieving long-term stable profit growth.

We categorize a company's qualities on a ten-point scale based on five valuation keys; 1 – Management, 2 – Ownership, 3 – Profit Outlook, 4 – Profitability and 5 – Financial Strength.

Each valuation key is assessed based a number of quantitative and qualitative key factors that are weighted differently according to how important they are deemed to be. Each key factor is allocated a number of points based on its rating. The assessment of each valuation key is based on the total number of points for these individual factors. The rating scale ranges from 0 to +10 points.

The overall rating for each valuation key is indicated by the size of the bar shown in the chart. The relative size of the bars therefore reflects the rating distribution between the different valuation keys.

Management

Our Management rating represents an assessment of the ability of the board of directors and management to manage the company in the best interests of the shareholders. A good board and management can make a mediocre business concept profitable, while a poor board and management can even lead a strong company into crisis. The factors used to assess a company's management are: 1 – Execution, 2 – Capital allocation, 3 – Communication, 4 – Experience, 5 – Leadership and 6 – Integrity.

Ownership

Our Ownership rating represents an assessment of the ownership exercised for longer-term value creation. Owner commitment and expertise are key to a company's stability and the board's ability to take action. Companies with a dispersed ownership structure without a clear controlling shareholder have historically performed worse than the market index over time. The factors used to assess Ownership are: 1 – Ownership structure, 2 – Owner commitment, 3 – Institutional ownership, 4 – Abuse of power, 5 – Reputation, and 6 – Financial sustainability.

Profit Outlook

Our Profit Outlook rating represents an assessment of a company's potential to achieve long-term stable profit growth. Over the long-term, the share price roughly mirrors the company's earnings trend. A company that does not grow may be a good short-term investment, but is usually unwise in the long term. The factors used to assess Profit Outlook are: 1 – Business model, 2 – Sale potential, 3 – Market growth, 4 – Market position, and 5 – Competitiveness.

Profitability

Our Profitability rating represents an assessment of how effective a company has historically utilised its capital to generate profit. Companies cannot survive if they are not profitable. The assessment of how profitable a company has been is based on a number of key ratios and criteria over a period of up to the past five years: 1 – Return on total assets (ROA), 2 – Return on equity (ROE), 3 – Net profit margin, 4 – Free cash flow, and 5 – Operating profit margin or EBIT.

Financial Strength

Our Financial Strength rating represents an assessment of a company's ability to pay in the short and long term. The core of a company's financial strength is its balance sheet and cash flow. Even the greatest potential is of no benefit unless the balance sheet can cope with funding growth. The assessment of a company's financial strength is based on a number of key ratios and criteria: 1 – Times-interest-coverage ratio, 2 – Debt-to-equity ratio, 3 – Quick ratio, 4 – Current ratio, 5 – Sales turnover, 6 – Capital needs, 7 – Cyclicality, and 8 – Forthcoming binary events.

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Disclaimer

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Redeye Rating (2018-09-05)

Rating	Management	Ownership	Profit outlook	Profitability	Financial Strength
7,5p - 10,0p	44	45	18	10	20
3,5p - 7,0p	83	76	111	35	49
0,0p - 3,0p	14	20	12	96	72
Company N	141	141	141	141	141

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CONFLICT OF INTERESTS

Viktor Wesstman owns shares in the company : No

Eddie 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.