

Transtema

Sector: Communication Services

M&A Fueled Growth Ahead

Redeye retains its positive view on Transtema following a Q1 report with underlying sales and EBITA in line with our forecasts. From Q2 and onwards, Tessta, which had a solid start to 2022, will be fully consolidated, driving sales and earnings.

Solid Underlying Numbers

Sales and adjusted EBITA (SEK 8m in M&A costs) largely aligned with our comparable forecasts. The adjusted EBITA margin was 6.4% (8.3) and did not reach the very high level seen in Q1 last year, partly because of high sick leave and rising energy costs. Nevertheless, the level was in line with our forecasts and above Transtema's >5% target. NOTE: Our headline forecasts consolidated Tessta from January 1 instead of the actual March 10, and were, thus, not comparable to the outcome. See table on page 2 for details.

Solid Start for Tessta

Tessta, consolidated on March 10 and thus included for 20 days in Q1, has had a solid start to 2022. According to management, Tessta has so far performed better than expected, and sales during Q1 significantly increased y/y, although from covid-19 affected levels last year.

New Base Case SEK 48 (54)

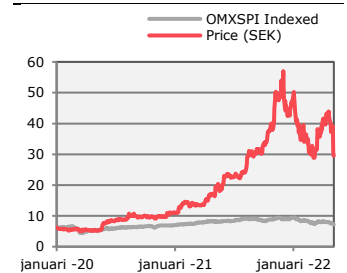
We lower our Base Case to SEK 48 (54). The decrease is mainly due to us raising the WACC somewhat following an increased risk-free rate. Despite the slight reduction of our Base Case, the upside potential is still significant at >60%, and we expect upcoming quarterly reports, with Tessta fully consolidated, to be the main catalyst from now on. We believe the recent sharp decline in the share price was related mainly to a misunderstanding of the consolidation of Tessta.

Key Financials (SEKm)	2020	2021	2022E	2023E	2024E
Sales	1405	1690	2101	2245	2313
Sales growth	-6%	20%	24%	7%	3%
EBITA	42	137	146	175	181
EBITA Margin (%)	3.0%	8.1%	7.0%	7.8%	7.8%
EV/Revenue			0.7	0.5	0.5
EV/EBITA			9.4	7.0	5.9

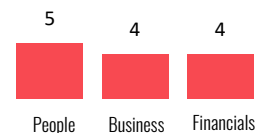
FAIR VALUE RANGE

BEAR	BASE	BULL
24	48	61

TRANS VERSUS OMXS30



REDEYE RATING



KEY STATS

Ticker	TRANS
Market	Small Cap
Share Price (SEK)	29.44
Market Cap (SEKm)	1149
Net Debt (SEKm)	54
Free Float (%)	65%
Avg. daily volume ('000)	5 490

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Solid Underlying Numbers

	Q1E 2022	Q1A 2022	Diff	Q1A 2021	Q4A 2021
Revenues	527.4	444.6	(15.7%)	387.9	467.2
Y/Y Growth (%)	36%	15%		13%	13%
Revenues (comparable)	446.8	444.6	(0.5%)	387.9	467.2
Y/Y Growth (%)	36%	15%		13%	13%
EBITA	37.5	20.4	(45.6%)	32.4	28.4
EBITA Margin (%)	7.1%	4.6%		8.3%	6.1%
Adjusted EBITA	37.5	28.4	(24.3%)		
Adjusted EBITA margin	7.1%	6.4%			
Adjusted EBITA (comparable)	29.2	28.4	(3.0%)		
Adjusted EBITA margin	6.5%	6.4%			
EPS	0.57	0.29	(49.1%)	0.68	0.59

Source: Transtema & Redeye Research

Reported sales and adjusted EBITA (adjusted for SEK 8m in M&A costs) came in below our expectations. However, as Tessta was consolidated March 10 and not January 1, as we assumed, our headline forecasts are not comparable to the actual figures. Instead, we must adjust our forecasts for the later than expected consolidation of Tessta. The adjustments are shown in the table below:

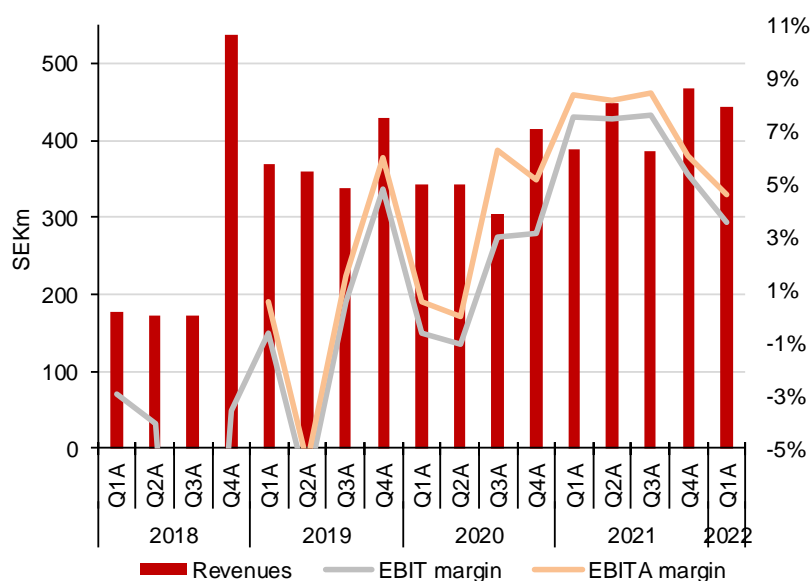
	FY 2022E	92 Days	20 Days	Diff	Redeye Forecast	Diff	Comparable Forecast
Tessta					Group		Group
Sales	420.0	103.6	23.0	80.5	527.4	80.5	446.8
EBITA	43.0	10.6	2.4	8.2	37.5	8.2	29.2
EBITA margin	10.2%	10.2%	10.2%	10.2%	7.1%		6.5%

Source: Transtema & Redeye Research

When adjusting for the actual consolidation, we end up with a revenue forecast of SEK 447m and an EBITA forecast of SEK 29.2m. As shown in the first table, that is largely in line with the outcome of SEK 445m in revenue and SEK 28.4m in EBITA. Considering the rapid share price decline of ~17% on the reporting day, we believe investors have missed the later than expected consolidation. While the organic adjusted EBITA margin was down somewhat y/y relative to a very strong, following high sick leave due to Omicron and increased energy prices, the outcome was in line with our forecasts.

According to management, Tessta has solidly started 2022 with a substantial increase in sales y/y, relative to Covid-19 affected levels last year. Also, organic sales growth was 5.4%. Regarding margins, we expect the negative effect from a high sick leave to be temporary, and it should not affect Q2. While we believe Transtema can compensate for increasing energy prices, its high exposure to large customers could make the compensating process longer and more difficult.

Revenues, EBITA- and EBIT margin



While not reaching the excellent Q1 2021 in terms of margins, with a 6.4% adjusted EBITA margin, Transtema is still clearly above its >5% EBITA margin target, despite high sick leave and increasing energy costs. Also, Transtema's margins remain significantly above its peers; see the Valuation segment for details.

ESG KPI:s

While most companies talk about ESG, few disclose any relevant data quarterly for good reasons. In the Q1 report, Transtema discloses basically all relevant ESG KPI:s quarterly. The data includes the share of electric vehicles, the share of renewable fuels, CO2e emissions, the number of severe accidents, etc.

We like the transparency that makes Transtema's ESG initiatives more tangible and allows analysts and investors to follow up on Transtema's performance. Also, we argue that detailed reporting reduces the ESG-related risks for investors, as they can get a comprehensive picture of the current situation. We believe the "Income Statement"-like reporting of ESG KPI:s suits analysts and investors well, as they are familiar with the format. Also, we believe Transtema's quarterly ESG reporting should inspire other companies with a high ambition regarding ESG.

Financial Forecasts

We leave our overall sales forecasts, adjusted for the actual consolidation of Tessta, largely unchanged for 2022E and 2023E. However, we lower our organic sales forecasts slightly while raising our assumptions for Tessta, which has had a solid start of 2022.

We lower our margin assumptions slightly for two reasons. First, we expect increased fuel costs to impact short- to mid-term margins negatively. Second, we had previously likely taken the very strong Q1-Q3 2021 into consideration to a too high degree. However, we still expect margins significantly above the >5% EBITA margin target.

Estimate Revisions	FYE 2022	Old	Change	FYE 2023	Old	Change
Revenues	2 100.7	2 193.7	(4.2%)	2 245.4	2 259.5	(0.6%)
Y/Y Growth (%)	49.5%	56.2%		6.9%	3.0%	
EBITA	146.1	175.0	(16.5%)	174.7	190.9	(8.5%)
EBITA Margin (%)	7.0%	8.0%		7.8%	8.4%	
EPS	2.25	2.79	(19.2%)	2.79	3.10	(9.8%)

Source: Transtema & Redeye Research

In 2022 and onwards, we expect organic growth of a few percent per annum and EBITA margins somewhat below 8%. However, we do not assume any material investments in or sales from new areas such as EV-charging. If Transtema is successful in its greenfield investment, we would likely see lower margins short-term in exchange for higher growth and possibly margins long-term.

Income Statement	2021	2022Q1	2022Q2	2022Q3	2022Q4	2022	2023	2024
Revenues	1 690	445	567	503	586	2 101	2 245	2 313
Y/Y Growth (%)	20.3%	14.6%	26.4%	30.2%	25.5%	24.3%	6.9%	3.0%
Cost of Revenues	(578)	(170)	(227)	(202)	(240)	(839)	(906)	(939)
Gross Profit	1 112	274	340	301	346	1 262	1 339	1 374
Gross Profit Margin (%)	65.8%	61.7%	60.0%	59.8%	59.1%	60.1%	59.6%	59.4%
Other external costs	(215)	(61)	(65)	(69)	(66)	(261)	(266)	(271)
Personnel expenses	(697)	(176)	(213)	(172)	(214)	(775)	(813)	(835)
Other operation income	3	1	1	1	1	2	2	2
EBITDA	202	38	63	61	67	229	262	269
EBITDA Margin (%)	12.0%	8.7%	11.1%	12.0%	11.4%	10.9%	11.7%	11.7%
Depreciation	(65)	(18)	(21)	(22)	(22)	(83)	(88)	(88)
EBITA	137	20	42	39	45	146	175	181
EBITA Margin (%)	8.1%	4.6%	7.3%	7.7%	7.7%	7.0%	7.8%	7.8%
Amortization	(13)	(5)	(7)	(7)	(7)	(24)	(25)	(25)
EBIT	124	16	35	32	39	122	149	156
EBIT Margin (%)	7.4%	3.5%	6.2%	6.4%	6.6%	5.8%	6.6%	6.7%
Interest Expenses	(10)	(3)	(3)	(3)	(3)	(12)	(12)	(12)
EBT	114	14	32	29	36	110	137	144
Income Tax Expenses	(25)	(3)	(7)	(6)	(8)	(24)	(30)	(32)
Effective Tax Rate (%)	22.0%	20.6%	22.0%	22.0%	22.0%	22.0%	22.0%	22.0%
Non-Controlling Interests	1	0	-	-	-	0	-	-
Net Income	90	11	25	23	28	86	107	112
Net Income Margin (%)	5.3%	2.5%	4.4%	4.5%	4.8%	4.1%	4.8%	4.9%

Source: Transtema & Redeye Research

Investment Case

Transtema 2.0

Following a few years with frequent acquisitions and focus mainly on Fiber-To-The-Home (FTTH) construction which ended badly, Transtema has reshaped its business, concentrating on the stable operations and maintenance market. Recent country-wide contracts with Telia and 3GIS, combined with impressive margin development in the last three quarters, indicate that the renewed strategy is a success. In addition to so far generating solid profits, the new focus has several advantages. ~70% of Transtema's revenues are recurring and, thus, independent of investments in new FTTH/B, which significantly increases the predictability and duration of its revenues. In the mean time, Transtema has improved its working capital substantially, now hitting negative net levels. We believe the market has not yet fully priced in Transtema's transformation to a stable and profitable company.

Scale Advantages

While Transtema is a personnel-dependent service business without substantial intangible assets, we believe the company has durable competitive advantages. Considering the importance of reliable communication networks and the limited acceptance for downtime, reaching all populated Sweden fast is vital – especially for large country-wide contracts.

Established in 85 locations and with ~900 technicians, Transtema reaches all populated Sweden in an hour. Establishing a similar organization is a substantial investment and a significant deal, like Transtema's Telia and 3GIS (Telenor and 3) deals, is probably necessary to justify running operations in all of Sweden. Thus, we believe market characteristics limit the risk of new players entering the market, which should support Transtema's long-term profitability. Also, we believe Transtema's nationwide organization can handle increasing volumes at limited cost increases, paving the way for higher margins if signing new substantial deals.

Demand for Availability and Reliability

Several structural trends, like digital health services, autonomous driving, the internet of things, and decentralized working, are driving demand for increased availability and reliability of communication networks. The acceptance for downtime is gradually decreasing as internet access is becoming increasingly vital for consumers and businesses alike and, going forward, unacceptable in some cases. We believe Transtema's services' rising importance will drive growth and reduce price pressure, as we assume network owners favor quality and comprehensive Service Level Agreements (SLA).

Counter-Thesis

Significant Customer Concentration

While including several different areas and contracts, Telia represents ~65% of Transtema's revenues. We believe that is a significant customer concentration, which increases the risk in Transtema's operation. However, Transtema is simultaneously a vital supplier to Telia's Swedish operations. While substantial customer concentration tends to cause price pressure, considering the importance of reliable networks, we believe it is in Telia's interest not to squeeze its suppliers. Especially not the larger ones, like Transtema with its nationwide capabilities.

Exposure to Legacy Technology

During the next 5-10 years, copper will gradually be phased out. Considering that Transtema generates ~35% of its sales from copper-related contracts, we expect a negative sales growth impact of about 5% annually. However, as copper is phased out, the fiber market expands, and 5G opens new growth opportunities. While there are several opportunities to compensate the lost copper business, it is usually harder to gain new business than defending current contracts. Also, technical shifts are a natural part of the communication network market and, thus, something businesses in the sector must handle.

Valuation

Bear Case 24 SEK

- Sales CAGR of ~2% 2020-2030
- No future M&A
- Terminal growth of 2%
- Average EBITA margin of ~5% 2021-2030
- Terminal EBITA margin of ~4%

Base Case 48 SEK

- Sales CAGR of ~3% 2020-2030
- No future M&A
- Terminal growth of 2%
- Average EBITA margin of ~7.8% 2021-2030
- Terminal EBITA margin of 7.7%

Bull Case 61 SEK

- Sales CAGR of ~4% 2020-2030
- No future M&A
- Terminal growth of 2%
- Average EBITA margin of ~9% 2021-2030
- Terminal EBITA margin of ~9%

We lower our Base Case to SEK 48 (54) due to an increased WACC as we raise the risk-free rate to 2% (1). However, somewhat lowered forecasts have a slight negative impact as well. Despite the slight reduction of our Base Case, the upside potential is still significant at >50%.

Also, note that Transtema has few institutional investors despite a market cap approaching SEK 1.5bn. The transformed Transtema has many features that we believe institutional investors find attractive, such as non-cyclical recurring revenue streams and a genuine commitment to ESG.

Peer Valuation

Transtema is trading at a significant discount to peers for 2023E. Also, its margins are the highest, and it has a solid track record since its transformation. Thus, we believe a premium is motivated, and our Base Case of SEK 48 equals 10x EBITA 2023E.

Company	EV	Sales	EV/SALES			EV/EBITA (x)			Sales growth			EBITA margin		
	(SEK)	20A	21A	22E	23E	21A	22E	23E	21A	22E	23E	21A	22E	23E
Eltel	1 391	8 242	0.2	0.2	0.2	10.4	6.4	5.1	-16%	-1%	1%	1.6%	2.6%	3.3%
Bravida	17 994	21 724	0.8	0.8	0.7	12.8	11.5	10.8	3%	7%	4%	6.5%	6.7%	6.8%
Caverion	6 969	2 140	0.3	0.3	0.3	12.7	10.0	8.5	-1%	6%	4%	2.4%	2.8%	3.2%
Enersense	1 266	235	0.5	0.5	0.5	20.9	10.3	8.8	59%	6%	3%	2.4%	4.6%	5.2%
Netel	1 922	2 420	0.8	0.6	0.5	11.0	7.7	6.7	n/a	32%	13%	7.2%	7.8%	7.9%
Median	4 180	5 191	0.4	0.4	0.4	12.8	10.2	8.6	1%	6%	4%	2.4%	3.7%	4.2%
Average	6 905	8 085	0.4	0.4	0.4	14.2	9.6	8.3	11%	5%	3%	3.2%	4.2%	4.6%
Transtema	1 375	1 405	0.7	0.7	0.5	8.2	9.4	7.0	20%	24%	7%	8.1%	7.0%	7.8%

Source: Redeye, FactSet

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: None

People: 5

Transtema receives the highest rating for People for several reasons. First, we believe management has relevant experience and a solid understanding of the market. Second, following operational and financial issues, its management has reshaped the business to profitability. Third, insiders, such as CEO Magnus Johansson, own a substantial share of Transtema. Fourth, we believe that management's communication is balanced and realistic.

Business: 4

Transtema receives a high rating for Business for several reasons. First, the group gets most of its revenue from operations, services, and maintenance, and ~70% is recurring. Second, the limited acceptance for downtime makes Transtema's services vital to its customers. Third, Transtema has established nationwide operations with ~900 technicians and a presence in ~85 locations, implying significant investments for new entrants

Financials: 3

Transtema receives an average rating for Financials. Recent improvements in organic growth, margins, and cash flow increase the rating, while weak performance a few years ago is working oppositely. Given that Transtema can preserve its recent improvements in margins, which we find likely, Transtema is heading for a higher rating over the coming years.

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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Redeye Rating (2022-05-09)

Rating	People	Business	Financials
5	32	15	4
3-4	155	137	48
0-2	5	40	140
total	192	192	192

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Fredrik Nilsson owns shares in the company : No

Jacob Svensson owns shares in the company : No

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