

Transtema

Sector: Communication Services

Charging for New Verticals

Redeye raises its forecasts and Base Case for Transtema following a strong Q3 report. As Transtema now is a healthy business, management highlights several growth opportunities, which we find attractive.

Excellent Margins Again

Like in Q1 and Q2, the EBITA margin was higher than 8%, far above Transtema's target of >5% and beating our forecast of 7.3%. EBITA beat our forecast by 18%. While we believed Transtema had successfully transformed in our Initiation Coverage in June, we likely underestimated the magnitude considering the Q2 and Q3 reports.

Expanding Into EV-charging

Considering the successful transformation of the business, it is natural for management to start focusing on growth. Management highlights electric vehicle (EV) charging, among others, as an interesting area. We believe areas where Transtema can utilize its nationwide organization, like EV-charging, are highly interesting. Interestingly, Transtema currently has four EV-charging-related vacancies.

New Base Case SEK 45 (35)

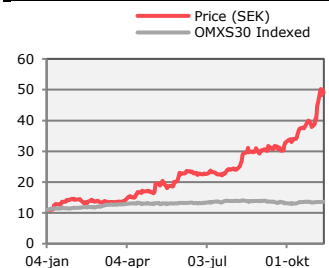
We raise our Base Case to SEK 45 (35), mainly due to increased margin assumptions. Once again, Transtema proves the capabilities of its current business, and we believe there are several interesting growth opportunities where M&A plays an important role.

Key Financials (SEKm)	2019	2020	2021E	2022E	2023E
Sales	1497	1405	1687	1757	1809
Sales growth	41%	-6%	20%	4%	3%
EBITA	13	42	138	137	143
EBITA Margin (%)	1%	3%	8%	8%	8%
EV/Revenue			1.1	1.0	1.0
EV/EBITA			14.0	13.3	12.1

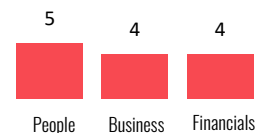
FAIR VALUE RANGE

BEAR	BASE	BULL
22	45	60

TRANS VERSUS OMXS30



REDEYE RATING



KEY STATS

Ticker	TRANS
Market	Small Cap
Share Price (SEK)	50
Market Cap (SEKm)	1930
Net Debt (SEKm)	0
Free Float (%)	64%
Avg. daily volume ('000)	4 780

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Excellent Margins – Again

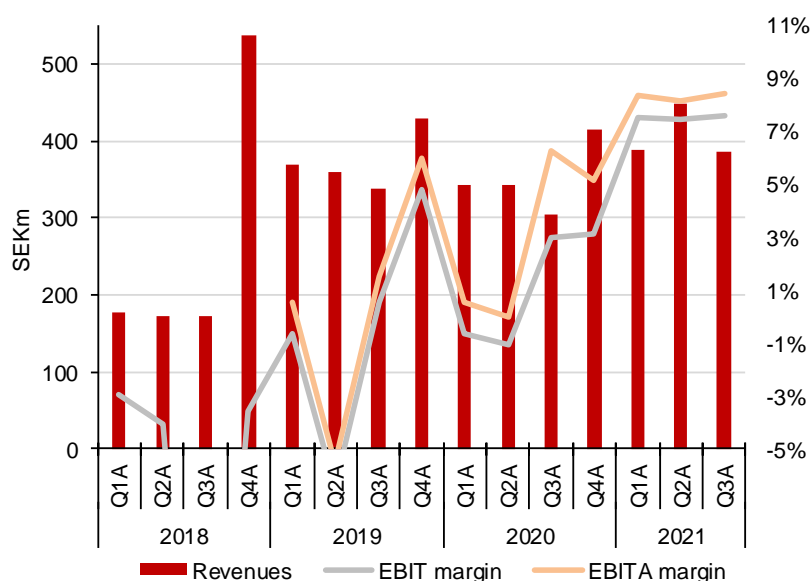
	Q3E 2021	Q3A 2021	Diff	Q3A 2020	Q2A 2021
Revenues	380.3	387.0	1.8%	304.2	448.1
Y/Y Growth (%)	25%	27%		-10%	30%
Gross Profit	244.9	255.9	4.5%	180.5	287.8
Gross Profit Margin (%)	64.4%	66.1%		59.3%	64.2%
Other external costs	(41.3)	(57.5)	39.1%	(29.5)	(52.3)
Y/Y Growth (%)					
Personnel expenses	(157.8)	(150.1)	(4.9%)	(115.3)	(183.6)
Y/Y Growth (%)					
EBITA	27.6	32.5	18.0%	19.1	36.5
EBITA Margin (%)	7.3%	8.4%		6.3%	8.2%
EPS	0.45	0.53	17.3%	(0.03)	0.50

Source: Transtema & Redeye Research

Sales grew by 27% y/y, which was largely in line with our forecasts. Organic growth was 31% - the organic growth was higher than reported due to divestments. The strong growth is mainly related to the large orders Transtema received in 2020. Although the deployment of 5G has started, the volumes are small so far. While we expect the large orders to positively impact sales growth in Q4 2021 and Q1 2022 as well to some extent, from Q2 2022 and onwards, we forecast organic growth of 3%.

Like in Q1 and Q2, the EBITA margin was higher than 8%, far above Transtema's target of >5% and beating our forecast of 7.3%. EBITA beat our forecast by 18%. While we believed Transtema had successfully transformed in our Initiation Coverage in June, we likely underestimated the magnitude considering the Q2 and Q3 reports. Although Transtema has a history of volatile margins, three consecutive quarters with EBITA margins above 8% suggest the transformed Transtema is a stable business.

Revenues, EBITA- and EBIT margin



The cost mix was substantially different from our forecast. However, the cost mix is dependent on the mix of in-house and third-party capacity, which is tough to estimate quarterly. We believe the EBITA margin should be in focus.

While 8% is significantly above Transtema's target of >5%, we believe the target considers future M&A and following integrations that might lower the margins, at least temporary, rather than implying Transtema currently is too profitable.

Turning Focus to Growth

Considering the successful transformation of the business with high and stable margins, it is natural for management to start focusing on growth. Management highlights electric vehicle (EV) charging, facilities management, and wireless communication networks as interesting areas. We believe areas where Transtema can utilize its nationwide organization is highly interesting, like those mentioned by management. While we noticed that Transtema is currently having four EV-charging-related vacancies indicating a greenfield investment, we would not rule out M&A in this area.

Year-to-date, chargeable cars constituted 43% of new car sales in Sweden, while only 5% of the total fleet is chargeable. Assuming this trend will continue, which we find very reasonable, the investments needed in chargers is significant

We believe electric vehicle charging is an extra interesting opportunity. Electric vehicles are becoming more and more attractive following declining prices and government subsidies (and raised taxes on alternatives), and the data mentioned above support that. However, charging remains a significant concern, according to most articles discussing the issue in automotive media. It is not uncommon for chargers to be dysfunctional, and the problem is often related to communications rather than power outages.

As the number of chargers increases, we believe that at least charging networks with nationwide ambitions will strive to have a single or a few service and maintenance partners with nationwide reach. While Transtema must add competencies and resources within EV-charging, as it is already doing, we believe Transtema's nationwide communication-focused organization is a significant competitive advantage in the battle for service and maintenance contracts.

Management foresees a market like Fiber-to-the-Home (FTTH), with a major building phase followed by a long tail of service and maintenance. While we believe service and maintenance is the most interesting area for Transtema, at least long-term, construction is interesting as well. The company is currently involved in local projects and has thus important references.

We do not include any EV-charging in our forecasts at this point and look forward to hearing more from management regarding the investments in EV-charging, which considering the four vacancies seem to be in play.

Financial Forecasts

Our final estimate revisions are largely in line with the preliminary, although we slightly lowered our sales forecasts for Q4 2021 and Q1 2022. Following another quarter with an EBITA margin above 8%, we raise our margin assumptions somewhat.

Estimate Revisions	FYE 2021	Old	Change	FYE 2022	Old	Change
Revenues	1 686.6	1 688.4	(0.1%)	1 756.6	1 761.8	(0.3%)
Y/Y Growth (%)	20.1%	20.2%		4.2%	4.3%	
Gross Profit	1 125.6	1 116.1	0.9%	1 165.3	1 159.2	0.5%
Gross Profit Margin (%)	66.7%	66.1%		66.3%	65.8%	
Other external costs	(222.7)	(206.5)	7.8%	(226.9)	(210.7)	7.7%
Y/Y Growth (%)	26.8%	17.6%		1.9%	2.0%	
Personnel expenses	(700.5)	(711.3)	(1.5%)	(733.8)	(748.4)	(1.9%)
Y/Y Growth (%)	27.1%	29.1%		4.8%	5.2%	
EBITA	138.1	131.3	5.2%	137.4	130.5	5.3%
EBITA Margin (%)	8.2%	7.8%		7.8%	7.4%	
EPS	2.34	2.20	6.2%	2.36	2.21	6.4%

Source: Transtema & Redeye Research

In 2022 and onwards, we expect organic growth of about 3% per annum and EBITA margins just 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	2020	2021Q1	2021Q2	2021Q3	2021Q4	2021	2022	2023	2024
Revenues	1 405	388	448	387	464	1 687	1 757	1 809	1 864
Y/Y Growth (%)	(6.2%)	13.2%	30.4%	27.1%	12.0%	20.1%	4.2%	3.0%	3.0%
Cost of Revenues	(602)	(112)	(160)	(131)	(158)	(561)	(591)	(613)	(635)
Gross Profit	803	276	288	256	306	1 126	1 165	1 196	1 228
Gross Profit Margin (%)	57.1%	71.2%	64.2%	66.1%	66.0%	66.7%	66.3%	66.1%	65.9%
Other external costs	(176)	(52)	(52)	(57)	(61)	(223)	(227)	(231)	(236)
Personnel expenses	(551)	(176)	(184)	(150)	(190)	(700)	(734)	(754)	(776)
Other operation income	9	1	1	1	1	3	2	2	2
EBITDA	118	48	53	49	55	205	207	212	218
EBITDA Margin (%)	8.4%	12.4%	11.7%	12.6%	11.9%	12.2%	11.8%	11.7%	11.7%
Depreciation	(75)	(16)	(16)	(16)	(19)	(67)	(69)	(70)	(70)
EBITA	42	32	37	33	37	138	137	143	148
EBITA Margin (%)	3.0%	8.3%	8.2%	8.4%	7.9%	8.2%	7.8%	7.9%	7.9%
Amortization	(26)	(3)	(3)	(3)	(3)	(13)	(14)	(14)	(14)
EBIT	16	29	33	29	33	125	124	129	134
EBIT Margin (%)	1.2%	7.5%	7.4%	7.6%	7.2%	7.4%	7.0%	7.1%	7.2%
Interest Expenses	(10)	(3)	(2)	(2)	(2)	(10)	(8)	(8)	(8)
EBT	8	26	31	27	31	115	116	121	126
Income Tax Expenses	15	0	(11)	(6)	(7)	(25)	(25)	(27)	(28)
Effective Tax Rate (%)	(200.5%)	(1.9%)	35.6%	22.8%	22.0%	22.0%	22.0%	22.0%	22.0%
Non-Controlling Interests	0	0	(0)	0	-	0	-	-	-
Net Income	4	26	19	21	24	90	90	95	98
Net Income Margin (%)	0.3%	6.7%	4.3%	5.3%	5.3%	5.3%	5.1%	5.2%	5.3%

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 22 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 ~3%

Base Case 45 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 6.9%

Bull Case 60 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 9.3%

We raise our Base Case to SEK 45 (35), mainly due to increased margin assumptions. Once again, Transtema proves the capabilities of its current business, and we believe there are several interesting growth opportunities where M&A plays an important role.

Also, note that Transtema has few institutional investors despite a market cap approaching SEK 2bn. 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 premium to peers for 2022E and 2023E. However, 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 45 equals 11x EBITA 2023E. Also, considering Transtema's high share of non-cyclical recurring revenues, 12x EBITA 2023E is not high compared to companies in other sectors with similar characteristics.

Company	EV	Sales	EV/SALES			EV/EBITA (x)			Sales growth			EBITA margin		
	(SEK)	20A	21E	22E	23E	21E	22E	23E	21E	22E	23E	21E	22E	23E
Eitel	2 428	9 843	0.3	0.3	0.3	18	12	9	-19%	-1%	1%	1.6%	2.6%	3.3%
Bravida	25 863	21 147	1.2	1.1	1.1	19	17	16	3%	6%	4%	6.4%	6.7%	6.9%
Caverion	9 835	23 273	0.4	0.4	0.4	11	9	8	0%	6%	5%	3.9%	4.5%	4.9%
Enersense	1 027	1 593	0.4	0.4	0.4	17	8	7	59%	6%	3%	2.4%	4.6%	5.2%
Median	6 131	15 495	0.4	0.4	0.4	18	10	8	1%	6%	4%	3.2%	4.5%	5.1%
Average	9 788	13 964	0.6	0.6	0.5	16	11	10	11%	4%	3%	3.6%	4.6%	5.1%
Transtema	1 937	1 405	1.1	1.0	1.0	14	13	12	20%	4%	3%	8.2%	7.8%	7.9%

Source: Redeye, FactSet

Balance Sheet and Cash Flow

Balance Sheet	2020	2021Q1	2021Q2	2021Q3	2021Q4	2021	2022	2023	2024
Property, Plant & Equipment, Net	28	34	33	33	32	32	31	31	30
Goodwill	77	74	72	70	70	70	70	70	70
Intangible Assets	64	65	63	62	58	58	45	31	18
Right-of-Use Assets	125	129	130	126	125	125	127	129	131
Shares in Associates	67	66	65	65	65	65	65	65	65
Other Long-Term Assets	27	27	15	9	9	9	9	9	9
Total Non-Current Assets	388	394	379	365	359	359	347	335	322
Cash & Equivalents	65	131	146	169	170	170	275	384	497
Inventories	17	21	19	17	20	20	21	21	22
Accounts Receivable	168	96	133	109	169	169	176	181	186
Other Current Assets	121	76	87	86	135	135	141	145	149
Total Current Assets	371	325	385	382	493	493	612	731	854
Total Assets	758	718	764	746	852	852	959	1 066	1 176
Long-Term Debt	19	7	32	29	29	29	29	29	29
Long-Term Lease Liabilities	80	81	82	76	76	76	76	76	76
Other Long-Term Liabilities	51	45	43	43	43	43	43	43	43
Total Non-current Liabilities	150	132	157	148	148	148	148	148	148
Short-Term Debt	49	47	14	14	14	14	14	14	14
Short-Term Lease Liabilities	48	49	50	52	52	52	52	52	52
Accounts Payable	140	115	139	115	169	169	176	181	186
Other Current Liabilities	212	186	198	191	219	219	228	235	242
Total Current Liabilities	448	398	401	372	454	454	470	482	494
Non-Controlling Interest	1	1	0	0	0	0	0	0	0
Shareholder's Equity	160	187	206	226	251	251	341	436	534
Total Liabilities & Equity	758	718	764	746	852	852	959	1 066	1 176

Source: Transtema & Redeye Research

Cash Flow	2020	2021Q1	2021Q2	2021Q3	2021Q4	2021	2022	2023	2024
Change in Net Working Capital	6	62	(10)	(4)	(29)	19	3	2	2
Operating Cash Flow	161	101	39	43	17	189	176	180	184
Investing Cash Flow	14	(8)	(2)	(2)	(3)	(14)	(15)	(15)	(15)
Financing Cash Flow	(128)	(28)	(22)	(17)	(14)	(81)	(56)	(56)	(56)
Cash Flow	47	65	15	24	1	94	105	109	113

Source: Transtema & Redeye Research

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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Recommendation structure

Redeye does not issue any investment recommendations for fundamental analysis. However, Redeye has developed a proprietary analysis and rating model, Redeye Rating, in which each company is analyzed and evaluated. This analysis aims to provide an independent assessment of the company in question, its opportunities, risks, etc. The purpose is to provide an objective and professional set of data for owners and investors to use in their decision-making.

Redeye Rating (2021-11-12)

Rating	People	Business	Financials
5	32	15	4
3-4	140	125	43
0-2	5	37	130
total	177	177	177

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CONFLICT OF INTERESTS

Fredrik Nilsson owns shares in the company : No

Jacob Svensson 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.