

# Transtema

Sector: Communication Services

## Goes West

Redeye retains its positive view on Transtema following the acquisition of Tessta Connect. Transtema adds exposure to the Norwegian market by acquiring a quality company at an attractive multiple. We raise our Base Case.

### A Norwegian TNS

Transtema acquires Tessta Connect, a leading provider of service and construction of telecommunication networks in Norway. Tessta Connect is like a Norwegian TNS, with major telecommunication companies on its customer list, but has a more construction-heavy mix of about 70/30% construction/service.

### Attractive Multiple

In 2021, Tessta Connect had sales of NOK 413m and an impressive EBITA margin of 10%. Transtema pays NOK 190m plus a potential earn-out of up to NOK 210m, implying an EV/EBITA of 4.6x excluding earn-out. While the earn-out requires increasing profit levels, a full earn-out will result in a slightly higher multiple of approximately 6x.

### New Base Case SEK 54 (45)

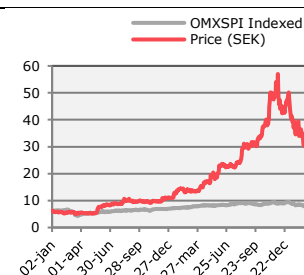
We raise our EBITA and EPS forecasts by 32% and 23% following the acquisition of Tessta Connect, resulting in a new Base Case of SEK 54 (45). Although the acquisition was announced more than two weeks ago, the market has not noticed. Also, considering Transtema's non-cyclical revenues and low valuation multiples, fears of increasing interest rates and a coming recession should have a relatively limited impact on Transtema. We believe the upcoming quarterly reports, where Tessta Connect will be consolidated, will be a catalyst for the share price.

Key Financials (SEKm)	2020	2021	2022E	2023E	2024E
Sales	1405	1690	2194	2260	2327
Sales growth	-6%	20%	30%	3%	3%
EBITA	42	137	175	191	200
EBITA margin	3.0%	8.1%	8.0%	8.4%	8.6%
EV/Sales		0.7	0.7	0.6	0.5
EV/EBITA		8.8	8.5	6.9	5.7

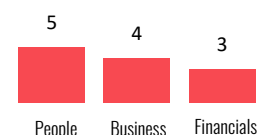
### FAIR VALUE RANGE

BEAR	BASE	BULL
27	54	69

### TRANS VERSUS OMXS30



### REDEYE RATING



### KEY STATS

Ticker	TRANS
Market	Small Cap
Share Price (SEK)	31.50
Market Cap (SEKm)	1229
Net Debt (SEKm)	132
Free Float (%)	65%
Avg. daily volume ('000)	6 590

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## Expanding Westwards Through M&A

Announced 25 February and completed 10 March, Transtema acquires Tessta Connect, a leading provider of service and construction of telecommunication networks in the Norwegian market. The company was founded in 1998 and is headquartered in Oslo. Tessta Connect is like TNS but has a more construction-heavy mix of about 70/30% construction/service and focuses, like Transtema, on ESG.

In 2021, Tessta Connect had sales of NOK 413m and an impressive EBITA margin of 10%. Transtema pays NOK 190m plus a potential earn-out of up to NOK 210m, implying an EV/EBITA of 4.6x excluding earn-out. While the earn-out requires increasing profit levels, a full earn-out will result in a slightly higher multiple of approximately 6x.

Considering Tessta Connect's position on the Norwegian market, its size, and, for the sector, very high margins, we believe 4.6x EBITA is attractive. Assuming Tessta Connect improves its profit significantly over the following years, resulting in a maximum earn-out, we believe ~6x EBITA is attractive as well. Apart from being very low absolute multiples, it is significantly below Transtema's pre-acquisition multiple of 10x EBITA (and the 8.5x post-acquisition multiple).

While Transtema has a mixed M&A track record from back in the days, management seems very confident in this deal. Management has been in dialog with the sellers for a long time, and the sellers will remain in charge of Tessta Connect throughout the earn-out period. Also, we get the impression that Transtema and the sellers believe there is a high chance that Tessta will increase its profits over the next years, resulting in an earn-out. Thus, we believe the 4.6x EBITA ex. earn-out multiple is a way for Transtema to reduce the risk. As mentioned, approximately 6x EBITA for a highly profitable and growing business is attractive as well.

Also, parts of the purchasing price are paid with Transtema shares, which, combined with the extensive earn-out, should result in aligned interests between Tessta's management and Transtema.

Interestingly, following the pandemic, 2021 was a rather soft year for Tessta Connect. However, partly thanks to its flexible business model with a high share of subcontractors, Tessta Connect maintained a solid EBITA margin of 10% despite negative sales growth.

While Transtema does not intend to achieve any cost synergies, as Tessta already has a streamlined organization, there is potential on the customer side. Transtema is a major supplier to Telia, while Tessta has a large Norwegian operating as a significant customer. Also, Tessta Connect has a lower share of service than Transtema, and we expect management to focus on increasing service, where Transtema has substantial know-how.

Tessta Connect will be consolidated from 1 January 2022, and we expect it to have a significant positive impact on sales, EBITA, and EPS – more on that in our Financial Forecasts segment.

## Sveder Becoming CEO, Johansson Chairman

At the beginning of March, Transtema announced that current CFO, Henning Sveder will take the role as CEO, following the annual general meeting on 5 May. Also, chairman and major shareholder Göran Nordlund (who points out he will remain as a major shareholder and increased his holdings a few days ago) will resign from the board and current CEO Magnus Johansson is recommended as new chairman. While stepping down as CEO, we like that current CEO Magnus Johansson, Transtema's largest shareholder, remains active in the company as chairman.

Henning Sveder has been the CFO for almost two years, and our impression is that he has a deep understanding of the business. Also, during these two years, Transtema has successfully transformed into a more stable and profitable company. Thus, Sveder's track record is solid, and it seems like a reasonable timing for succession.

## Financial Forecasts

We add Tessta Connect to our forecast from 1 January 2022 and onwards. While we lower our organic margin forecasts somewhat for H1 2022 following increased fuel costs and above-normal sickness leave due to Omicron, most of the changes are due to Tessta Connect.

We forecast almost SEK 2.2bn in sales in 2022E, slightly above the proforma 2021 of SEK ~2100m. However, we previously estimated some growth in Transtema, which we stick to, and we expect some organic growth in Tessta Connect. We assume an EBITA margin of 8% for 2022E, slightly below the proforma 2021 of ~8.5%. However, 2021 was a very strong year for Transtema margin-wise, and as mentioned, we see a risk for some pressure on margins in H1. As Tessta's cost mix is undisclosed, our split between cost of revenues and personnel expenses etc., are mere guesstimates at this point.

All in all, we believe the acquisition of Tessta Connect will lead to significant growth in sales and EBITA in 2022E. Also, on the EPS level, we forecast a substantial growth of 23%. We assume a 50/25/25 split between goodwill, intangible- and tangible assets and account for 50% of the earn-out.

Estimate Revisions	FYE 2022	Old	Change	FYE 2023	Old	Change
<b>Revenues</b>	<b>2 193.7</b>	<b>1 760.1</b>	<b>24.6%</b>	<b>2 259.5</b>	<b>1 812.9</b>	<b>24.6%</b>
Y/Y Growth (%)	56.2%	25.3%		3.0%	3.0%	
<b>EBITA</b>	<b>175.0</b>	<b>132.8</b>	<b>31.8%</b>	<b>190.9</b>	<b>135.3</b>	<b>41.1%</b>
EBITA Margin (%)	8.0%	7.5%		8.4%	7.5%	
<b>EPS</b>	<b>2.79</b>	<b>2.26</b>	<b>23.1%</b>	<b>3.10</b>	<b>2.31</b>	<b>33.7%</b>

Source: Transtema & Redeye Research

Income Statement	2021	2022Q1	2022Q2	2022Q3	2022Q4	2022	2023	2024
<b>Revenues</b>	<b>1 690</b>	<b>527</b>	<b>570</b>	<b>507</b>	<b>590</b>	<b>2 194</b>	<b>2 260</b>	<b>2 327</b>
Y/Y Growth (%)	20.3%	35.9%	27.2%	31.0%	26.2%	29.8%	3.0%	3.0%
Cost of Revenues	(578)	(206)	(226)	(202)	(237)	(871)	(891)	(922)
<b>Gross Profit</b>	<b>1 112</b>	<b>322</b>	<b>344</b>	<b>305</b>	<b>353</b>	<b>1 323</b>	<b>1 368</b>	<b>1 406</b>
Gross Profit Margin (%)	65.8%	61.0%	60.3%	60.2%	59.8%	60.3%	60.6%	60.4%
Other external costs	(215)	(65)	(65)	(69)	(66)	(265)	(270)	(275)
Personnel expenses	(697)	(196)	(211)	(171)	(213)	(790)	(812)	(834)
Other operation income	3	1	1	1	1	2	2	2
<b>EBITDA</b>	<b>202</b>	<b>61</b>	<b>68</b>	<b>66</b>	<b>75</b>	<b>270</b>	<b>288</b>	<b>298</b>
EBITDA Margin (%)	12.0%	11.7%	11.9%	13.0%	12.7%	12.3%	12.8%	12.8%
Depreciation	(65)	(24)	(23)	(24)	(24)	(95)	(97)	(98)
<b>EBITA</b>	<b>137</b>	<b>37</b>	<b>45</b>	<b>42</b>	<b>51</b>	<b>175</b>	<b>191</b>	<b>200</b>
EBITA Margin (%)	8.1%	7.1%	7.8%	8.3%	8.6%	8.0%	8.4%	8.6%
Amortization	(13)	(7)	(7)	(7)	(7)	(26)	(27)	(27)
<b>EBIT</b>	<b>124</b>	<b>31</b>	<b>38</b>	<b>35</b>	<b>44</b>	<b>149</b>	<b>164</b>	<b>173</b>
EBIT Margin (%)	7.4%	5.9%	6.7%	7.0%	7.5%	6.8%	7.3%	7.4%
Interest Expenses	(10)	(3)	(3)	(3)	(3)	(12)	(12)	(12)
<b>EBT</b>	<b>114</b>	<b>28</b>	<b>35</b>	<b>32</b>	<b>41</b>	<b>137</b>	<b>152</b>	<b>161</b>
Income Tax Expenses	(25)	(6)	(8)	(7)	(9)	(30)	(33)	(35)
Effective Tax Rate (%)	22.0%	22.0%	22.0%	22.0%	22.0%	22.0%	22.0%	22.0%
Non-Controlling Interests	1	-	-	-	-	-	-	-
<b>Net Income</b>	<b>90</b>	<b>22</b>	<b>27</b>	<b>25</b>	<b>32</b>	<b>107</b>	<b>119</b>	<b>126</b>
Net Income Margin (%)	5.3%	4.1%	4.8%	5.0%	5.5%	4.9%	5.3%	5.4%

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 27 SEK

- Sales CAGR of ~2% 2022-2030
- No future M&A
- Terminal growth of 2%
- Average EBITA margin of ~6% 2021-2030
- Terminal EBITA margin of ~4%

### Base Case 54 SEK

- Sales CAGR of ~3% 2022-2030
- No future M&A
- Terminal growth of 2%
- Average EBITA margin of ~8.4% 2021-2030
- Terminal EBITA margin of ~8%

### Bull Case 69 SEK

- Sales CAGR of ~4% 2022-2030
- No future M&A
- Terminal growth of 2%
- Average EBITA margin of ~9% 2021-2030
- Terminal EBITA margin of ~10%

We raise our Base Case to SEK 54 (45) following the acquisition of Tessta Connect. The acquisition was made at an attractive multiple, there is an industrial logic, and the target has solid profitability. We believe Transtema is an interesting non-cyclical "value" play with growth options, such as M&A and EV-charging, that could play out over the next few years.

Also, note that Transtema has few institutional investors despite a market cap of SEK ~1.3bn. 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 discount to peers for 2022E and 2023E. Other than size, we find no reason for the discount, and back in Q3, Transtema was trading at a premium. 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 54 equals ~11.5x 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	2 021	8 242	0.2	0.2	0.2	15.1	9.3	7.4	-16%	-1%	1%	1.6%	2.6%	3.3%
Bravida	23 138	21 724	1.1	1.0	1.0	16.5	14.8	13.9	3%	7%	4%	6.5%	6.7%	6.8%
Caverion	7 952	2 140	0.3	0.3	0.3	14.5	11.5	9.6	-1%	6%	4%	2.4%	2.8%	3.2%
Enersense	1 292	235	0.5	0.5	0.5	21.4	10.5	9.0	59%	6%	3%	2.4%	4.6%	5.2%
Netel	1 962	2 420	0.8	0.6	0.5	11.3	7.9	6.9	n/a	32%	13%	7.2%	7.8%	7.9%
<b>Median</b>	<b>4 986</b>	<b>5 191</b>	<b>0.4</b>	<b>0.4</b>	<b>0.4</b>	<b>15.8</b>	<b>11.0</b>	<b>9.3</b>	<b>1%</b>	<b>6%</b>	<b>4%</b>	<b>2.4%</b>	<b>3.7%</b>	<b>4.2%</b>
<b>Average</b>	<b>8 601</b>	<b>8 085</b>	<b>0.5</b>	<b>0.5</b>	<b>0.5</b>	<b>16.9</b>	<b>11.5</b>	<b>10.0</b>	<b>11%</b>	<b>5%</b>	<b>3%</b>	<b>3.2%</b>	<b>4.2%</b>	<b>4.6%</b>
<b>Transtema</b>	<b>1 481</b>	<b>1 405</b>	<b>0.7</b>	<b>0.7</b>	<b>0.6</b>	<b>8.8</b>	<b>8.5</b>	<b>6.9</b>	<b>20%</b>	<b>30%</b>	<b>3%</b>	<b>8.1%</b>	<b>8.0%</b>	<b>8.4%</b>

Source: Redeye, FactSet

## Balance Sheet and Cash Flow

Balance Sheet	2021	2022Q1	2022Q2	2022Q3	2022Q4	2022	2023	2024
Property, Plant & Equipment, Net	34	105	103	101	99	99	90	82
Goodwill	69	214	214	214	214	214	214	214
Intangible Assets	60	126	120	113	107	107	80	54
Right-of-Use Assets	131	129	128	126	124	124	116	107
Shares in Associates	56	56	56	56	56	56	56	56
Other Long-Term Assets	1	1	1	1	1	1	1	1
<b>Total Non-Current Assets</b>	<b>351</b>	<b>631</b>	<b>621</b>	<b>611</b>	<b>601</b>	<b>601</b>	<b>557</b>	<b>514</b>
Cash & Equivalents	178	78	120	160	207	207	372	543
Inventories	18	22	23	24	26	26	27	27
Accounts Receivable	153	183	195	207	219	219	226	233
Other Current Assets	160	146	156	166	175	175	181	186
<b>Total Current Assets</b>	<b>509</b>	<b>429</b>	<b>494</b>	<b>557</b>	<b>628</b>	<b>628</b>	<b>805</b>	<b>990</b>
<b>Total Assets</b>	<b>860</b>	<b>1 060</b>	<b>1 115</b>	<b>1 168</b>	<b>1 228</b>	<b>1 228</b>	<b>1 362</b>	<b>1 503</b>
Long-Term Debt	25	175	175	175	175	325	325	325
Long-Term Lease Liabilities	78	78	78	78	78	78	78	78
Other Long-Term Liabilities	43	43	43	43	43	43	43	43
<b>Total Non-current Liabilities</b>	<b>146</b>	<b>296</b>	<b>296</b>	<b>296</b>	<b>296</b>	<b>446</b>	<b>446</b>	<b>446</b>
Short-Term Debt	14	14	14	14	14	14	14	14
Short-Term Lease Liabilities	55	55	55	55	55	55	55	55
Accounts Payable	146	183	195	207	219	219	226	233
Other Current Liabilities	246	238	254	269	285	285	294	303
<b>Total Current Liabilities</b>	<b>462</b>	<b>490</b>	<b>518</b>	<b>546</b>	<b>574</b>	<b>574</b>	<b>589</b>	<b>605</b>
Non-Controlling Interest	1	1	1	1	1	1	1	1
Shareholder's Equity	250	272	300	325	357	357	476	602
<b>Total Liabilities &amp; Equity</b>	<b>860</b>	<b>1 060</b>	<b>1 115</b>	<b>1 168</b>	<b>1 228</b>	<b>1 378</b>	<b>1 512</b>	<b>1 654</b>

Source: Transtema &amp; Redeye Research

Cash Flow	2021	2022Q1	2022Q2	2022Q3	2022Q4	2022	2023	2024
Change in Net Working Capital	16	9	5	5	5	22	3	3
<b>Operating Cash Flow</b>	<b>183</b>	<b>61</b>	<b>62</b>	<b>60</b>	<b>67</b>	<b>250</b>	<b>245</b>	<b>253</b>
<b>Investing Cash Flow</b>	<b>(14)</b>	<b>(297)</b>	<b>(6)</b>	<b>(6)</b>	<b>(6)</b>	<b>(315)</b>	<b>(25)</b>	<b>(25)</b>
<b>Financing Cash Flow</b>	<b>(84)</b>	<b>136</b>	<b>(14)</b>	<b>(14)</b>	<b>(14)</b>	<b>94</b>	<b>(56)</b>	<b>(56)</b>
<b>Cash Flow</b>	<b>85</b>	<b>(100)</b>	<b>42</b>	<b>40</b>	<b>47</b>	<b>29</b>	<b>165</b>	<b>172</b>

Source: Transtema &amp; 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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Rating	People	Business	Financials
5	32	15	4
3-4	150	132	47
0-2	5	40	136
<b>total</b>	<b>187</b>	<b>187</b>	<b>187</b>

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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.