

IAR SYSTEMS

Winds of change

IAR Systems is trading at a 2022e EV/EBIT of 12x. Although the recent CEO dismissal could cloud short-term operational momentum, we believe it could signal a turning point in IAR Systems' two-year uphill climb. Having reset our forecasts for Secure Thingz, we have cut our fair value to SEK130–220 (150–220) and expect IAR to report 19% organic sales growth YOY in 2022e.

What we learnt from Q3: 1) on our numbers, IAR reported 17% underlying organic growth in Q3 YOY (adjusted for revenue recognition of strategic customers); 2) IAR will review its licence model and we do not rule out an eventual SaaS transformation; and 3) acting CEO Richard Lind gave a good first impression but revealed no strategic news.

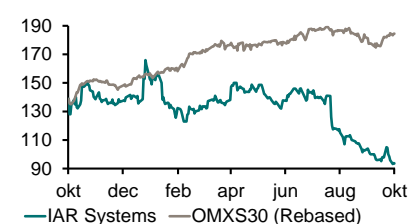
2022–2023e EPS reduced by 21–17%, as: 1) our Embedded Workbench forecasts are broadly unchanged, but 2) we have cut our sales expectations for Secure Thingz for 2022–2023e by 80%, which has thus lowered our group sales forecasts by 8%, which, at a 97% gross margin, has had a material effect on our EPS estimates. The board's CEO dismissal signals an ambition to accelerate and improve the sales organisation, which to us suggests that near-term traction is still a few quarters out while a new CEO implements the changes needed. The medium-term embedded security market opportunity with an 'out of the box' solution for mainstream MCUs remains lucrative for IAR, but it will probably take time before IoT device security regulation and standards really affect the marketplace, in our view.

Fair value cut to SEK130–220 (150–220), to reflect our estimate changes, corresponding to a 2022e EV/EBIT of 22x. We estimate that the legacy workbench business should be valued at cSEK130/share and as we get more signals that IAR Systems has reached a turning point of its negative two-year earnings-revisions trend, perceptions of the company may change. On the downside, it could take a few quarters before a new CEO can accelerate IAR's growth strategy and with new eyes on its ~SEK400m investments in IoT security, there could be impairment risks.

Year-end Dec	2017	2018	2019	2020	2021e	2022e	2023e
Revenue (SEKm)	345	385	406	372	360	427	487
EBITDA adj (SEKm)	127	140	146	133	124	165	204
EBIT adj (SEKm)	107	119	108	84	71	103	134
PTP (SEKm)	106	117	107	77	67	98	126
EPS rep (SEK)	6.33	6.67	5.96	4.36	3.83	5.40	7.00
EPS adj (SEK)	6.33	6.67	5.96	4.36	3.80	5.40	7.00
DPS (SEK)	5.00	5.00	3.00	0.00	0.00	1.90	2.70
Revenue growth (%)	5.1	11.7	5.3	-8.3	-3.2	18.6	13.9
EBITDA growth adj (%)	12.4	10.1	4.1	-9.0	-6.4	32.9	23.5
EPS growth adj (%)	2.6	5.3	-10.6	-26.8	-12.9	42.3	29.5
EBITDA margin adj (%)	36.9	36.4	35.9	35.7	34.5	38.6	41.9
EV/Sales adj (x)	6.58	8.32	6.30	5.12	3.37	2.79	2.39
EV/EBITDA adj (x)	17.8	22.9	17.5	14.3	9.8	7.2	5.7
EV/EBIT adj (x)	21.1	27.0	23.6	22.7	17.2	11.6	8.7
P/E adj (x)	29.8	36.4	31.2	32.1	24.6	17.3	13.4
P/Book (x)	8.22	6.02	4.28	3.11	1.84	1.72	1.59
ROE (%)	28.1	21.6	14.2	9.9	7.9	10.3	12.4
ROCE (%)	33.6	26.1	17.7	12.4	9.4	12.3	15.1
Dividend yield (%)	2.6	2.1	1.6	0.0	0.0	2.0	2.9
FCF yield (%)	3.6	1.4	0.9	1.9	3.4	3.6	5.3

Source: Company (historical figures), DNB Markets (estimates)

IARB versus OMXS30 (12m)



Source: Factset

SUMMARY

Share price (SEK)	93.6
Tickers	IARB SS

CAPITAL STRUCTURE

No. of shares (m)	13.6
No. of shares fully dil. (m)	13.7
Market cap. (SEKm)	1,277
NIBD adj end-2021e (SEKm)	-63
Enterprise value adj (SEKm)	1,214
Net debt/EBITDA adj (x)	-0.51
Free float (%)	100

Source: Company, DNB Markets (estimates)

Note: Unless otherwise stated, the share prices in this note are the last closing price.

NEXT EVENT

Q4 2021	10/02/2022
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ESTIMATE CHANGES (SEK)

Year-end Dec	2021e	2022e	2023e
Sales (old)	383.0	464.9	530.5
Sales (new)	360.2	427.3	486.8
Change (%)	-5.9	-8.1	-8.2
EPS (old)	4.80	6.80	8.43
EPS (new)	3.80	5.40	7.00
Change (%)	-20.9	-20.5	-17.0

Source: DNB Markets,

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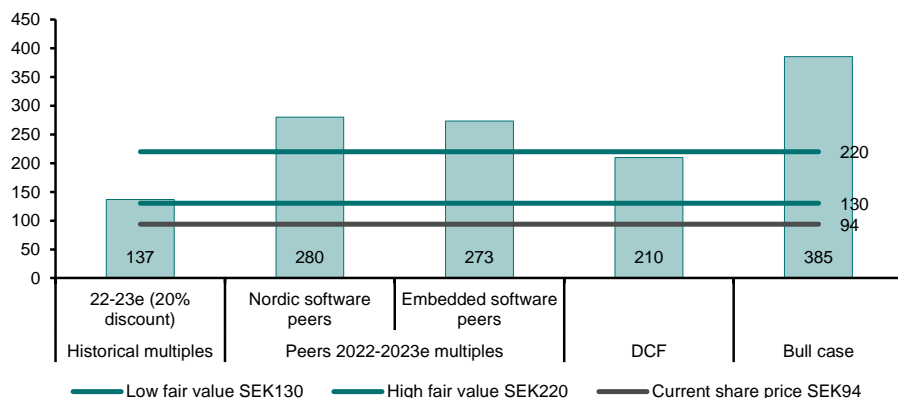
ANALYSTS

Joachim Gunell

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Overview

Valuation (add listing currency here, e.g. SEK)



Source: DNB Markets

Downside risks to our fair value

- Failure to resurrect the growth story. If investors lose trust in IAR Systems' ability to resume growth, it could trigger a share devaluation, as in 2019.
- Disappointing disclosures regarding key strategic partnerships in terms of when they will materialise and the fee structure (as seen with its Renesas Synergy agreement). Thus, it would be negative if the Secure Thingz collaboration were to fall short of management's expectations.
- Impairments of goodwill.
- IAR Systems is highly sensitive to a strengthening of the SEK (particularly against the USD, EUR, and JPY).

Source: DNB Markets

DNB Markets estimates

- As a market leader in a niche industry growing by the mid-single digits for its core programming tools with the potential to accelerate organic growth to 15–20% from new product launches (for which SEK400m+ of R&D investments has already been taken), our assessed medium-term value-creation potential remains high, but so is the burden of execution at this stage.
- We estimate that IAR Systems should generate a 2020–2023 EPS CAGR of 17%, with significant potential expected beyond our forecast period.

Source: DNB Markets

Valuation methodology

- Blending our peer group of Nordic software and embedded software peers with IAR Systems' historical multiples and a DCF suggests a SEK130–220 fair value (methodology unchanged).
- Applying its historical valuation (P/E 26x, EV/EBIT 20x) to our 2022 estimates suggests SEK140–190.
- On our estimates, IAR Systems is valued at 2022e P/E of 17x, an EV/EBIT of 12x, and an EV/sales of 3x.

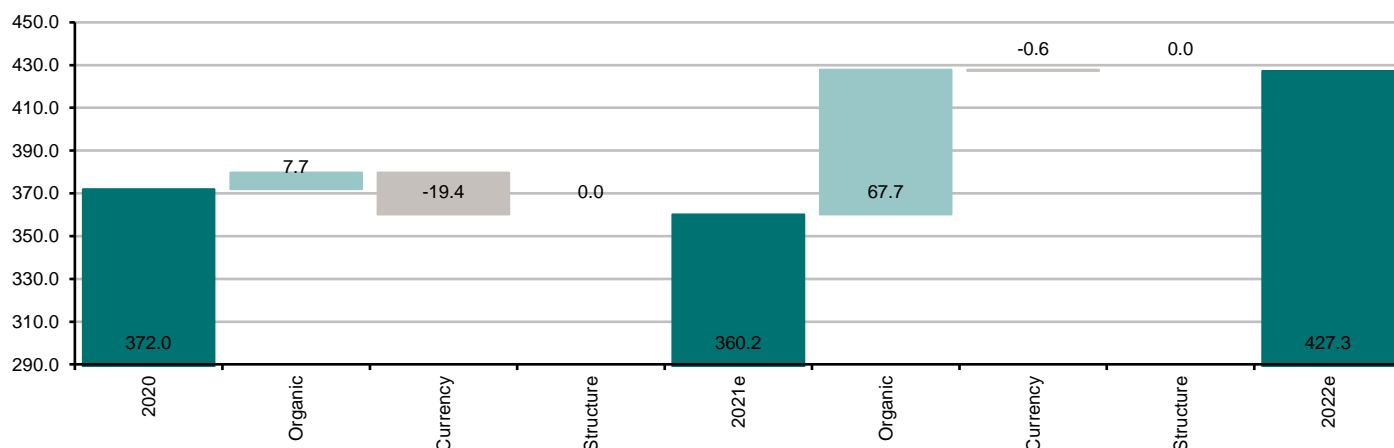
Source: DNB Markets

Upside risks to our fair value

- The company over-delivering on its financial targets (particularly 10–15% organic growth).
- If IAR Systems' new security offering gains faster penetration than we assume by leveraging on its head-start, we believe there is potential for shareholder value creation beyond our fair value.
- Value-enhancing acquisitions to be integrated in its product offering or new strategic partnerships.
- Better cost control (as it has a reputation for tight cost control), implying higher margins.

Source: DNB Markets

Sales bridge 2020–2022e (SEKm)



Source: DNB Markets (forecasts), company (historical data)

ESG overview

Sustainability assessment

	Positive	Negative
Conclusions	<ul style="list-style-type: none"> ■ IAR Systems’ software-development tools are market-leading in terms of code quality, analysis, functional safety, and security. Its software ensures that the code is in line with industry standards, thereby guaranteeing its reliability when applied. ■ Increased IoT security legislation drives demand for its products, as its OEM customers must comply with new security design requirements. 	<ul style="list-style-type: none"> ■ Data loss or security bugs in the software code could trigger regulatory scrutiny as well as legal costs and reputational damage, hampering its growth prospects. ■ IAR Systems’ competitiveness relies greatly on its ability to continuously innovate. For this, its highly skilled workforce is a key resource. Failure to attract and retain such professionals could lead to delays in innovation and a loss of market share.
Actions being taken by company	<ul style="list-style-type: none"> ■ Embedded programmers need to protect their code from IP theft and illegal copying, as IoT security issues are becoming increasingly prevalent. Following the acquisition of Secure Thingz, IAR Systems’ tools are increasingly linked to sustainability, as they help developers take control of security from inception in the IP throughout the lifecycle of a digital product. 	<ul style="list-style-type: none"> ■ IAR Systems’ development tools are the most used in the embedded industry, owing to its leading optimisation technology, comprehensive debugger quality, and renowned technical support. This is confirmed by its loyal customer base. It has 46,000 OEM customers and 150,000 technology users, 95% of which are recurring customers, we believe.

Key ESG drivers

Short-term

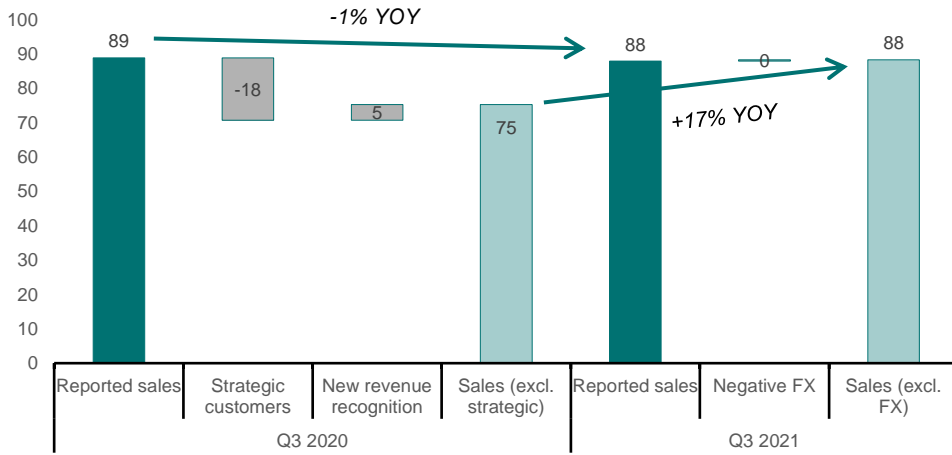
- Today, fewer than 5% of new IoT devices have embedded security. ABI research forecasts that penetration will increase to 20% by 2022.
- IAR Systems’ security offering (C-Trust and Embedded Trust) ensures that its customers’ intellectual property is protected against IP theft, overproduction, and piracy, and that software updates can be managed in a secure fashion. In other words, it creates a secure infrastructure and protects its customers’ digital products from sabotage programmes and data intrusion. Examples of customer use cases have included:
 - A leading vending machine provider, whose IP was stolen (stolen credit card and transaction details); a global white goods company, whose stolen IP led to twice as many products being manufactured; a leading door-sensor provider, whose IP was stolen internally, which led to direct revenue loss, etc.
- To stay ahead of the competition, IAR Systems relies heavily on its employees in the development and innovation of new technologies.
- Following the integration of Secure Thingz, IAR Systems’ addressable market has expanded from application development into manufacturing and update management (the entire lifecycle of embedded systems). To keep pace with competition in a larger market, it needs to retain highly skilled software engineers, which could come at a higher cost than its traditional business.
- As an increasingly larger part of IAR Systems should revolve around Cambridge-based Secure Thingz. This could create some corporate cultural challenges versus the Uppsala-based legacy business.

Long-term

- Regulators are likely to play an active role in the long-term uptake of secure development tools. This should have an impact on programmers’ designs, as applications need to remain secure across the entire lifecycle to comply with new legislation. We note legislative initiatives in Europe (UK government, ETSI, ENISA) and the US (California IoT Security law, NIST’s evolving cyber security act), and government initiatives across Singapore, Japan, South Korea, China, etc.
- Considering its offering of software development tools to over 46,000 clients as well as the sensitive nature of the data it handles, IAR Systems is exposed to possible hacking attempts and misappropriation of technological data.

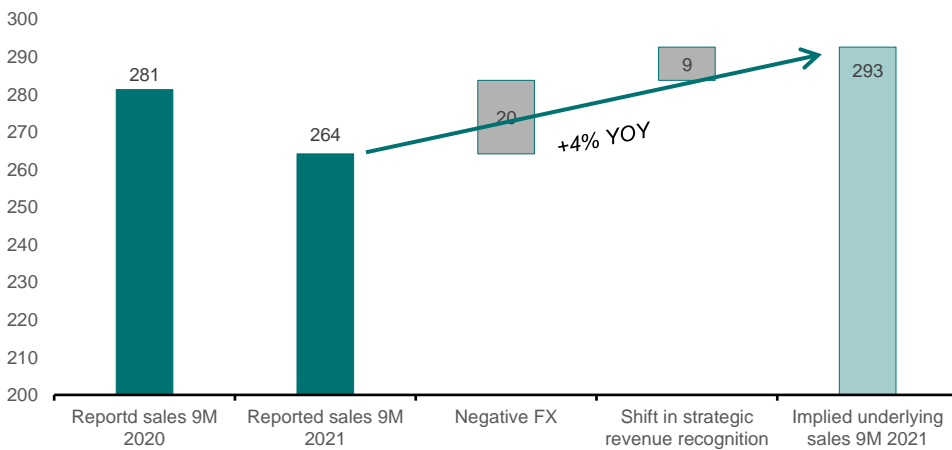
Is the underlying growth at a turning point?

Figure 1: Implied organic sales growth in Q3 2021 YOY excluding strategic customer comparables and negative FX impact (Q3 2020–Q3 2021)



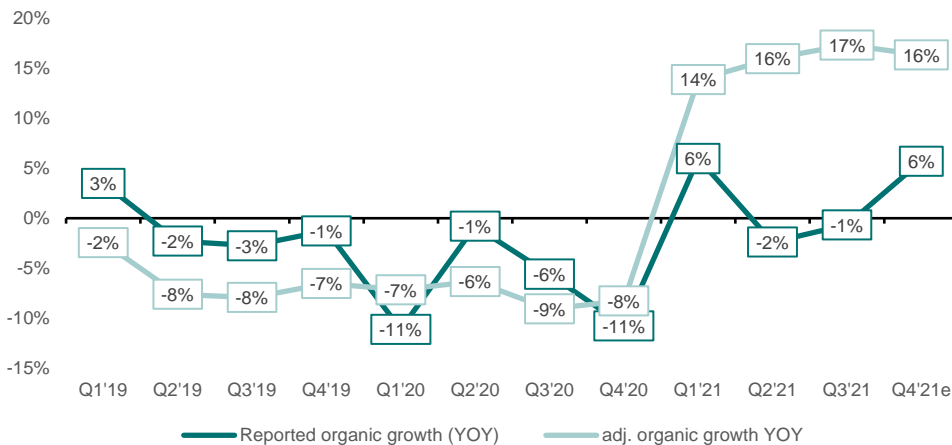
Source: Company (underlying data), DNB Markets (graph structuring)

Figure 2: We calculate underlying sales growth of 4% YOY YTD 2021



Source: Company (underlying data), DNB Markets (graph structuring)

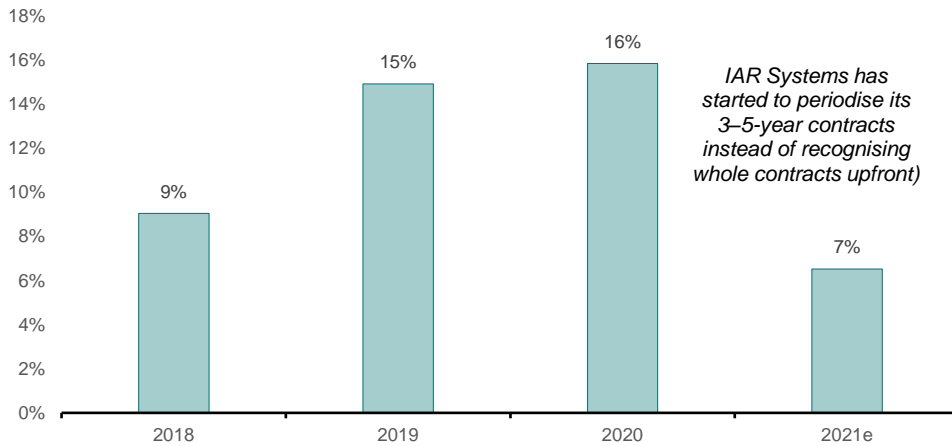
Figure 3: IAR Systems – organic growth YOY adj. for new accounting method of strategic customers signals organic growth is already at a turning point



Source: Company (underlying data), DNB Markets (graph structuring)

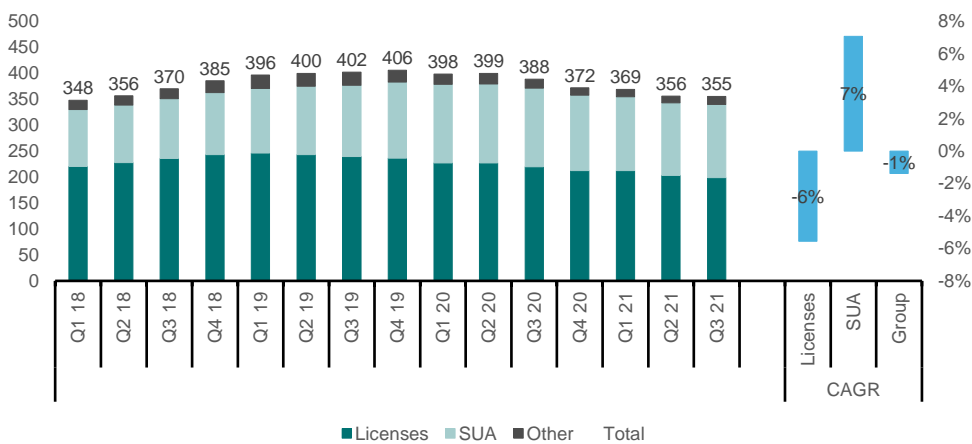
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Figure 4: IAR Systems – strategic sales as % of group (shift in accounting method in Q2 2021)



Source: Company (underlying data), DNB Markets (graph structuring)

Figure 5: LTM sales by product segment and CAGR (Q1 2018–Q3 2021)

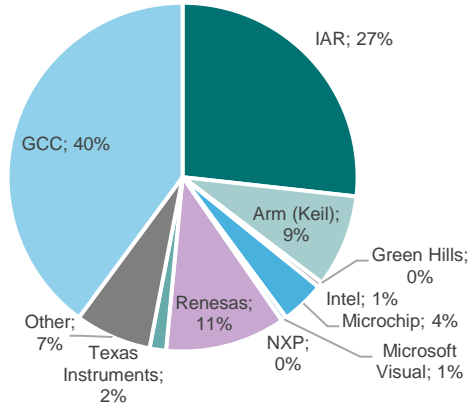


Source: Company (underlying data), DNB Markets (graph structuring)

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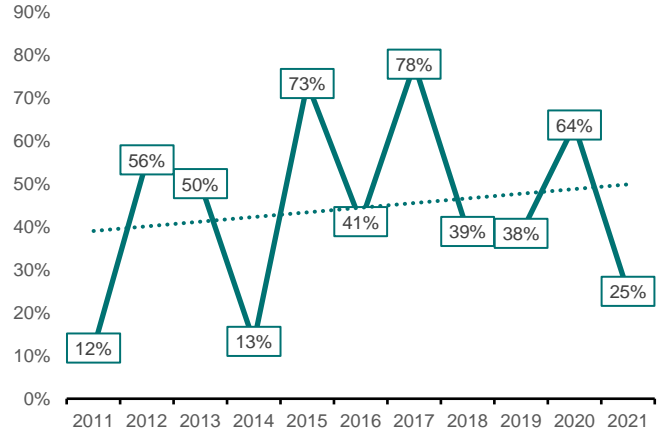
Is IAR System losing market share?

Figure 6: IAR Systems' compiler frequency in EEMBC's CoreMark benchmark (2015–2021)



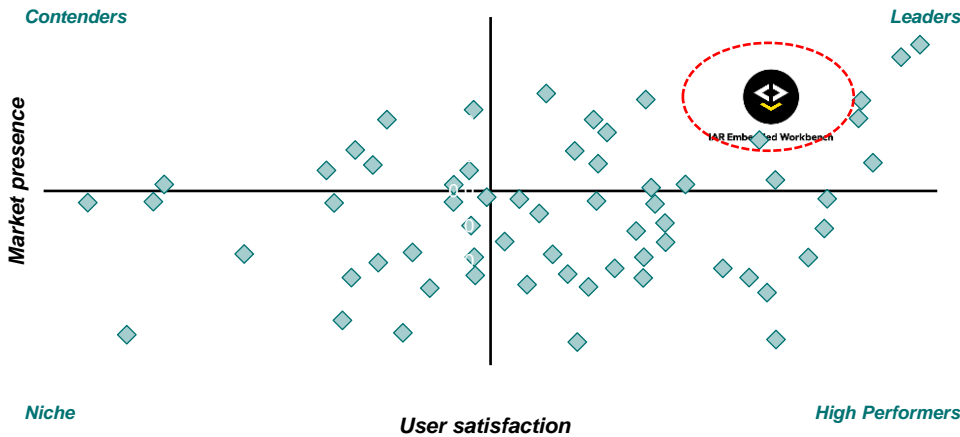
Source: EEMBC (industry alliance, which develops benchmarks to help system designers to select optimal processors and understand performance and energy characteristics of their systems. CoreMark is a benchmark that measures the performance of microcontrollers (MCUs) and central processing units (CPUs) used in embedded systems.)

Figure 7: Frequency of compiler selection excl. GCC (2011–2021) in EEMBC's CoreMark benchmark



Source: EEMBC (industry alliance, which develops benchmarks to help system designers to select optimal processors and understand performance and energy characteristics of their systems. CoreMark is a benchmark that measures the performance of microcontrollers (MCUs) and central processing units (CPUs) used in embedded systems.)

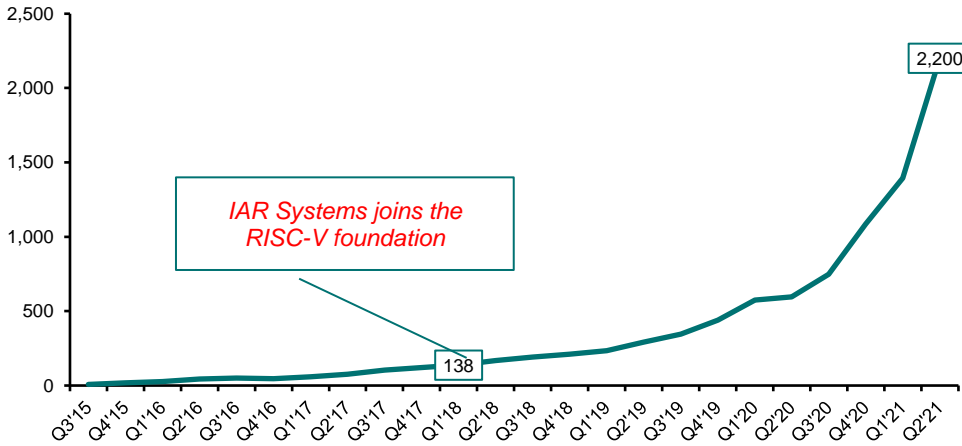
Figure 8: G2 Grid for Low-Code Development Platforms



Source: G2 Grid
 Note: G2 scores products and sellers based on reviews gathered from its user community, as well as data aggregated from online sources and social networks. Score is based on market presence and user satisfaction

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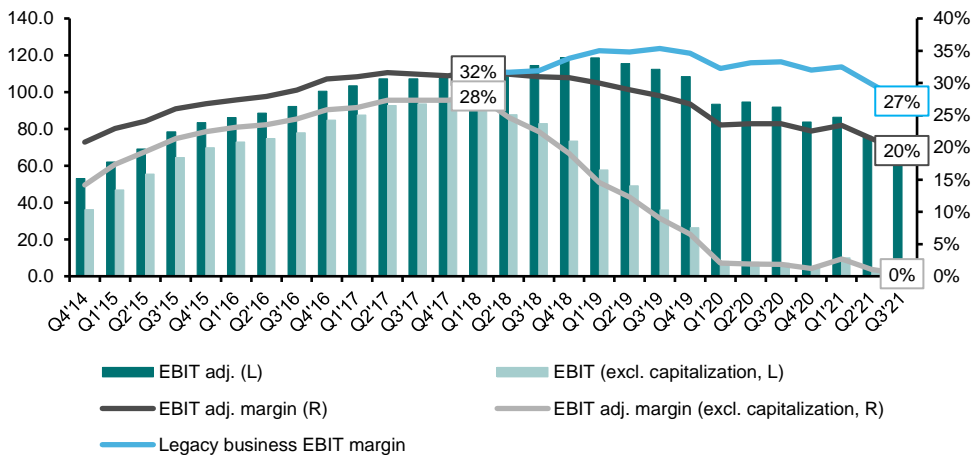
Figure 9: 2,000+ RISC-V ecosystem members growing at 90%+ YTD (number of electronics industry members)



Source: RISC-V Foundation

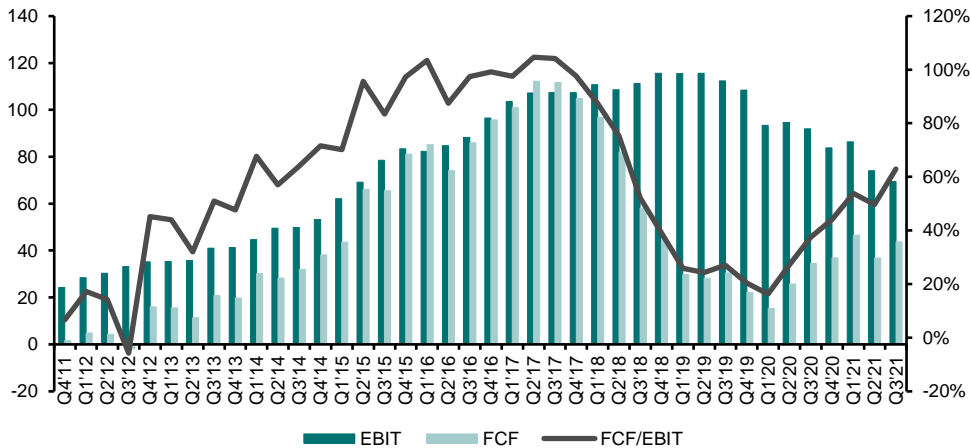
What is the underlying profitability?

Figure 10: EBIT and margin trajectory (excluding capitalisation of development costs) (LTM, Q4 2014–Q3 2021)



Source: DNB Markets (estimates), company (historical data)

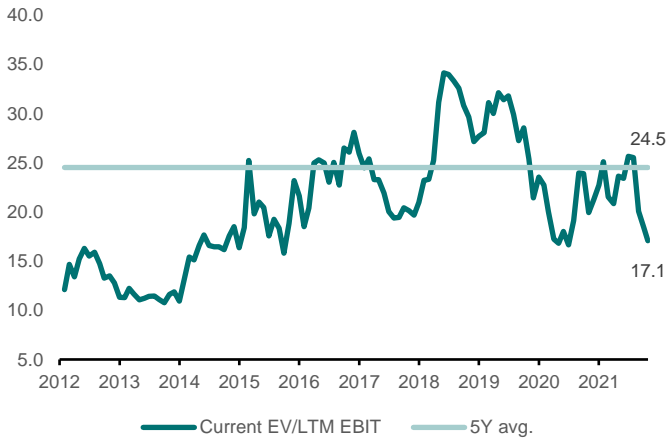
Figure 11: Unimpressive cash conversion since the Secure Thingz acquisition in 2018 could be at a turning point after SEK400m+ of investments in new products (SEKm)



Source: DNB Markets (forecasts), company (historical data)

Valuation

Figure 12: IAR Systems EV/12-month trailing EBIT (2012–2021)



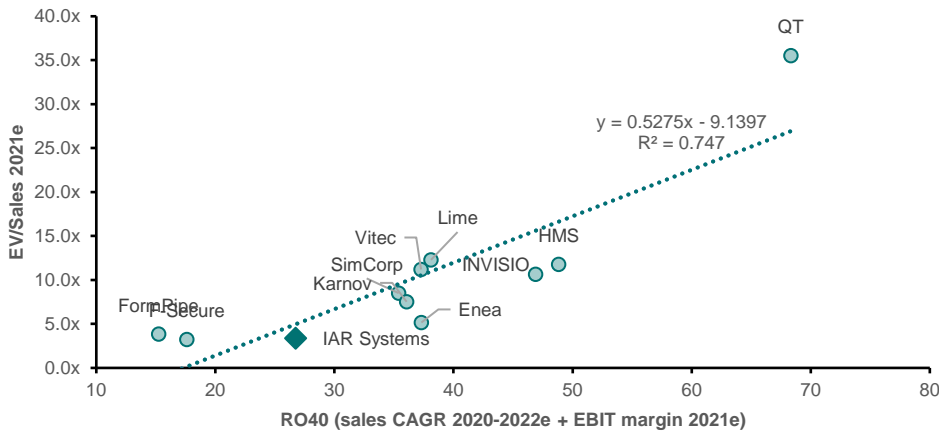
Source: Bloomberg (underlying data), DNB Markets (graph structuring)

Figure 13: IAR Systems – share price versus consensus NTM EPS (SEK)



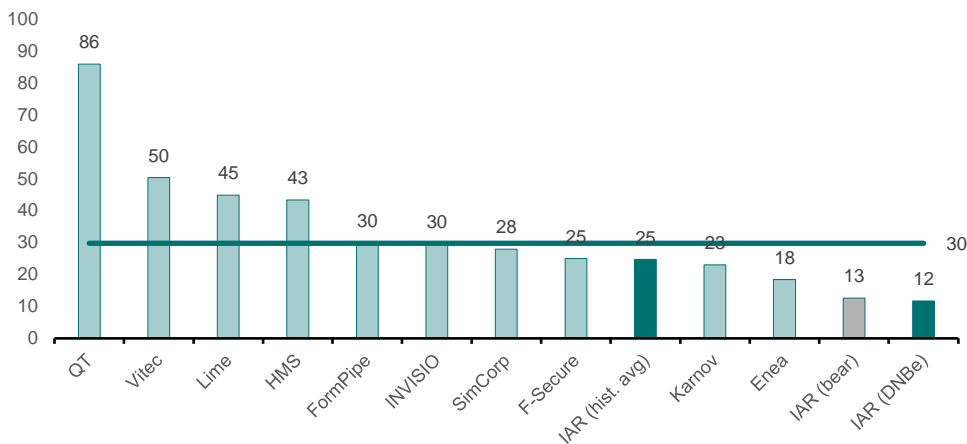
Source: Bloomberg (underlying data), DNB Markets (graph structuring)

Figure 14: IARs selected Nordic peers EV/sales 2021e versus RO40 (sales CAGR + EBIT margin)



Source: Bloomberg (underlying data), DNB Markets (graph structuring)

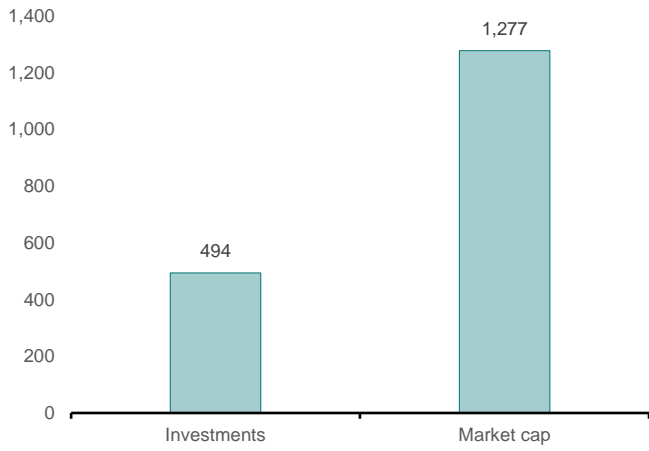
Figure 15: IARs selected Nordic peers EV/EBIT 2022e



Source: Bloomberg (underlying data), DNB Markets (graph structuring)

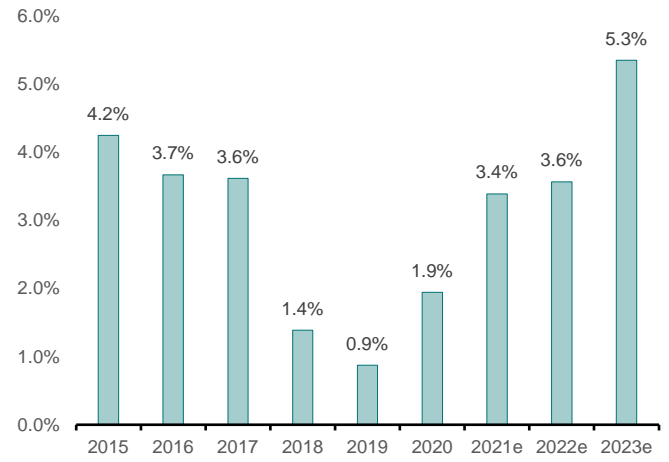
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Figure 16: IAR investments in intangible assets since 2016 + acquisitions (SEKm)



Source: Company and Bloomberg (underlying data), DNB Markets (graph structuring)

Figure 17: IAR Systems FCF yield (2015–2023e)



Source: Company (historical figures), DNB Markets (estimates)

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Q3 results

Figure 18: Q3 results versus expectations

Key highlights (SEKm, except per share data)	Q3 2021		Deviation (%)		Q3 2020		DNBe	
	Actual	DNB	DNB	DNB	Actual	DNB	2021e	
Sales	87.9	92.7	-5%		88.9	360.2		
Gross profit	85.1	90.1	-6%		86.2	348.0		
Margin	96.8%	97.2%			97.0%	96.6%		
EBIT adjusted	18.8	20.4	-8%		25.4	70.5		
Margin	21.4%	22.0%	-0.6pp		28.6%	19.6%		
One-offs	2.1	0.0				0.1		
EBIT	20.9	20.4	2%		25.4	70.6		
Margin	23.8%	22.0%	1.8pp		28.6%	19.6%		
EPS	1.17	1.12	4%		1.37	3.80		
Growth YOY								
Sales growth	-1.1%	4.3%	-5.4pp		-11.1%	-3.2%		
-of w hich organic	-0.7%	5.1%	-5.7pp		-5.6%	2.1%		
-of w hich FX	-0.4%	-0.8%	0.4pp		-5.5%	-5.2%		
Divisions (SEKm)	Q3 2021				Q3 2020		2021e	
	Actual	DNB			Actual	DNB		
Sales								
Legacy IAR Systems	87.8	92.2	-5%		88.5	359.5		
Royalty-based revenue	0.0	0.0	n.a.		0.0	0.0		
Secure Thingz	0.1	0.5	-80%		0.4	0.7		
Group	87.9	92.7	-5%		88.9	360.2		
EBIT adjusted								
Legacy IAR Systems + Secure Thingz	18.8	20.4	-8%		25.4	70.5		
Royalty-based revenue	0.0	0.0	n.a.		0.0	0.0		
Group	18.8	20.4	-8%		25.4	70.5		
FX impact								
Sales	-0.4%	-0.8%	0.4pp		-5.5%	-5.2%		
EBIT	4.7%	4.7%	0pp		-11.7%	-19.4%		

Source: Company (historical figures), DNB Markets (estimates)

Estimate revisions

Figure 19: Estimate changes

(SEKm, except per share data)	Old			New			Change		
	2021e	2022e	2023e	2021e	2022e	2023e	2021e	2022e	2023e
Sales									
Legacy IAR Systems	380.5	429.1	458.8	359.5	425.9	466.8	-6%	-1%	2%
Royalty-based revenue	0.0	0.0	0.0	0.0	0.0	0.0			
Secure Thingz	2.5	35.7	71.7	0.7	1.4	20.0	-72%	-96%	-72%
Group Total	383.0	464.9	530.5	360.2	427.3	486.8	-6%	-8%	-8%
EBIT adjusted									
Legacy IAR Systems + Secure Thingz	88.4	128.5	160.4	70.5	102.7	133.6	-20%	-20%	-17%
Royalty-based revenue	0.0	0.0	0.0	0.0	0.0	0.0			
Group Total	88.4	128.5	160.4	70.5	102.7	133.6	-20%	-20%	-17%
EBIT adjusted margin									
Legacy IAR Systems + Secure Thingz	23.1%	27.6%	30.2%	19.6%	24.0%	27.4%	-351bp	-360bp	-279bp
Royalty-based revenue	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0bp	0bp	0bp
Group Total	23.1%	27.6%	30.2%	19.6%	24.0%	27.4%	-351bp	-360bp	-279bp
Organic growth components									
Legacy IAR Systems	8.8%	11.9%	6.4%	3.2%	18.6%	9.6%	-560bp	667bp	316bp
Royalty-based revenue	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0bp	0bp	0bp
Secure Thingz	-0.7%	8.6%	7.7%	-1.2%	0.2%	4.4%	-48bp	-842bp	-334bp
Group Total	8.1%	20.5%	14.1%	2.1%	18.8%	13.9%	-608bp	-175bp	-18bp
Group									
Sales	383.0	464.9	530.5	360.2	427.3	486.8	-6%	-8%	-8%
Sales growth	3.0%	21.4%	14.1%	-3.2%	18.6%	13.9%	-613bp	-276bp	-18bp
Organic	8.1%	20.5%	14.1%	2.1%	18.8%	13.9%	-608bp	-175bp	-18bp
Structure	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0bp	0bp	0bp
Currency	-5.2%	0.8%	0.0%	-5.2%	-0.2%	0.0%	-4bp	-101bp	0bp
Gross profit	369.6	450.0	515.1	348.0	414.2	473.3	-6%	-8%	-8%
Margin	96.5%	96.8%	97.1%	96.6%	96.9%	97.2%	13bp	14bp	13bp
EBIT adjusted	88.4	128.5	160.4	70.5	102.7	133.6	-20%	-20%	-17%
Margin	23.1%	27.6%	30.2%	19.6%	24.0%	27.4%	-351bp	-360bp	-279bp
Adjustments	-2.0	0.0	0.0	0.1	0.0	0.0			
EBIT	86.4	128.5	160.4	70.6	102.7	133.6	-18%	-20%	-17%
Margin	22.6%	27.6%	30.2%	19.6%	24.0%	27.4%	-296bp	-360bp	-279bp
Net financial items	-3.7	-5.7	-8.0	-3.6	-5.1	-7.2			
Pretax profit	82.7	122.8	152.4	67.0	97.6	126.4	-19%	-21%	-17%
Tax	-19.2	-30.1	-37.3	-15.1	-23.9	-31.0	-22%	-21%	-17%
Tax rate	23.2%	24.5%	24.5%	22.5%	24.5%	24.5%	-74bp	0bp	0bp
Net profit	63.5	92.7	115.0	51.9	73.7	95.4	-18%	-21%	-17%
EPS adjusted	4.80	6.80	8.43	3.80	5.40	7.00	-21%	-21%	-17%
EPS	4.65	6.80	8.43	3.83	5.40	7.00	-18%	-21%	-17%
DPS	0.00	2.40	3.40	0.00	1.90	2.70		-21%	-21%

Source: DNB Markets

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Figure 20: Quarterly estimates by division

(SEKm, except per share data)	Q1'20	Q2'20	Q3'20	Q4'20	Q1'21	Q2'21	Q3'21	Q4'21e	Q1'22e	Q2'22e	Q3'22e	Q4'22e
Sales												
Legacy IAR Systems	91.4	97.6	88.5	89.5	88.6	87.2	87.8	95.9	98.1	109.3	108.8	109.7
Royalty-based revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Secure Thingz	0.9	2.5	0.4	1.2	0.3	0.2	0.1	0.1	0.2	0.3	0.4	0.5
Group Total	92.3	100.1	88.9	90.7	88.9	87.4	87.9	96.0	98.3	109.6	109.2	110.2
EBIT												
Legacy IAR Systems + Secure Thingz	14.4	25.0	25.4	19.0	17.0	12.7	20.7	20.2	21.0	26.2	26.7	28.8
Royalty-based revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Group Total	14.4	25.0	25.4	19.0	17.0	12.7	20.7	20.2	21.0	26.2	26.7	28.8
EBIT adjusted margin												
Legacy IAR Systems + Secure Thingz	15.8%	25.6%	28.7%	21.2%	19.2%	14.6%	23.6%	21.1%	21.4%	23.9%	24.6%	26.3%
Royalty-based revenue												
Group Total	15.6%	25.0%	28.6%	20.9%	19.1%	14.5%	23.5%	21.0%	21.4%	23.9%	24.5%	26.1%
Organic growth												
Legacy IAR Systems	-11.0%	-0.8%	-5.6%	-10.6%	5.9%	-2.4%	-0.7%	6.9%	10.0%	24.9%	25.0%	15.0%
Royalty-based revenue	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Secure Thingz	-0.1%	0.0%	0.0%	-0.1%	0.0%	0.0%	0.0%	-1.2%	-0.1%	0.1%	0.3%	0.4%
Group Total	-11.1%	-0.8%	-5.6%	-10.8%	6.0%	-2.4%	-0.7%	5.7%	9.9%	25.1%	25.3%	15.4%
Group												
Sales	92.3	100.1	88.9	90.7	88.9	87.4	87.9	96.0	98.3	109.6	109.2	110.2
Sales growth	-7.5%	1.1%	-11.1%	-15.1%	-3.7%	-12.7%	-1.1%	5.9%	10.6%	25.4%	24.2%	14.7%
Organic	-11.1%	-0.8%	-5.6%	-10.8%	6.0%	-2.4%	-0.7%	5.7%	9.9%	25.1%	25.3%	15.4%
Structure	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Currency	3.6%	1.9%	-5.5%	-4.3%	-9.6%	-10.3%	-0.4%	0.2%	0.7%	0.4%	-1.1%	-0.6%
Gross profit	88.3	96.7	86.2	86.7	85.5	84.7	85.1	92.7	94.8	106.6	106.1	106.7
Margin	95.7%	96.6%	97.0%	95.6%	96.2%	96.9%	96.8%	96.6%	96.5%	97.2%	97.1%	96.9%
EBIT adjusted	14.4	25.0	25.4	19.0	17.0	14.7	18.6	20.2	21.0	26.2	26.7	28.8
Margin	15.6%	25.0%	28.6%	20.9%	19.1%	16.8%	21.2%	21.0%	21.4%	23.9%	24.5%	26.1%
Adjustments	0.0	0.0	0.0	0.0	0.0	-2.0	2.1	0.0	0.0	0.0	0.0	0.0
EBIT	14.4	25.0	25.4	19.0	17.0	12.7	20.7	20.2	21.0	26.2	26.7	28.8
Margin	15.6%	25.0%	28.6%	20.9%	19.1%	14.5%	23.5%	21.0%	21.4%	23.9%	24.5%	26.1%
Net financial items	-0.1	-1.9	-0.5	-4.5	-0.6	-1.2	-0.3	-1.5	-0.4	-2.0	-0.2	-2.5
Pretax profit	14.3	23.1	24.9	14.5	16.4	11.5	20.4	18.7	20.6	24.1	26.6	26.3
Tax	-3.2	-5.5	-6.2	-2.5	-3.6	-2.2	-4.7	-4.6	-5.0	-5.9	-6.5	-6.5
Tax rate	22.4%	23.8%	24.9%	17.2%	22.0%	19.1%	23.0%	24.5%	24.5%	24.5%	24.5%	24.5%
Net profit	11.1	17.6	18.7	12.0	12.8	9.3	15.7	14.1	15.6	18.2	20.0	19.9
EPS adjusted	0.81	1.29	1.37	0.88	0.94	0.83	1.00	1.04	1.14	1.34	1.47	1.46
EPS	0.81	1.29	1.37	0.88	0.94	0.68	1.17	1.04	1.14	1.34	1.47	1.46
DPS	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	1.90	0.00	0.00

Source: DNB Markets (forecasts), company (historical data)

Figure 21: IAR Systems valuation versus listed peers

	Mkt. cap.		P/E (x)			EV/EBIT (x)			EV/Sales (x)			Div. yield (%)		ROE (%)		EBIT margin		CAGR 2020–2022e (%)		
	(SEKbn)	2021	2022e	2023e	2021	2022e	2023e	2021	2022e	2023e	2021e	2022e	2021e	2022e	2021e	2022e	Sales	EBIT	EPS	
IAR Systems (DNBe)	1.3	24.6	17.3	13.4	17.3	11.6	8.6	3.4	2.8	2.4	0.0	2.0	7	10	19.6	24.0	7	11	11	
<i>Premium/discount</i>		-64%	-70%	-72%	-70%	-75%	-77%	-81%	-81%	-81%										
IAR Systems (Cons.)	1.3	19.5	13.8	11.1	14.2	9.3	7.2	3.3	2.7	2.4		2.6	10	13	22.5	27.7	11	20	19	
<i>Premium/discount</i>		-72%	-76%	-77%	-75%	-80%	-81%	-81%	-81%	-81%										
Nordic software peers																				
QT Group	42.6		109.3	73.8		85.8	57.2	35.5	26.1	20.3	0.0	0.1	52	49	24.8	30.0	44	70	69	
Admicom	4.5	51.5	43.5	35.9	38.9	32.8	26.5	17.7	15.0	12.8	1.1	1.3	35	35	45.1	44.7	16	16	46	
Fortnox	36.1	142.8	96.2	68.9	113.3	74.7	51.8	38.0	28.2	21.6	0.1	0.2	35	33	33.4	37.4	35	35	36	
HMS Networks	22.3	64.8	56.2	51.7	51.7	43.3	39.2	11.8	9.9	9.3	0.5	0.6	29	32	23.1	22.9	26	38	38	
INVISIO Communications	7.3	88.1	39.2	27.0	67.5	29.6	19.7	10.6	7.7	6.2	0.6	1.1	19	36	15.7	25.4	31	40	46	
Lime Technologies	4.7	63.3	51.4	42.0	59.9	44.8	35.9	12.3	10.5	9.2	0.6	0.6	48	50	20.3	22.9	18	18	16	
SimCorp	42.1	40.6	36.2	32.7	31.4	27.9	25.1	8.5	7.8	7.2	1.0	1.1	35	34	26.9	27.7	8	12	13	
Vitec Software	17.2	55.6	48.5	42.5	59.0	50.3	42.3	11.2	10.0	9.0	0.4	0.5	20	18	19.1	20.0	18	35	30	
Embedded software peers																				
Cadence Design Systems	402.4	51.9	47.4	42.8	41.9	37.4	32.6	15.5	14.3	13.2	0.2	1.2	35	33	37.0	37.5	10	18	15	
ANSYS	278.9	52.7	47.3	42.5	42.8	39.7	37.3	17.3	15.6	14.3	0.0	0.0	14	14	41.0	40.7	13	18	12	
Xilinx	392.1	60.6	48.8	44.4	56.8	45.5	37.4	14.1	12.2	11.1	0.8	0.8	29	26	25.0	26.6	7	8	6	
Altium	32.1	86.9	77.0	63.6	64.2	57.1	46.4	19.8	16.8	14.3	1.2	1.2	20	19	31.1	29.3	6	2	5	
Average	106.9	69.0	58.4	47.3	57.0	47.4	37.6	17.7	14.5	12.4	0.5	0.7	31	32	28.5	30.4	19	26	28	
Median	34.1	60.6	48.7	42.7	56.8	44.0	37.3	14.8	13.2	12.0	0.5	0.7	32	33	26.0	28.5	17	18	23	

Source: Bloomberg (underlying data), DNB Markets (further calculations)

Summary of positives

World-leading provider of software-development tools and services

Sweden-based IAR Systems is a world-leading provider of software tools and services for embedded systems (a chip containing embedded software) that enable the development of digital products for 46,000+ customers with 150,000+ users in end-markets, underpinned by the growing demand for digital technology. We believe it has a resilient business model based on selling flexible right-to-use licences to access its wholly owned software toolchain (the IAR Embedded Workbench), which enables close customer relationships, high customer retention, and consistent revenue streams, complemented by a royalty-based agreement with world-leading processor vendor Renesas Electronics. The March 2018 acquisition of Secure Thingz (the leading provider of advanced security solutions that help customers take control of digital products from inception) has made IAR Systems the frontrunner ahead of the paradigm shift associated with security solutions for embedded systems in the Internet of Things (IoT).

Embedded resilience in a sticky business

We consider IAR Systems' key competitive advantage to be its proprietary technology platform, the IAR Embedded Workbench, which holds a c40% global market share. In our view, IAR Systems' competitive strengths include: 1) its complete toolchain for product developers; 2) as it is independent, it can support a wide range of design architecture – customers can choose the programming environment and tools according to their own needs, regardless of processor or project, which avoids locking customers into one technical platform; 3) superior quality, as its commercial customers cannot compromise tools' code performance, reliability, user-friendliness, or time-to-market by using inferior technologies, such as open-source alternatives; 4) it is a leading participant in embedded systems security, and should be able to leverage its head-start and unique technology to maximise the market potential; and 5) a scaled-up management team with the ability to execute the growth potential in the business, in our view.

IAR 4.0

IAR Systems has gone through various phases since 2010 in which it has streamlined the business towards proprietary software, created a more specialised company, and shifted its project-based business model to scalable licence sales, which has substantially improved margins. In our view, it is now heading into a fourth phase: the growth story. We believe that IAR 4.0 (our interpretation of IAR Systems' next phase) marks the shift from being a supplier of a compiler to becoming the go-to software tool partner for global names such as Amazon and Renesas Electronics as they position their embedded systems ahead of the IoT.

Growing addressable market with the spread of digital technology

The spread of digital technology is driving the market for embedded systems. Thus, the market has numerous underlying drivers that indicate a continuation of the solid industry growth of the past decade. Global Market Insights estimates a 6% market CAGR until 2025. We believe the factors that could affect growth for IAR Systems are likely to be: 1) a continued increase in the number (and complexity) of embedded systems driven by the IoT; 2) demand for reliable and advanced software tools that offer faster time-to-market and a complete development platform; 3) the automotive opportunity as cars become mobile computing platforms; 4) RISC-V adoption; 5) market consolidation and participants becoming too dominant; and 6) untapped potential in security solutions for embedded systems.

Security for embedded systems could mark a paradigm shift for IAR Systems

After acquiring Secure Thingz in March 2018, we believe IAR Systems is the frontrunner in offering secure embedded systems. Thefts of IP (code), cloning, counterfeiting, etc., have made security issues the no.1 barrier to IoT adoption. The security market for embedded systems is in its inception phase, but we expect it to grow rapidly through 2023, driven by: 1) securing IP as a business imperative; and 2) increasingly stringent security legislation. The share of secure, new embedded products is set to grow. In Q2 2019, IAR Systems launched its security offering (C-Trust and Embedded Trust), which ensures that customers' IP is protected against theft, overproduction, and piracy, and that software updates can be managed securely.

Its software tools and services enable the development of digital products...

...in end-markets underpinned by growing demand for digital technology

IAR Systems leads the market for software development tools with c40% global market share

Key competitive strengths:

- 1) unique and complete toolchain
- 2) independence
- 3) high-quality products
- 4) frontrunner in security solutions
- 5) management's ability to achieve its long-term potential

Setting the scene for the growth story

Numerous market drivers indicate a continuation of the solid industry growth

Untapped potential in security offering with an addressable market opportunity of USD3bn highlights that if IAR Systems is able to grab just a small market share, it could be a swing factor for its operations

We forecast 2020–2023 sales and EBIT CAGRs of 9% and 17%, respectively

We forecast a 2020–2023 sales CAGR and untapped potential in security solutions for embedded systems of 9%, and an EBIT CAGR of 17% based on a strong market outlook underpinned by: 1) an increase in the number (and complexity) of embedded systems; 2) growing demand for reliable and advanced software tools that offer faster time-to-market and complete development platforms; 3) the automotive opportunity, as cars become mobile computing platforms; and 4) rapid RISC-V adoption.

Market drivers should create more processors and lines of code, driving demand for software-development tools and a user-friendly total solution enabling customers to re-use code

This should be driven by a 10% organic sales CAGR for its legacy licensing business (99% of 2020 sales), including new launches in 64-bit, RISC-V, and Linux, as the aforementioned market drivers should translate into more processors and lines of code, driving demand for software-development tools and possibly programmers (user keys) for IAR Systems, as well as a full user-friendly total solution enabling customers to re-use large amounts of code. In our view, the key growth opportunities for its legacy business are:

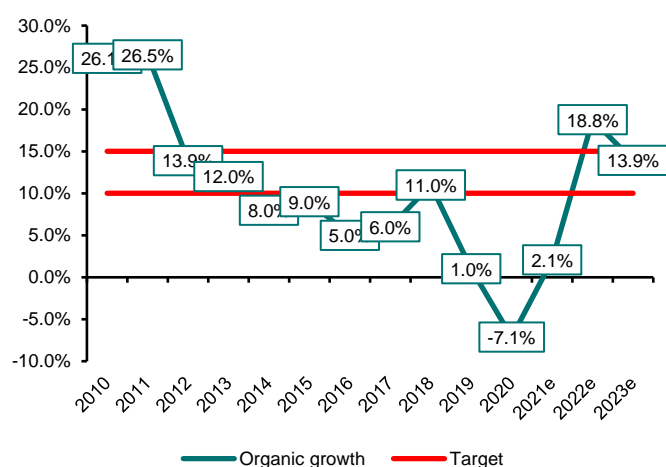
- 1 Growing RISC-V adoption, as its tools launched in May 2019 have been well received by customers (especially in China, which accounts for low single digits of group sales), setting the stage for accelerated organic growth.
- 2 Strategic customer sales now represent c10–15% of sales, highlighting that larger OEMs (in some cases 100+ developers) are increasingly standardising on IAR Systems’ tools.
- 3 Increased penetration from existing and new technologies in the IAR Embedded Workbench, which should drive add-on sales.

IAR Systems’ security offering lends the greatest growth potential, in our view, as it has a solid track record of offering new products to existing customers. In a simplified scenario, we believe its existing customer base could represent a >SEK10bn revenue pool for its security offering. This should provide a long runway for future growth, but in the short term we expect: 1) security legislation to play an active role in the update of secure development tools; and 2) the company to focus on larger customer accounts. Furthermore, discussions with its customers and partners at Embedded World 2019 cemented our view of IAR Systems’ value proposition.

We expect Secure Thingz to contribute to group sales with 2% organic growth CAGR in 2020–2023

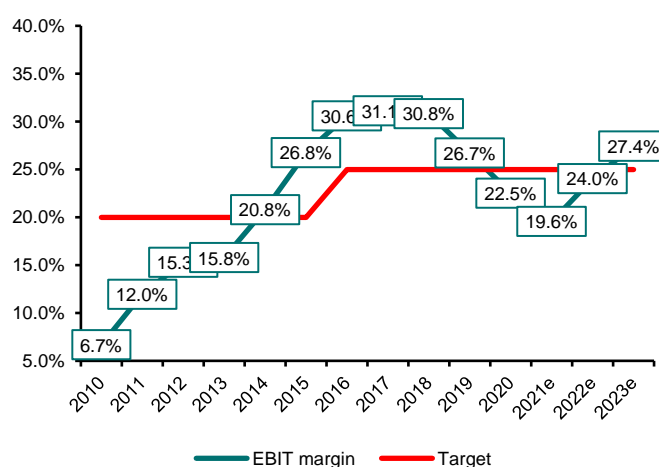
We forecast a 2020–2023 EBIT CAGR of 27%, which implies an increase in the margin from 23% in 2020 to 27% in 2023e, driven by: 1) solid organic volume growth; and 2) ample operational leverage (hurt in 2018–2020 by the integration of Secure Thingz) in 2021–2023e, as we believe IAR Systems should continue to benefit from economies of scale due to its large fixed cost base.

Figure 22: Organic sales growth (2010–2023e)



Source: DNB Markets (forecasts), company (historical data)

Figure 23: Adj. EBIT margin (2010–2023e)



Source: DNB Markets (forecasts), company (historical data)

Financial targets

IAR Systems has three financial targets: 1) average organic growth of 10–15% annually; 2) an adj. EBIT margin in excess of 25% over a business cycle; and 3) a dividend payout of 30–50% of annual net income.

Figure 24: IAR Systems' financial targets – reported and DNB Markets' estimates

	Reported fiscal years					IAR target	DNB Markets' estimates		
	2016	2017	2018	2019	2020		2021e	2022e	2023e
Organic growth	5.0%	6.0%	11.0%	1.0%	-7.1%	10–15%	2.1%	18.8%	13.9%
EBIT margin	30.6%	31.1%	30.8%	26.7%	22.5%	>25%	19.6%	24.0%	27.4%
Payout ratio	113.3%	79.0%	74.9%	83.9%	0.0%	30–50%	0%	35%	39%

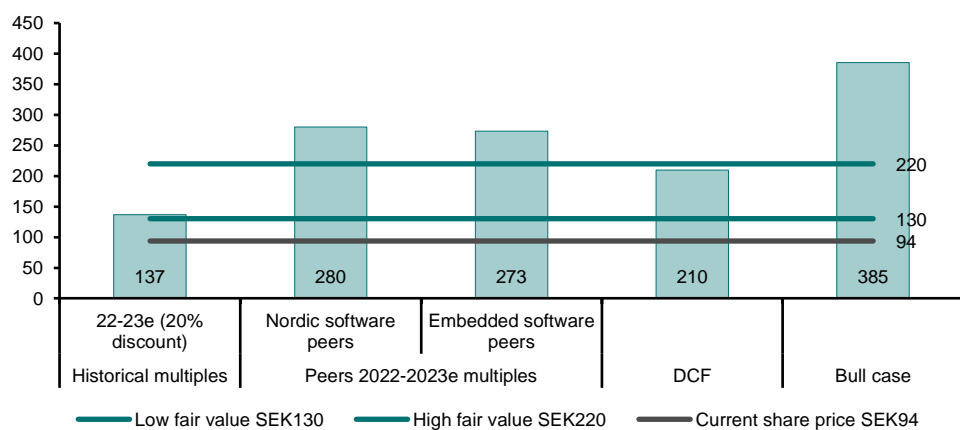
Source: DNB Markets (forecasts), company (historical data and targets)

We calculate a fair value of SEK130–220/share

Based on IAR Systems' historical valuation multiples (P/E of 26x, EV/EBIT of 20x), our group of Nordic software peers, embedded software peers, and our DCF model, we calculate a fair value of SEK130–220/share. At the current share price, our estimates calculate to a 2022e P/E of 17x, an EV/EBIT of 12x, and an EV/sales of 3x.

Fair value of SEK130–220/share

Figure 25: Valuation summary (SEK/share)



Source: DNB Markets

Summary of negatives

The key negatives that could affect our fair value are: 1) an inability to resurrect the growth story, e.g. if IAR Systems failed to capture the underlying market growth, or if there was prolonged market consolidation (causing market uncertainty) or delays in key strategic initiatives; 2) market entry by large participants with significant resources that have thus far overlooked the potential in software tools for embedded systems; and 3) FX headwinds, as the company is fairly sensitive to fluctuations in the SEK as it does not hedge its currency flows (with >99% of sales from markets outside Sweden but 50% of its cost base in SEK).

- **Failure to resurrect the growth story.** Having reported average local-currency growth of 20% in 2010–2013, 9% in 2014–2015, and 3% in 2016–2020, we believe the key potential negative to the valuation is a failure to resurrect the organic growth story. While we have identified numerous market drivers that should fuel organic growth in our forecast period, an inability to capture these trends, delays in when the factors materialise, or disappointing disclosures regarding the new strategic alliances in royalty fees, licensing structures, etc., could raise questions about the operations and thus the valuation.
- **FX headwinds.** Although >99% of sales are from markets outside Sweden, we estimate ~50% of the fixed cost base is denominated in SEK; hence the company is fairly sensitive to fluctuations in this currency. If the SEK were to strengthen by 10% against its most important currencies (USD, EUR, JPY) as well as the GBP and KRW in 2020, we estimate a ~10% FX headwind for sales and a ~30% headwind for 2021 EBIT.
- **Intensified competitive landscape.** While the company holds leading positions across most processor types, it still faces a highly competitive environment, particularly from the independent supplier Green Hills Software and Arm's development tool, Kiel. If competitiveness were to intensify or market growth rates were to abate, there could be pressure on the pricing of software licences (from those not giving it away free) in efforts to recapture growth or gain market share. While we believe the commercial viability of open-source names is a limited risk for IAR Systems' offering, any success for these alternatives could result in reduced licensing revenues for IAR Systems.
- **Continued market consolidation.** The ongoing consolidation trend among processor vendors could last longer than IAR Systems expects. If this continues to create market uncertainty and disrupt IAR Systems' partner network, it could hamper its growth prospects. Also, if the acquisitions of embedded software companies continue, it could cap IAR Systems' ability to integrate new technologies into its product offering. If it fails to acquire new technologies or create strategic alliances to integrate into its offering, this could impede its ability to address new market trends that should contribute to growth.
- **Large companies entering the market.** While we believe the barriers to entry are considerable, we also believe the attractiveness of this market has been somewhat overlooked by industry giants as they have often acquired development-tool companies and given away the products 'free' to reduce costs. As many competitors in the semiconductor industry (particularly processor vendors), especially global giants such as Google and Amazon, are well resourced, it could pose a threat if they were to consider increasing their presence in software-development tools.
- **Limited supply of qualified personnel.** In an industry characterised by rapid technological development, it is vital for IAR Systems to continually improve its product offering through innovation. A need for its technology and products to be market-leading means it has to retain well-qualified employees, particularly in the technological aspects of product development. Failure to respond quickly to technological developments through qualified personnel could hurt its operations.
- **Worsening economic conditions.** A deteriorating global economy would probably cause a downturn in the cyclical semiconductor industry and customers' end-markets, which could affect the number of new microprocessors and, consequently, demand for software-development tools that programme the chips.

Large competitors with significant resources have thus far overlooked the potential in software tools for embedded systems

IAR Systems is sensitive to fluctuations in the SEK

Growth prospects could be hampered by further consolidation

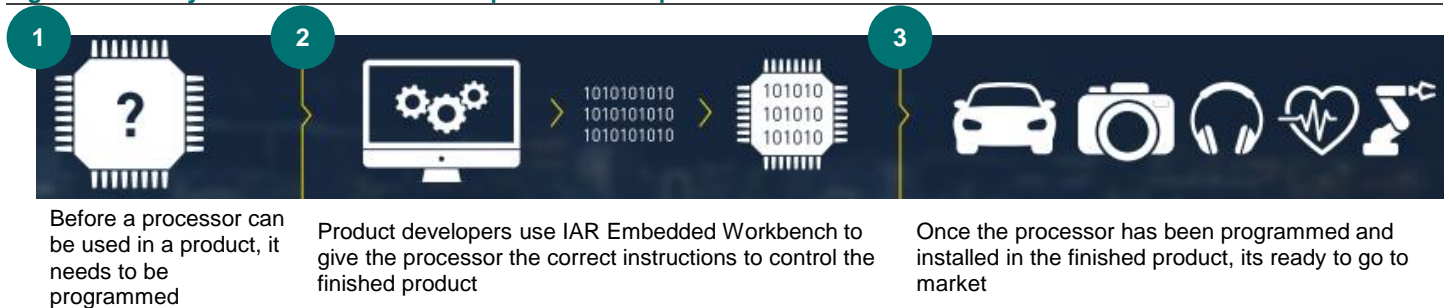
Retaining talented employees is key

Business overview

Dating back to 1983, IAR Systems is an independent provider of software for the programming of microprocessors in embedded systems (the control function in digital products). Its leading software – the IAR Embedded Workbench – facilitates, quality-assures, and improves the time-to-market of programming instructions in processors. The customer base of 46,000+ OEM customers and 150,000+ technology users is found mainly in end-markets underpinned by growing demand for digital technology and embedded systems, such as industrial automation, medical technology, telecommunications, consumer electronics, and the automotive industry.

World-leading provider of software for programming processors in embedded systems, which enable the development of digital products

Figure 26: IAR Systems' role in customers' product development



Source: Company

Headquartered in Uppsala (Sweden), the company holds a leading global market share of ~40% with 95%+ of sales stemming from markets outside the Nordics and a headcount of 210. IAR Systems' business model is primarily licence-based, where customers pay for a flexible right-to-use licence to access the IAR Embedded Workbench®, giving it attractive and steady revenue streams (~35% recurring revenues). In addition, IAR Systems underwent two of the most comprehensive product launches in its history in 2019. With the launch of its security offering (C-Trust and Embedded Trust) as well as the launch of a subscription-based model for RISC-V tools, we believe the building blocks are in place to take the case to the next level.

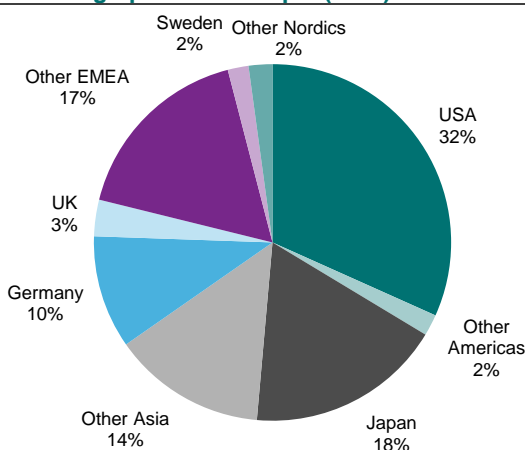
40% global market share with 57% licence-based revenues, which are flexible for customers and leverage the number of programmers using its licence...

- **IAR Embedded Workbench (99% of 2020 sales)**, based on the number of licence users (perpetual software keys) of the IAR Embedded Workbench sold when a developer programmes a product. The traditional licence costs cSEK30,000–50,000 (upfront), while the customer can add support and updates for an annual cost of 20% of the licence price.
- **Secure Thingz (1%)**. C-Trust at ~SEK30,000/seat as a perpetual licence targeting IAR Systems' 150,000 users and Embedded Trust at ~SEK150,000/seat as an annual subscription licence targeting the security experts at IAR Systems' 46,000 OEM customers.

In 2019, IAR Systems also introduced a subscription model through its RISC-V tools and Embedded Trust...

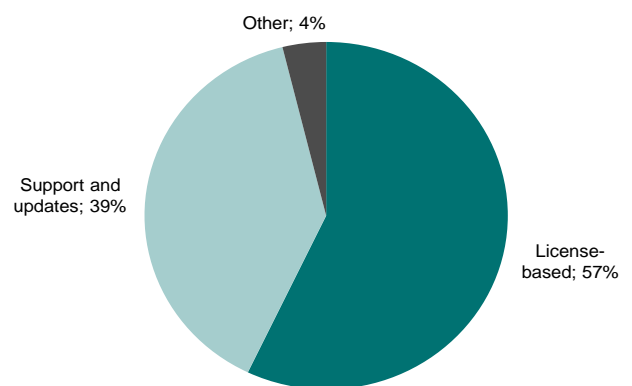
...complemented by royalty-based revenue that leverages the number of chips used in customers' production, which falls straight through to EBIT

Figure 27: Geographical sales split (2020)



Source: Company

Figure 28: Sales by business model (2020)



Source: Company

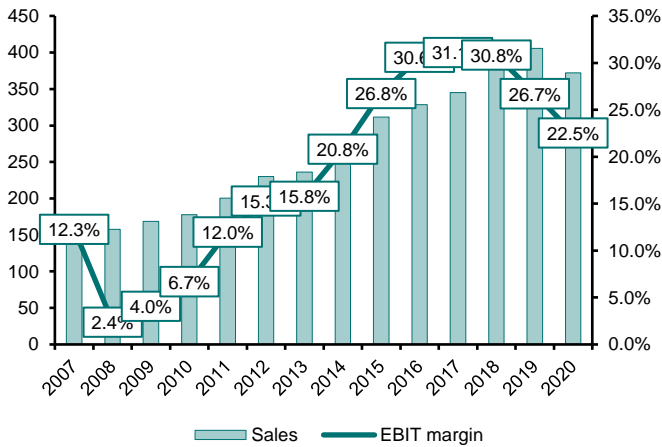
28 October 2021

IAR Systems was acquired by IT conglomerate Nocom in 2005. However, by 2010, Nocom (then known as Intoi) wanted to focus on proprietary software and create a more specialised company, so it kept only IAR Systems and took on that name.

With 2020 net sales of SEK372m, IAR Systems is 3x larger than the company acquired in 2005. While generating a sales CAGR of 8% over the past 10 years, it was able to significantly boost underlying profitability from an adj. EBIT margin of 12.3% in 2007 to 22.5% in 2020, which we attribute to: 1) the scalability of its high-gross-margin standardised software; 2) the increased focus on proprietary products; and 3) increased cost-efficiency (given the large fixed cost base, where personnel costs represent 65% of sales).

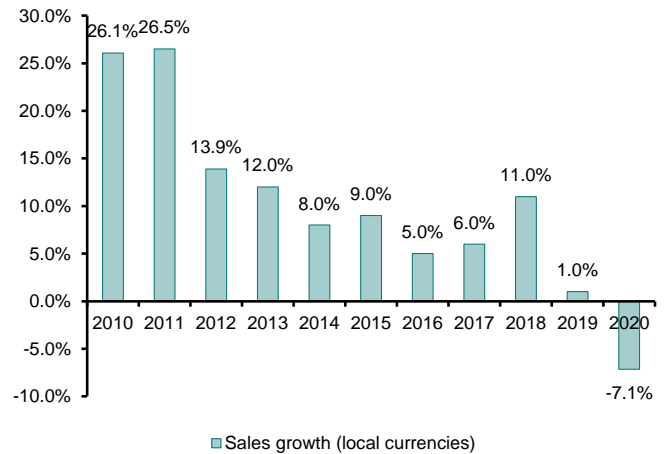
...with profitable growth, a sales CAGR of 8%, and an adj. EBIT CAGR of 22% in the past 10 years

Figure 29: IAR Systems – sales (SEKm) and adj. EBIT margin



Source: Company

Figure 30: IAR Systems – sales growth in local currencies



Source: Company

IAR Systems’ key competitive advantage in our view is its flagship product, the IAR Embedded Workbench, which is a complete toolchain for customers. As it is independent, the software supports 14,000+ processors for embedded systems from the major process vendors with 8-, 16-, and 32-bit architecture, meaning customers can choose the programming environment and tools according to their own needs regardless of processor or project, which avoids locking customers into one technical platform. Moreover, it can re-use 70–80% of previously developed code instead of rewriting it (saving time and resources).

Key competitive advantage: cutting-edge, wholly owned technology that maximises customer benefits and offers a complete solution...

Over the past few years, IAR Systems has expanded its product portfolio to offer several adjacent products integrated into the IAR Embedded Workbench to optimise the code programming, for instance C-STAT and C-RUN (static and dynamic analysis that quality-assures and strengthens the reliability of the programming), Embedded Trust (security development environment for IoT solutions), and C-Trust (delivering secure, encrypted code) through its acquisition of Secure Thingz, as well as support for RISC-V, positioning IAR Systems in two of the embedded industry’s hottest themes. In addition to driving add-on sales, this – combined with a comprehensive support organisation – has translated into impressive customer retention (95% recurring customers) and strengthened IAR Systems’ competitiveness.

...which, combined with complementary integrated products and comprehensive support, means a loyal customer base (95% recurring customers)

Figure 31: IAR Embedded Workbench® sold to >46,000 customer organisations

IDE Tools	Build Tools	C-SPY Debugger	C-Trust	Embedded Trust
<ul style="list-style-type: none"> - Editor - Project manager - Library Tools 	<ul style="list-style-type: none"> - IAR C/C++ Compiler - Assembler - Linker - RISC-V support 	<ul style="list-style-type: none"> - Simulator driver - Hardware debugging - Power debugging - RTOS plugins 	<ul style="list-style-type: none"> - Adds security to IAR Embedded Workbench - Delivery of secure and encrypted code - Inhibits unauthorized manufacturing 	<ul style="list-style-type: none"> - Security development environment - Identity and certificate management - Secure Boot Manager - Secure deployment and manufacturing mastering



Source: Company (information), DNB Markets (graph structuring)

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Forecast changes – P&L

(SEKm)	New			Old			Change		
	2021e	2022e	2023e	2021e	2022e	2023e	2021e	2022e	2023e
Revenues	360	427	487	383	465	530	-23	-38	-44
Cost of sales	-12	-13	-13	-13	-15	-15	1	2	2
Gross profit	348	414	473	370	450	515	-22	-36	-42
Operating expenses	-224	-249	-269	-230	-259	-284	7	10	15
EBITDA	124	165	204	139	191	231	-15	-26	-27
EBITDA adj	124	165	204	139	191	231	-15	-26	-27
EBITDA margin (%)	34.5	38.6	41.9	36.3	41.1	43.5	-1.8	-2.4	-1.6
Depreciation	-4	-5	-5	-3	-4	-5	0	0	0
Amortisation	-50	-58	-65	-49	-58	-65	-1	0	1
EBIT	71	103	134	86	129	160	-16	-26	-27
EBIT adj	71	103	134	88	129	160	-18	-26	-27
Net financial items	-4	-5	-7	-4	-6	-8	0	1	1
PBT	67	98	126	83	123	152	-16	-25	-26
Taxes	-15	-24	-31	-19	-30	-37	4	6	6
Minorities	0	0	0			0			0
Net profit	52	74	95	63	93	115	-12	-19	-20
Adjustments to net profit	0	0	0	-1	0	0	2	0	0
Net profit adj	52	74	95	62	93	115	-10	-19	-20
<i>Per share data (SEK)</i>									
EPS	3.83	5.40	7.00	4.65	6.80	8.43	-0.83	-1.39	-1.44
EPS adj	3.80	5.40	7.00	4.80	6.80	8.43	-1.00	-1.39	-1.44
DPS ordinary	0.00	1.90	2.70	0.00	2.40	3.40	0.00	-0.50	-0.70
DPS	0.00	1.90	2.70	0.00	2.40	3.40	0.00	-0.50	-0.70
<i>Other key metrics (%)</i>									
Revenue growth	-3.2	18.6	13.9	3.0	21.4	14.1	-6.1	-2.8	-0.2
EBIT adj growth	-15.9	45.7	30.0	5.5	45.4	24.8	-21.4	0.4	5.2
EPS adj growth	-12.9	42.3	29.5	10.1	41.6	24.1	-23.0	0.6	5.4
Avg. number of shares (m)	14	14	14	14	14	14	0	0	0
Capex	-77	-81	-89	-76	-81	-88	-1	0	-1
OpFCF	47	84	115	63	110	142	-16	-26	-28
Working capital	60	80	120	61	103	153	-1	-22	-33
NIBD adj	-63	-83	-114	-59	-83	-128	-4	1	14

Source: DNB Markets

Forecast changes – By segment and assumptions

(SEKm)	New			Old			Change		
	2021e	2022e	2023e	2021e	2022e	2023e	2021e	2022e	2023e
Assumptions									
Revenue org. % YOY	2.06	18.79	13.93	8.15	20.54	14.11	-6.08	-1.75	-0.18
Structure impact % YOY	0.00	0.00	0.00			0.00			0.00
Currency impact % YOY	-5.23	-0.17	0.00	-5.19	0.83	0.00	-0.04	-1.01	0.00

Source: DNB Markets

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Quarterly numbers

(SEKm)	Q2 2020	Q3 2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021	Q4 2021e	Q1 2022e	Q2 2022e	Q3 2022e	Q4 2022e
Revenues	100	89	91	89	87	88	96	98	110	109	110
Cost of sales	-3	-3	-4	-3	-3	-3	-3	-3	-3	-3	-3
Gross profit	97	86	87	86	85	85	93	95	107	106	107
Operating expenses	-60	-49	-54	-56	-59	-50	-59	-61	-64	-62	-63
EBITDA	37	37	33	30	26	35	34	34	43	44	44
Depreciation	-1	0	-1	-1	-1	-1	-1	-1	-1	-1	-1
Amortisation	-11	-11	-13	-12	-12	-13	-12	-13	-15	-16	-14
EBIT	25	25	19	17	13	21	20	21	26	27	29
Net financial items	-2	-1	-5	-1	-1	0	-1	0	-2	0	-2
PBT	23	25	15	16	12	20	19	21	24	27	26
Taxes	-6	-6	-3	-4	-2	-5	-5	-5	-6	-7	-6
Minorities	0	0	0	0	0	0	0	0	0	0	0
Net profit	18	19	12	13	9	16	14	16	18	20	20
Adjustments to net profit	0	0	0	0	-1	2	0	0	0	0	0
Net profit adj	18	19	12	13	8	17	14	16	18	20	20
Dividend paid	0	0	0	0	0	0	0	0	-26	0	0
Avg. number of shares (m)	14	14	14	14	14	14	14	14	14	14	14
<i>Per share data (SEK)</i>											
EPS	1.29	1.37	0.88	0.94	0.68	1.17	1.04	1.14	1.34	1.47	1.46
EPS adj	1.29	1.37	0.88	0.94	0.83	1.00	1.04	1.14	1.34	1.47	1.46
DPS ordinary	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	1.90	0.00	0.00
DPS	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	1.90	0.00	0.00
<i>Growth and margins (%)</i>											
Revenues, QOQ growth	8.5	-11.2	2.0	-2.0	-1.7	0.6	9.2	2.4	11.5	-0.4	0.9
Revenues, YOY growth	1.1	-11.1	-15.1	-3.7	-12.7	-1.1	5.9	10.6	25.4	24.2	14.7
EPS adj, YOY growth	7.8	-13.4	-40.0	15.4	-35.8	-27.3	18.1	21.6	61.5	47.6	40.5
Gross margin	96.6	97.0	95.6	96.2	96.9	96.8	96.6	96.5	97.2	97.1	96.9
EBITDA adj margin	36.8	41.4	35.8	33.5	29.7	39.6	35.0	34.9	38.9	40.4	40.0
Depreciation/revenues	-1.2	-0.4	-0.9	-0.7	-1.1	-1.1	-1.0	-0.8	-1.2	-1.2	-1.0
EBIT adj margin	25.0	28.6	20.9	19.1	16.8	21.2	21.0	21.4	23.9	24.5	26.1
Net profit margin	17.6	21.0	13.2	14.4	10.6	17.9	14.7	15.8	16.6	18.4	18.0

Source: Company (historical figures), DNB Markets (estimates)

Adjustments to quarterly numbers

(SEKm)	Q2 2020	Q3 2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021	Q4 2021e	Q1 2022e	Q2 2022e	Q3 2022e	Q4 2022e
EBITDA	37	37	33	30	26	35	34	34	43	44	44
EBITDA adj	37	37	33	30	26	35	34	34	43	44	44
EBIT	25	25	19	17	13	21	20	21	26	27	29
Other EBIT adjustments	0	0	0	0	-2	2	0	0	0	0	0
EBIT adj	25	25	19	17	15	19	20	21	26	27	29
Net profit	18	19	12	13	9	16	14	16	18	20	20
Other EBIT adjustments	0	0	0	0	-2	2	0	0	0	0	0
Tax adjustments	0	0	0	0	0	0	0	0	0	0	0
Other adjustments	0	0	0	0	0	0	0	0	0	0	0
Net profit adj	18	19	12	13	8	17	14	16	18	20	20

Source: Company (historical figures), DNB Markets (estimates)

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Quarterly numbers by segment and assumptions

(SEKm)	Q2 2020	Q3 2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021	Q4 2021e	Q1 2022e	Q2 2022e	Q3 2022e	Q4 2022e
Assumptions											
Revenue org. % YOY	-0.81	-5.60	-10.77	5.96	-2.40	-0.67	5.69	9.85	25.06	25.31	15.38
Structure impact % YOY	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Currency impact % YOY	1.92	-5.50	-4.31	-9.64	-10.29	-0.45	0.17	0.70	0.36	-1.07	-0.64

Source: Company (historical figures), DNB Markets (estimates)

Annual P&L

(SEKm)	2014	2015	2016	2017	2018	2019	2020	2021e	2022e	2023e	
Revenues	256	312	328	345	385	406	372	360	427	487	
Cost of sales	-13	-10	-12	-9	-9	-11	-14	-12	-13	-13	
Gross profit	243	301	316	337	376	395	358	348	414	473	
Operating expenses	-179	-203	-203	-209	-236	-249	-225	-224	-249	-269	
EBITDA	64	98	113	127	140	146	133	124	165	204	
Depreciation	-2	-3	-3	-2	-3	-3	-3	-4	-5	-5	
Amortisation	-8	-12	-14	-17	-22	-34	-46	-50	-58	-65	
EBIT	53	83	97	107	116	108	84	71	103	134	
Net financial items	0	0	0	-2	-2	-1	-7	-4	-5	-7	
PBT	54	83	100	106	117	107	77	67	98	126	
Taxes	-11	-20	-22	-26	-26	-26	-17	-15	-24	-31	
Effective tax rate (%)	21	24	22	24	22	24	23	23	25	25	
Minorities	0	0	0	0	0	0	0	0	0	0	
Net profit	42	63	78	80	91	81	59	52	74	95	
Adjustments to net profit	0	0	-3	0	-2	0	0	0	0	0	
Net profit adj	42	63	75	80	88	81	59	52	74	95	
Dividend paid	0	-63	-88	-63	-68	-68	0	0	-26	-37	
Avg. number of shares	13	13	13	13	14	14	14	14	14	14	
<i>Per share data (SEK)</i>											
EPS	3.34	5.02	6.18	6.33	6.67	5.96	4.36	3.83	5.40	7.00	
EPS adj	3.34	5.02	6.18	6.33	6.67	5.96	4.36	3.80	5.40	7.00	
DPS ordinary	0.00	5.00	7.00	5.00	5.00	3.00	0.00	0.00	1.90	2.70	
DPS	0.00	5.00	7.00	5.00	5.00	3.00	0.00	0.00	1.90	2.70	
<i>Growth and margins (%)</i>											
Revenue growth	8.3	21.9	5.4	5.1	11.7	5.3	-8.3	-3.2	18.6	13.9	
EPS adj growth	59.2	50.2	23.0	2.6	5.3	-10.6	-26.8	-12.9	42.3	29.5	
Gross margin	95.0	96.7	96.3	97.5	97.7	97.3	96.2	96.6	96.9	97.2	
EBITDA margin	24.9	31.5	34.5	36.9	36.4	35.9	35.7	34.5	38.6	41.9	
EBITDA adj margin	24.9	31.5	34.5	36.9	36.4	35.9	35.7	34.5	38.6	41.9	
Depreciation/revenues	-0.9	-0.8	-0.8	-0.7	-0.7	-0.8	-0.8	-1.0	-1.1	-1.1	
EBIT margin	20.8	26.8	29.4	31.1	30.0	26.7	22.5	19.6	24.0	27.4	
EBIT adj margin	20.8	26.8	30.6	31.1	30.8	26.7	22.5	19.6	24.0	27.4	
PBT margin	21.0	26.7	30.5	30.6	30.4	26.4	20.6	18.6	22.8	26.0	
Net profit margin	16.5	20.3	23.8	23.2	23.6	20.0	16.0	14.4	17.3	19.6	

Source: Company (historical figures), DNB Markets (estimates)

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Adjustments to annual P&L

(SEKm)	2014	2015	2016	2017	2018	2019	2020	2021e	2022e	2023e
EBITDA	64	98	113	127	140	146	133	124	165	204
EBITDA adj	64	98	113	127	140	146	133	124	165	204
EBIT	53	83	97	107	116	108	84	71	103	134
Other EBIT adjustments	0	0	-4	0	-3	0	0	0	0	0
EBIT adj	53	83	101	107	119	108	84	71	103	134
Net profit	42	63	78	80	91	81	59	52	74	95
Other EBIT adjustments	0	0	-4	0	-3	0	0	0	0	0
Tax adjustments	0	0	0	0	0	0	0	0	0	0
Other adjustments	0	0	0	0	0	0	0	0	0	0
Net profit adj	42	63	75	80	88	81	59	52	74	95
<i>Per share data (SEK)</i>										
EPS	3.34	5.02	6.18	6.33	6.67	5.96	4.36	3.83	5.40	7.00
Recommended adjustment	0.00	0.00	0.00	0.00	0.00	0.00	0.00	-0.03	0.00	0.00
EPS adj	3.34	5.02	6.18	6.33	6.67	5.96	4.36	3.80	5.40	7.00

Source: Company (historical figures), DNB Markets (estimates)

Cash flow

(SEKm)	2014	2015	2016	2017	2018	2019	2020	2021e	2022e	2023e
Net profit	42	63	78	80	91	81	59	52	74	95
Depreciation and amortisation	10	15	17	20	25	37	49	54	62	70
Cash flow from operations (CFO)	70	99	114	124	93	106	118	121	126	157
Capital expenditure	-32	-19	-19	-19	-47	-84	-81	-77	-81	-89
Acquisitions/Investments	0	0	0	0	-171	-19	0	0	0	0
Divestments	0	1	0	0	0	0	0	0	0	0
Cash flow from investing (CFI)	-32	-18	-19	-38	-218	-102	-81	-77	-81	-89
Free cash flow (FCF)	39	80	95	86	-125	4	37	43	45	68
Net change in debt	0	0	0	0	0	30	6	1	0	0
Dividends paid	0	-63	-88	-63	-68	-68	0	0	-26	-37
Share issue (repurchase)	-53	0	0	0	172	0	0	0	0	0
Other	0	0	0	0	4	-14	-30	-18	-9	0
Cash flow from financing (CFF)	-53	-64	-88	-63	108	-52	-25	-17	-35	-37
Total cash flow (CFO+CFI+CFF)	-15	17	7	23	-17	-49	12	26	11	31
<i>FCFF calculation</i>										
Free cash flow	39	80	95	86	-125	4	37	43	45	68
Less: tax shields/other	0	0	0	0	0	0	0	0	0	0
Less: acquisitions	0	0	0	0	171	19	0	0	0	0
Less: divestments	0	-1	0	0	0	0	0	0	0	0
Growth (%)										
CFO	72.7	40.4	15.7	8.5	-25.3	14.1	12.0	1.8	4.9	24.5
CFI	-66.0	42.3	-3.3	-98.9	-478.5	53.0	20.4	5.1	-4.7	-10.1
FCF	78.7	108.3	18.5	-9.4	-244.7	102.8	957.1	16.8	5.3	50.0
CFF	-550.8	-19.5	-39.0	28.5	270.4	-148.3	52.7	30.9	-105.3	-5.6
FCFF	nm	nm	nm	nm	nm	nm	nm	nm	nm	nm

Source: Company (historical figures), DNB Markets (estimates)

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Balance sheet

(SEKm)	2014	2015	2016	2017	2018	2019	2020	2021e	2022e	2023e
Assets	375	399	396	410	722	825	834	910	948	1,007
Inventories	4	5	6	5	7	7	6	6	7	8
Trade receivables	39	44	48	51	63	67	59	55	63	72
Other receivables	11	20	19	12	38	52	64	59	59	59
Current financial assets	0	0	0	0	0	0	0	0	0	0
Cash and cash equivalents	71	89	99	120	106	61	68	96	107	138
Current assets	124	158	172	187	214	186	196	216	236	276
Property, plant and equipment	8	7	6	6	9	64	54	14	13	11
Other intangible assets	186	192	197	194	484	568	577	673	693	714
Deferred tax assets	51	37	16	3	13	5	4	4	4	4
Non-current financial assets	6	5	5	20	2	2	3	3	3	3
Non-current assets	251	241	224	223	508	639	638	694	712	731
Total assets	375	399	396	410	722	825	834	910	948	1,007
Equity and liabilities	375	399	396	410	722	825	834	910	948	1,007
Total equity	289	291	280	290	550	592	613	695	742	801
Trade payables	5	5	5	6	7	9	5	6	5	6
Other payables and accruals	65	84	92	31	131	117	111	46	46	46
Short-term debt	1	1	1	1	2	38	35	18	18	18
Total current liabilities	71	90	99	102	140	164	150	156	156	156
Long-term debt	2	1	2	2	1	41	32	15	6	6
Deferred tax liabilities	15	17	15	14	30	27	37	43	43	43
Other non-current liabilities	0	1	1	2	2	1	1	1	1	1
Total non-current liabilities	16	18	18	17	32	69	70	59	50	50
Total liabilities	87	108	116	120	172	233	220	215	205	206
Total equity and liabilities	375	399	396	410	722	825	834	910	948	1,007
<i>Key metrics</i>										
Net interest bearing debt	-68	-88	-97	-117	-103	18	-2	-63	-83	-114

Source: Company (historical figures), DNB Markets (estimates)

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Valuation ratios

(SEKm)	2014	2015	2016	2017	2018	2019	2020	2021e	2022e	2023e
<i>Enterprise value</i>										
Share price (SEK)	74.75	150.00	206.00	189.00	243.00	186.00	139.80	93.60	93.60	93.60
Number of shares (m)	12.63	12.63	12.63	12.63	13.62	13.63	13.63	13.64	13.64	13.64
Market capitalisation	944	1,895	2,602	2,387	3,310	2,535	1,905	1,277	1,277	1,277
Net interest bearing debt	-68	-88	-97	-117	-103	18	-2	-63	-83	-114
Adjustments to NIBD	0	0	0	0	0	0	0	0	0	0
Net interest bearing debt adj	-68	-88	-97	-117	-103	18	-2	-63	-83	-114
EV	876	1,807	2,505	2,270	3,206	2,554	1,904	1,214	1,194	1,163
EV adj	876	1,807	2,505	2,270	3,206	2,554	1,904	1,214	1,194	1,163
<i>Valuation</i>										
EPS	3.34	5.02	6.18	6.33	6.67	5.96	4.36	3.83	5.40	7.00
EPS adj	3.34	5.02	6.18	6.33	6.67	5.96	4.36	3.80	5.40	7.00
DPS ordinary	0.00	5.00	7.00	5.00	5.00	3.00	0.00	0.00	1.90	2.70
DPS	0.00	5.00	7.00	5.00	5.00	3.00	0.00	0.00	1.90	2.70
P/E	22.4	29.9	33.4	29.8	36.4	31.2	32.1	24.5	17.3	13.4
P/E adj	22.4	29.9	33.4	29.8	36.4	31.2	32.1	24.6	17.3	13.4
P/B	3.27	6.51	9.31	8.22	6.02	4.28	3.11	1.84	1.72	1.59
Average ROE	14.5%	21.9%	27.3%	28.1%	21.6%	14.2%	9.9%	7.9%	10.3%	12.4%
Earnings yield adj	4.5%	3.3%	3.0%	3.4%	2.7%	3.2%	3.1%	4.1%	5.8%	7.5%
Dividend yield	0.0%	3.3%	3.4%	2.6%	2.1%	1.6%	0.0%	0.0%	2.0%	2.9%
Free cash flow yield	4.1%	4.2%	3.7%	3.6%	-3.8%	0.1%	1.9%	3.4%	3.6%	5.3%
EV/SALES	3.42	5.80	7.63	6.58	8.32	6.30	5.12	3.37	2.79	2.39
EV/SALES adj	3.42	5.80	7.63	6.58	8.32	6.30	5.12	3.37	2.79	2.39
EV/EBITDA	13.8	18.4	22.1	17.8	22.9	17.5	14.3	9.8	7.2	5.7
EV/EBITDA adj	13.8	18.4	22.1	17.8	22.9	17.5	14.3	9.8	7.2	5.7
EV/EBIT	16.5	21.7	26.0	21.1	27.7	23.6	22.7	17.2	11.6	8.7
EV/EBIT adj	16.5	21.7	24.9	21.1	27.0	23.6	22.7	17.2	11.6	8.7
EV/capital employed	3.0	6.2	8.9	6.4	5.8	3.8	2.8	1.5	1.4	1.3
EV/NOPLAT	22.2	29.3	35.1	28.6	37.5	31.8	30.7	23.2	15.7	11.8
EV/OpFCF (taxed)	50.1	31.6	36.6	28.3	51.4	75.1	64.5	42.4	20.8	14.5

Source: Company (historical figures), DNB Markets (estimates)

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Key accounting ratios

	2014	2015	2016	2017	2018	2019	2020	2021e	2022e	2023e
<i>Profitability (%)</i>										
ROA	11.3	16.4	19.6	19.9	16.0	10.5	7.2	6.0	7.9	9.8
ROCE	18.1	28.5	34.9	33.6	26.1	17.7	12.4	9.4	12.3	15.1
ROCE after tax	13.4	21.1	25.8	24.8	19.3	13.1	9.2	7.0	9.1	11.2
<i>Return on invested capital (%)</i>										
Net PPE/revenues	3.1	2.1	1.9	1.8	2.3	15.7	14.6	3.9	3.0	2.2
Working capital/revenues	20.9	22.0	22.4	24.6	19.3	5.4	12.3	16.6	18.8	24.7
<i>Cash flow ratios (%)</i>										
FCF/revenues	15.1	25.8	29.0	25.0	-32.4	0.9	9.9	12.0	10.6	14.0
FCF yield (%)	4.1	4.2	3.7	3.6	1.4	0.9	1.9	3.4	3.6	5.3
CFO/revenues	27.5	31.7	34.8	35.9	24.0	26.1	31.8	33.5	29.6	32.3
CFO/market capitalisation	7.4	5.2	4.4	5.2	2.8	4.2	6.2	9.4	9.9	12.3
CFO/capex	217.6	508.8	614.0	652.1	197.9	126.4	145.5	155.9	156.2	176.6
CFO/current liabilities	99.4	110.2	115.8	121.1	66.2	64.4	78.9	77.0	81.2	100.6
Cash conversion ratio	91.5	126.8	122.2	107.9	-137.6	4.3	62.3	83.2	61.7	71.5
Capex/revenues	12.6	6.2	5.7	5.5	12.1	20.6	21.9	21.5	18.9	18.3
Capex/depreciation	1404.3	776.0	744.0	791.7	1800.0	2696.8	2625.8	2179.0	1796.5	1635.6
OpFCF margin	12.2	25.3	28.8	31.4	24.2	15.3	13.8	13.0	19.7	23.6
Total payout ratio	0.0	99.6	113.3	78.9	75.0	50.4	0.0	0.0	35.1	38.6
<i>Leverage and solvency (x)</i>										
Net debt/EBITDA	-1.08	-0.89	-0.85	-0.92	-0.74	0.13	-0.01	-0.51	-0.50	-0.56
Total debt/total capital (BV)	0.01	0.00	0.01	0.01	0.00	0.10	0.08	0.04	0.03	0.02
LTD / (LTD + equity (MV))	0.00	0.00	0.00	0.00	0.00	0.02	0.02	0.01	0.00	0.00
<i>Cash conversion cycle</i>										
Inventory turnover days	104.7	180.7	167.5	223.3	267.7	223.1	147.6	181.2	191.9	214.9
Receivables turnover days	70.9	74.5	74.7	66.2	96.1	106.8	120.2	115.9	104.6	97.9
Credit period	147.1	170.1	158.6	244.8	296.1	310.9	129.4	183.4	148.9	164.8
Cash conversion cycle	28.5	85.1	83.7	44.8	67.7	18.9	138.3	113.7	147.7	147.9

Source: Company (historical figures), DNB Markets (estimates)

28 October 2021

Important Information

Company: IAR Systems
 Coverage by Analyst: Joachim Gunell
 Date: 27/10/2021

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