

IAR SYSTEMS

Resetting expectations on security

We have lowered our 2021–2022e EPS by c15% to reflect the slower ramp-up of IoT security. Challenges remain, but as customer behaviour normalises, with solid traction for 64-bit, RISC-V, and functional safety products, we see sales and EPS CAGRs of 13% and 25%, respectively, to 2023e. We have lowered our fair value to SEK150–220 (180-250), which corresponds to a 2022e P/E of 27x.

Q2 short of expectations. Given the roughly flat top-line growth 2018–2021 (-4% CAGR in new license sales offset by 8% CAGR in support and maintenance licenses), Q2's -2% organic sales growth YOY fell short of our 5% estimate. Many customers' projects are still postponed and decision-making processes are delayed owing to the pandemic. However, the exclusion of SEK21m in sales to strategic customers (IAR Systems has started to periodise its 3–5-year contracts instead of recognising whole contracts upfront) and SEK-10m in FX effects YOY would result in sales growth of c20% YOY. With a 5% miss to our Q2e sales and lower-than-expected capitalised development costs, the adj. EBIT of SEK15m (17% margin, -42% YOY) was 30% below our estimate.

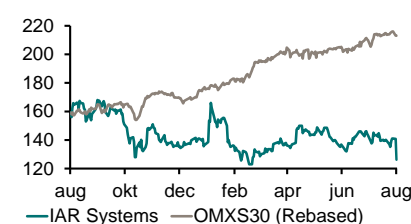
2021–2022e EPS lowered by c15%, as we have reduced our expectations for the ramp-up of Secure Thingz sales, which have underperformed our expectations for the past two years. We have kept the rest of our forecasts broadly unchanged; we lower our group sales forecasts by c6% but with 97% gross margins operating leverage becomes a headwind. We see IoT security standards as a key demand driver (i.e. Consumer IoT EN 303 645), but believe it will take time for legislative tailwinds to drive adoption. Although still representing a small base, we are encouraged by the ample traction for its 64-bit, RISC-V, and functional safety products, which showed 100%+ YOY growth in Q2.

Our SEK150–220 (180–250) fair value corresponds to a 2022e EV/EBIT of 19x and a P/E of 27x. We believe the market wants stronger signals that IAR Systems' negative two-year earnings-revisions trend has reached a turning point. We estimate that the legacy workbench business should be valued at cSEK140/share.

Year-end Dec	2017	2018	2019	2020	2021e	2022e	2023e
Revenue (SEKm)	345	385	406	372	383	465	530
EBITDA adj (SEKm)	127	140	146	133	139	191	231
EBIT adj (SEKm)	107	119	108	84	88	129	160
PTP (SEKm)	106	117	107	77	83	123	152
EPS rep (SEK)	6.33	6.67	5.96	4.36	4.65	6.80	8.43
EPS adj (SEK)	6.33	6.67	5.96	4.36	4.80	6.80	8.43
DPS (SEK)	5.00	5.00	3.00	0.00	0.00	2.40	3.40
Revenue growth (%)	5.1	11.7	5.3	-8.3	3.0	21.4	14.1
EBITDA growth adj (%)	12.4	10.1	4.1	-9.0	4.8	37.2	20.9
EPS growth adj (%)	2.6	5.3	-10.6	-26.8	10.1	41.6	24.1
EBITDA margin adj (%)	36.9	36.4	35.9	35.7	36.3	41.1	43.5
EV/Sales adj (x)	6.58	8.32	6.30	5.12	4.34	3.52	3.00
EV/EBITDA adj (x)	17.8	22.9	17.5	14.3	11.9	8.6	6.9
EV/EBIT adj (x)	21.1	27.0	23.6	22.7	18.8	12.7	9.9
P/E adj (x)	29.8	36.4	31.2	32.1	26.3	18.6	15.0
P/Book (x)	8.22	6.02	4.28	3.11	2.45	2.26	2.07
ROE (%)	28.1	21.6	14.2	9.9	9.7	12.7	14.5
ROCE (%)	33.6	26.1	17.7	12.4	11.8	15.1	17.5
Dividend yield (%)	2.6	2.1	1.6	0.0	0.0	1.9	2.7
FCF yield (%)	3.6	1.4	0.9	1.9	2.3	3.3	5.3

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

IARB versus OMXS30 (12m)



Source: Factset

SUMMARY

Share price (SEK)	126
Tickers	IARB SS

CAPITAL STRUCTURE

No. of shares (m)	13.6
No. of shares fully dil. (m)	13.7
Market cap. (SEKm)	1,721
NIBD adj end-2021e (SEKm)	-59
Enterprise value adj (SEKm)	1,662
Net debt/EBITDA adj (x)	-0.42
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

Q3 2021	27/10/2021
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ESTIMATE CHANGES (SEK)

Year-end Dec	2021e	2022e	2023e
Sales (old)	408.7	490.7	549.3
Sales (new)	383.0	464.9	530.5
Change (%)	-6.3	-5.3	-3.4
EPS (old)	5.74	7.83	9.21
EPS (new)	4.80	6.80	8.43
Change (%)	-16.4	-13.2	-8.4

Source: DNB Markets,

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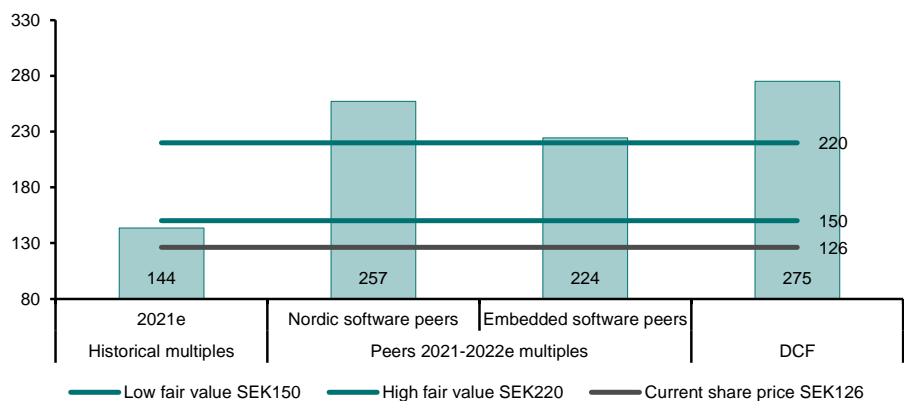
ANALYSTS

Joachim Gunell

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Overview

Valuation (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.
- 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 25%+, 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 SEK150–220 fair value (methodology unchanged).
- Applying its historical valuation (P/E 27x, EV/EBIT 20x) to our 2022 estimates suggests SEK180–220.
- On our estimates, IAR Systems is valued at 2022e P/E of 19x, an EV/EBIT of 13x, and an EV/sales of 4x.

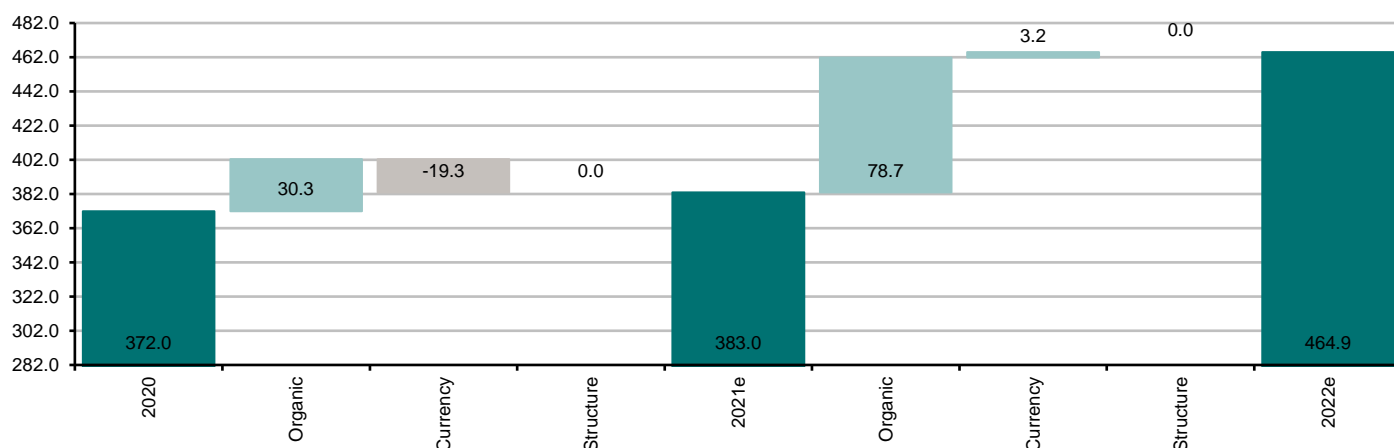
Source: DNB Markets

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.

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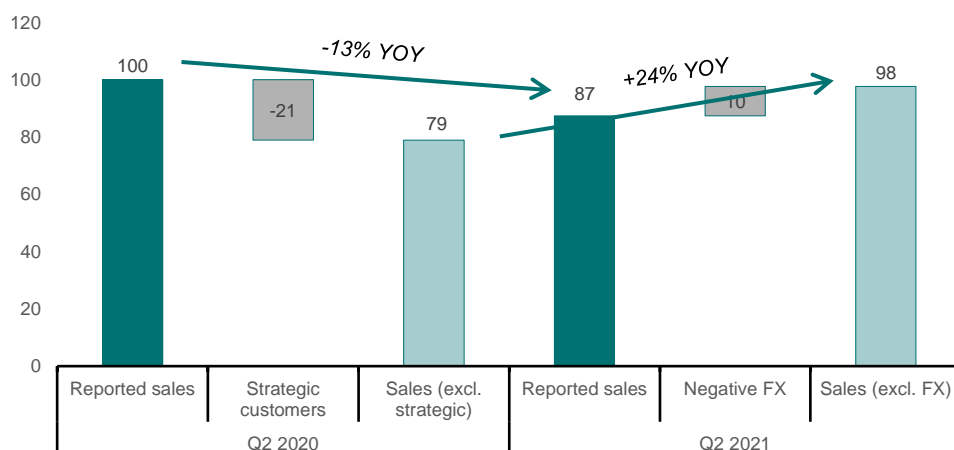
Q2 results

Figure 1: Q2 results versus expectations

Key highlights (SEKm, except per share data)	Q2 2021		Deviation (%)		Q2 2020		DNBe	
	Actual	DNB	DNB	DNB	Actual	DNB	2021e	
Sales	87.4	91.6	-5%	-4	100.1		383.0	
Gross profit	84.7	88.7	-4%	-4	96.7		369.6	
Margin	96.9%	96.9%			96.6%		96.5%	
EBIT adjusted	14.6	20.8	-30%	-6	25.0		88.4	
Margin	16.7%	22.7%	-6pp		25.0%		23.1%	
One-offs	-2.0	0.0					-2.0	
EBIT	12.6	20.8	-39%	-8	25.0		86.4	
Margin	14.4%	22.7%	-8.3pp		25.0%		22.6%	
EPS	0.68	1.05	-35%	0	1.29		4.80	
Growth YOY								
Sales growth	-12.7%	-8.5%	-4.2pp		1.1%		3.0%	
-of which organic	-2.4%	-1.0%	-1.4pp		-0.8%		8.1%	
-of which FX	-10.3%	-7.5%	-2.8pp		1.9%		-5.2%	
Divisions								
(SEKm)	Q2 2021				Q2 2020		2021e	
	Actual	DNB			Actual	DNB		
Sales								
Legacy IAR Systems	87.2	90.1	-3%	-3	97.6		380.5	
Royalty-based revenue	0.0	0.0	n.a.	0	0.0		0.0	
Secure Thingz	0.2	1.5	-87%	-1	2.5		2.5	
Group	87.4	91.6	-5%	-4	100.1		383.0	
EBIT adjusted								
Legacy IAR Systems + Secure Thingz	14.6	20.8	-30%	-6	25.0		88.4	
Royalty-based revenue	0.0	0.0	n.a.	0	0.0		0.0	
Group	14.6	20.8	-30%	-6	25.0		88.4	
FX impact								
Sales	-10.3%	-7.5%	-2.8pp		1.9%		-5.2%	
EBIT	-22.0%	-23.6%	1.6pp		5.5%		-19.4%	

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

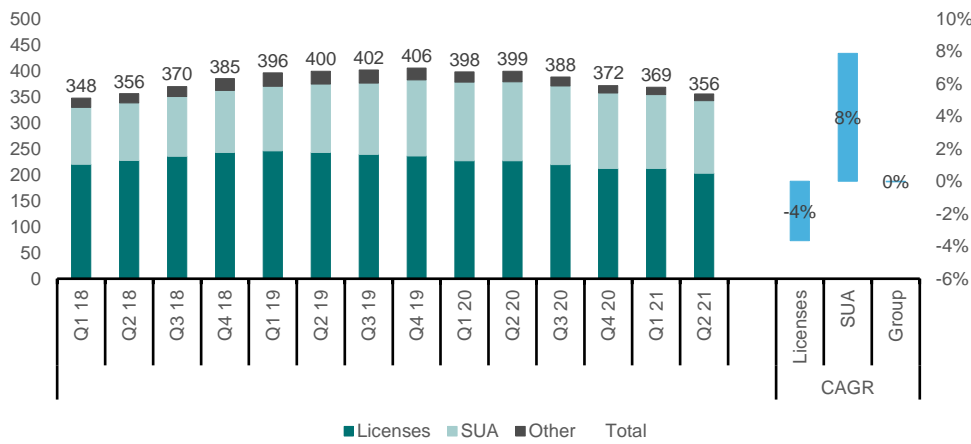
Figure 2: Implied YOY sales growth in Q2 excluding strategic customer comparables and negative FX impact (Q2 2020–Q2 2021)



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

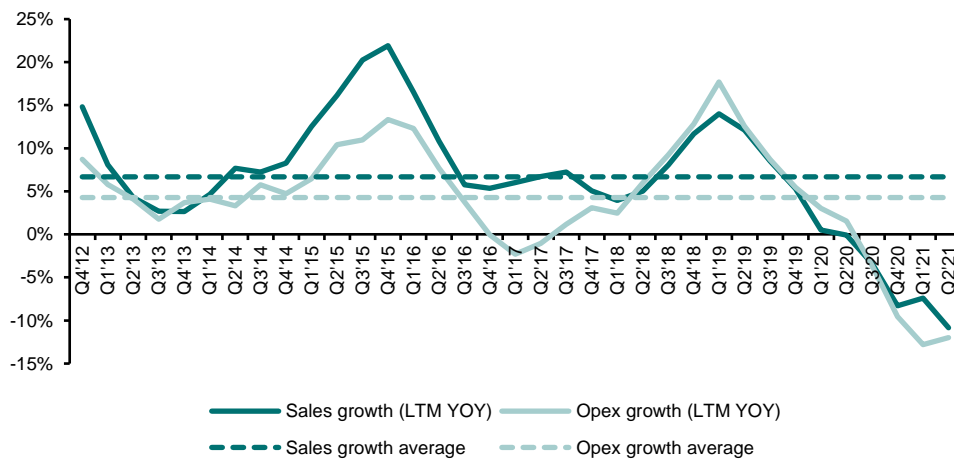
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Figure 3: LTM sales by product segment and CAGR (Q1 2018–Q2 2021)



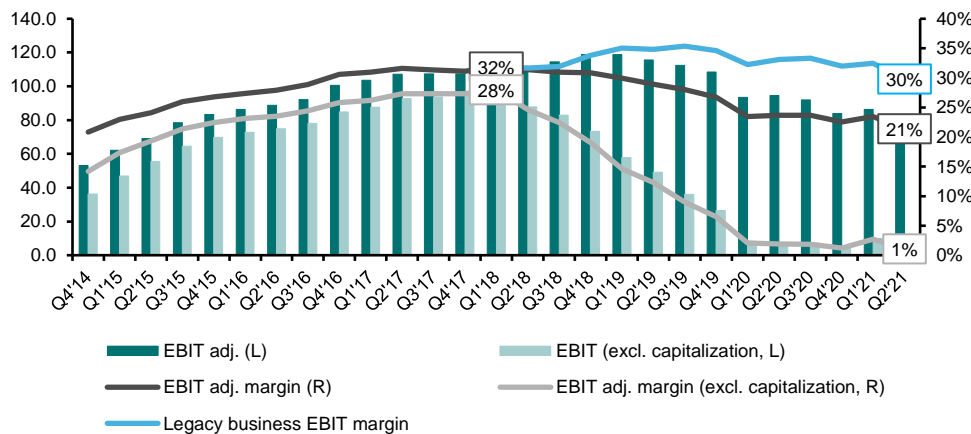
Source: Company (underlying data), DNB Markets (graph structuring)

Figure 4: Sales growth surpassed by opex growth in recent years (LTM)



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

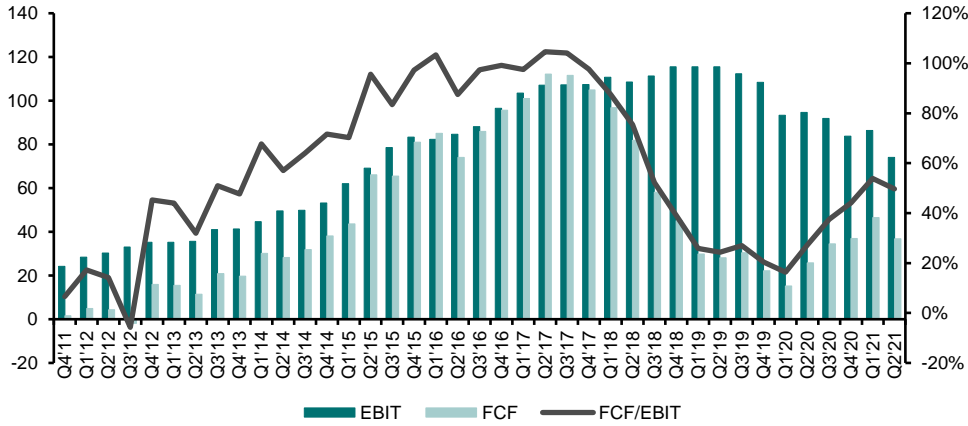
Figure 5: EBIT and margin trajectory (excluding capitalisation of development costs) (LTM, Q4 2014–Q2 2021)



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

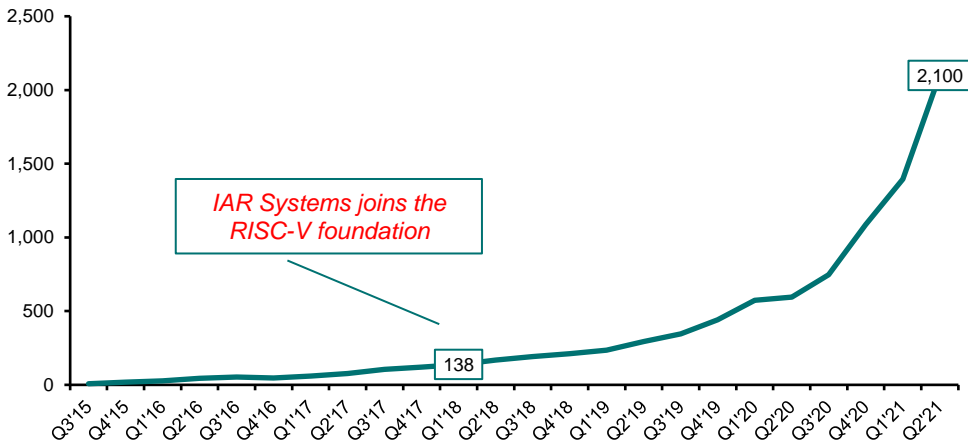
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Figure 6: Unimpressive cash conversion since the Secure Thingz acquisition in 2018 could be at a turning point after SEK400m+ of investments in new products (SEKm)



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

Figure 7: 2,000+ RISC-V ecosystem members growing at 90%+ YTD (number of electronics industry members)



Source: RISC-V Foundation

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Estimate revisions

Figure 8: Estimate changes

(SEKm, except per share data)	Old			New			Change		
	2021e	2022e	2023e	2021e	2022e	2023e	2021e	2022e	2023e
Sales									
Legacy IAR Systems	389.3	429.8	461.0	380.5	429.1	458.8	-2%	0%	0%
Royalty-based revenue	0.0	0.0	0.0	0.0	0.0	0.0			
Secure Thingz	19.4	60.9	88.2	2.5	35.7	71.7	-87%	-41%	-19%
Group Total	408.7	490.7	549.3	383.0	464.9	530.5	-6%	-5%	-3%
EBIT adjusted									
Legacy IAR Systems + Secure Thingz	107.6	147.6	174.9	88.4	128.5	160.4	-18%	-13%	-8%
Royalty-based revenue	0.0	0.0	0.0	0.0	0.0	0.0			
Group Total	107.6	147.6	174.9	88.4	128.5	160.4	-18%	-13%	-8%
EBIT adjusted margin									
Legacy IAR Systems + Secure Thingz	26.3%	30.1%	31.8%	23.1%	27.6%	30.2%	-325bp	-243bp	-162bp
Royalty-based revenue	100.0%	0.0%	0.0%	0.0%	0.0%	0.0%	-10000bp	0bp	0bp
Group Total	26.3%	30.1%	31.8%	23.1%	27.6%	30.2%	-325bp	-243bp	-162bp
Organic growth components									
Legacy IAR Systems	11.2%	9.8%	6.3%	8.8%	11.9%	6.4%	-241bp	214bp	14bp
Royalty-based revenue	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0bp	0bp	0bp
Secure Thingz	4.0%	10.4%	5.7%	-0.7%	8.6%	7.7%	-468bp	-176bp	204bp
Group Total	15.2%	20.2%	11.9%	8.1%	20.5%	14.1%	-708bp	39bp	218bp
Group									
Sales	408.7	490.7	549.3	383.0	464.9	530.5	-6%	-5%	-3%
Sales growth	9.9%	20.1%	11.9%	3.0%	21.4%	14.1%	-691bp	131bp	218bp
Organic	15.2%	20.2%	11.9%	8.1%	20.5%	14.1%	-708bp	39bp	218bp
Structure	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0bp	0bp	0bp
Currency	-5.4%	-0.1%	0.0%	-5.2%	0.8%	0.0%	18bp	92bp	0bp
Gross profit	394.4	474.5	532.3	369.6	450.0	515.1	-6%	-5%	-3%
Margin	96.5%	96.7%	96.9%	96.5%	96.8%	97.1%	0bp	9bp	20bp
EBIT adjusted	107.6	147.6	174.9	88.4	128.5	160.4	-18%	-13%	-8%
Margin	26.3%	30.1%	31.8%	23.1%	27.6%	30.2%	-325bp	-243bp	-162bp
Adjustments	0.0	0.0	0.0	-2.0	0.0	0.0			
EBIT	107.6	147.6	174.9	86.4	128.5	160.4	-20%	-13%	-8%
Margin	26.3%	30.1%	31.8%	22.6%	27.6%	30.2%	-377bp	-243bp	-162bp
Net financial items	-4.5	-6.1	-8.5	-3.7	-5.7	-8.0			
Pretax profit	103.1	141.5	166.4	82.7	122.8	152.4	-20%	-13%	-8%
Tax	-24.9	-34.7	-40.8	-19.2	-30.1	-37.3	-23%	-13%	-8%
Tax rate	24.1%	24.5%	24.5%	23.2%	24.5%	24.5%	-85bp	0bp	0bp
Net profit	78.3	106.8	125.6	63.5	92.7	115.0	-19%	-13%	-8%
EPS adjusted	5.74	7.83	9.21	4.80	6.80	8.43	-16%	-13%	-8%
EPS	5.74	7.83	9.21	4.65	6.80	8.43	-19%	-13%	-8%
DPS	0.00	2.87	3.92	0.00	2.40	3.40		-16%	-13%

Source: DNB Markets

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Figure 9: Quarterly estimates by division

(SEKm, except per share data)	Q1'19	Q2'19	Q3'19	Q4'19	Q1'20	Q2'20	Q3'20	Q4'20	Q1'21	Q2'21	Q3'21e	Q4'21e
Sales												
Legacy IAR Systems	98.0	96.8	98.1	105.1	91.4	97.6	88.5	89.5	88.6	87.2	92.2	112.5
Royalty-based revenue	1.4	1.5	1.6	1.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Secure Thingz	0.4	0.7	0.3	0.3	0.9	2.5	0.4	1.2	0.3	0.2	0.5	1.5
Group Total	99.8	99.0	100.0	106.8	92.3	100.1	88.9	90.7	88.9	87.4	92.7	114.0
EBIT												
Legacy IAR Systems + Secure Thingz	28.0	22.3	26.5	25.7	14.4	25.0	25.4	19.0	17.0	12.7	20.4	36.3
Royalty-based revenue	1.4	1.5	1.6	1.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Group Total	29.4	23.8	28.1	27.1	14.4	25.0	25.4	19.0	17.0	12.7	20.4	36.3
EBIT adjusted margin												
Legacy IAR Systems + Secure Thingz	28.6%	23.0%	27.0%	24.5%	15.8%	25.6%	28.7%	21.2%	19.2%	14.6%	22.1%	32.3%
Royalty-based revenue	100.0%	100.0%	100.0%	100.0%								
Group Total	29.5%	24.0%	28.1%	25.4%	15.6%	25.0%	28.6%	20.9%	19.1%	14.5%	22.0%	31.9%
Organic growth												
Legacy IAR Systems	3.4%	-2.3%	-2.7%	-1.2%	-11.0%	-0.8%	-5.6%	-10.6%	5.9%	-2.4%	5.0%	24.7%
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	0.0%	0.0%	0.0%	0.0%	-0.1%	0.0%	0.0%	-0.1%	0.0%	0.0%	0.1%	0.3%
Group Total	3.5%	-2.3%	-2.8%	-1.3%	-11.1%	-0.8%	-5.6%	-10.8%	6.0%	-2.4%	5.1%	25.0%
Group												
Sales	99.8	99.0	100.0	106.8	92.3	100.1	88.9	90.7	88.9	87.4	92.7	114.0
Sales growth	12.3%	3.6%	2.1%	3.9%	-7.5%	1.1%	-11.1%	-15.1%	-3.7%	-12.7%	4.3%	25.7%
Organic	3.5%	-2.3%	-2.8%	-1.3%	-11.1%	-0.8%	-5.6%	-10.8%	6.0%	-2.4%	5.1%	25.0%
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	8.8%	5.9%	4.9%	5.2%	3.6%	1.9%	-5.5%	-4.3%	-9.6%	-10.3%	-0.8%	0.7%
Gross profit	97.7	96.5	97.5	103.1	88.3	96.7	86.2	86.7	85.5	84.7	90.1	109.3
Margin	97.9%	97.5%	97.5%	96.5%	95.7%	96.6%	97.0%	95.6%	96.2%	96.9%	97.2%	95.8%
EBIT adjusted	29.4	23.8	28.1	27.1	14.4	25.0	25.4	19.0	17.0	14.7	20.4	36.3
Margin	29.5%	24.0%	28.1%	25.4%	15.6%	25.0%	28.6%	20.9%	19.1%	16.8%	22.0%	31.9%
Adjustments	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-2.0	0.0	0.0
EBIT	29.4	23.8	28.1	27.1	14.4	25.0	25.4	19.0	17.0	12.7	20.4	36.3
Margin	29.5%	24.0%	28.1%	25.4%	15.6%	25.0%	28.6%	20.9%	19.1%	14.5%	22.0%	31.9%
Net financial items	-0.2	-2.0	0.7	0.1	-0.1	-1.9	-0.5	-4.5	-0.6	-1.2	-0.1	-1.7
Pretax profit	29.2	21.8	28.8	27.2	14.3	23.1	24.9	14.5	16.4	11.5	20.3	34.6
Tax	-6.3	-5.1	-7.2	-7.2	-3.2	-5.5	-6.2	-2.5	-3.6	-2.2	-5.0	-8.5
Tax rate	21.6%	23.4%	25.0%	26.5%	22.4%	23.8%	24.9%	17.2%	22.0%	19.1%	24.5%	24.5%
Net profit	22.9	16.7	21.6	20.0	11.1	17.6	18.7	12.0	12.8	9.3	15.3	26.1
EPS adjusted	1.64	1.20	1.58	1.46	0.81	1.29	1.37	0.88	0.94	0.83	1.12	1.91
EPS	1.68	1.23	1.58	1.47	0.81	1.29	1.37	0.88	0.94	0.68	1.12	1.91
DPS	0.00	5.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00

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

Figure 10: IAR Systems valuation versus listed peers

	Mkt. cap. (SEKbn)	P/E (x)			EV/EBIT (x)			EV/Sales (x)			Div. yield (%)		ROE (%)		EBIT margin		CAGR 2020–2022e (%)			
		2021	2022e	2023e	2021	2022e	2023e	2021	2022e	2023e	2021e	2022e	2021e	2022e	2021e	2022e	Sales	EBIT	EPS	
IAR Systems (DNBe)	1.7	27.1	18.6	15.0	18.8	12.6	9.8	4.3	3.5	3.0	0.0	1.9	9	12	23.1	27.6	12	24	25	
<i>Premium/discount</i>		-56%	-65%	-66%	-61%	-70%	-71%	-73%	-74%	-74%										
IAR Systems (Cons.)	1.7	22.0	16.1	13.7	15.4	10.9	9.0	4.2	3.5	3.1		2.3			26.4	30.1	14	29	27	
<i>Premium/discount</i>		-64%	-70%	-68%	-68%	-74%	-74%	-74%	-74%	-73%										
Nordic software peers																				
QT Group	37.3		98.2	65.0		76.4	50.3	30.6	22.9	17.8	0.0	0.1	52	47	24.5	29.4	42	66	65	
Admicom	4.6	50.4	42.6	35.6	38.6	32.3	26.4	17.6	15.0	12.8	1.1	1.3	33	34	45.4	45.4	16	17	47	
Fortnox	27.4	109.0	78.4	55.9	84.6	60.1	42.0	28.4	21.7	16.8	0.2	0.2	35	31	33.4	35.6	34	31	31	
HMS Networks	18.9	53.7	52.7	49.1	41.2	38.8	35.5	9.9	8.8	8.2	0.6	0.7	26	22	23.9	22.5	23	34	31	
INVISIO Communications	7.9	69.5	38.5	27.5	53.6	29.4	20.3	10.7	8.0	6.5	0.6	1.1	26	38	19.9	26.6	34	46	52	
Lime Technologies	5.0	69.4	53.5	44.5															18	
SimCorp	47.7	44.3	39.3	35.5	34.4	30.2	27.5	9.3	8.6	7.9	0.9	1.0	35	35	27.0	28.2	8	13	14	
Vitec Software	15.4	52.7	46.3	41.4	53.4	46.6	40.0	10.4	9.5	8.7	0.4	0.5	24	23	19.4	20.2	16	34	30	
Embedded software peers																				
Cadence Design Systems	362.1	47.1	42.9	38.9	38.7	34.9	31.7	13.8	12.8	11.8	0.2	1.3	34	33	36.1	36.9	10	16	14	
ANSYS	272.0	50.4	45.2	40.6	40.8	36.5	33.9	16.5	15.0	13.7	0.0	0.0	14	14	41.1	42.2	13	20	12	
Xilinx	305.4	46.3	37.8	33.5	43.0	34.9	28.7	10.6	9.2	8.4	1.0	1.1	29	26	25.0	26.0	7	7	5	
Altium	29.2	77.6	64.2	54.1	56.5	48.3	40.2	18.1	16.1	13.6	1.3	1.3	20	19	31.2	32.2	3	5	9	
Average	94.4	60.9	53.3	43.5	48.5	42.6	34.2	16.0	13.4	11.5	0.6	0.8	30	29	29.7	31.4	19	26	27	
Median	28.3	52.7	45.7	41.0	42.1	36.5	33.9	13.8	12.8	11.8	0.6	1.0	29	31	27.0	29.4	16	20	24	

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 number one barrier to IoT adoption. The security market for embedded systems is in its inception phase, but we expect it to grow rapidly through 2022, 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 from 5% to almost 20% by 2022e, according to ABI Research. 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:

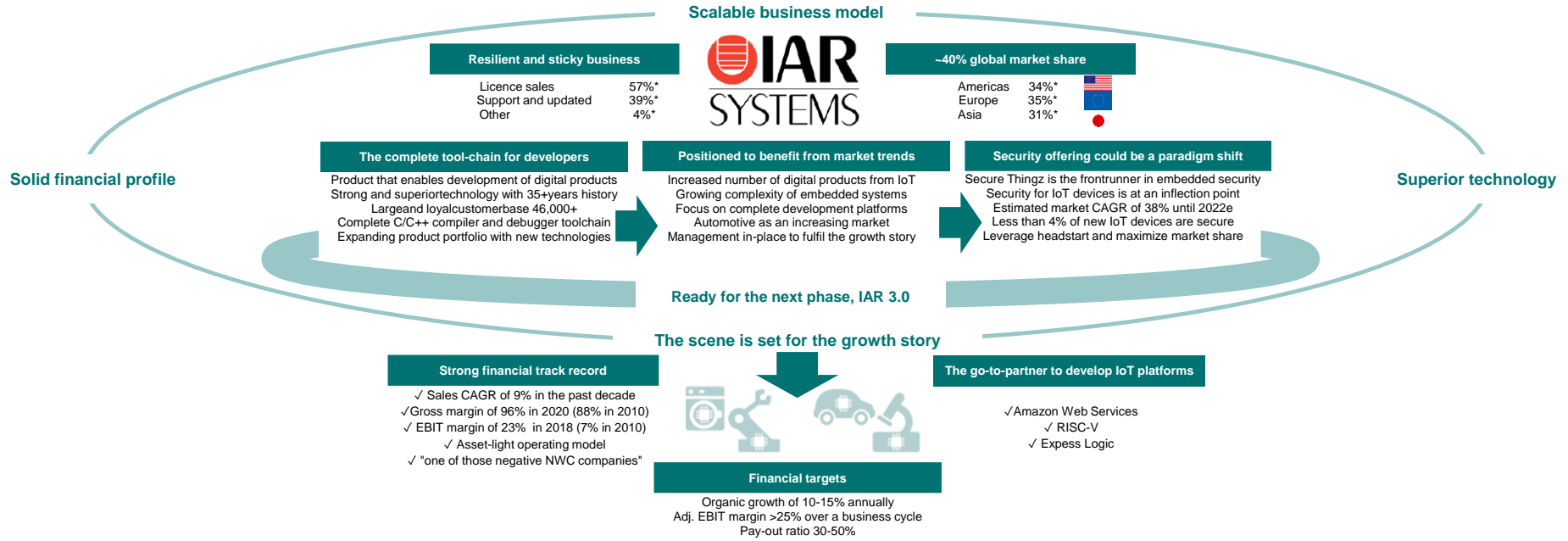
- 1) unique and complete toolchain
- 2) independence
- 3) high-quality products
- 4) frontrunner in security solutions
- 5) management's ability to achieve its long-term potential

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

Figure 11: IAR Systems at a glance



Source: Company (underlying data), DNB Markets (compilation)

We forecast 2020–2023 sales and EBIT CAGRs of 13% and 24%, respectively

We forecast a 2020–2023 sales CAGR and untapped potential in security solutions for embedded systems of 13%, and an EBIT CAGR of 24% 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 9% 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 6% organic growth CAGR in 2020–2023

We forecast a 2020–2023 EBIT CAGR of 24%, which implies an increase in the margin from 23% in 2020 to 30% 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 12: Organic sales growth (2010–2023e)

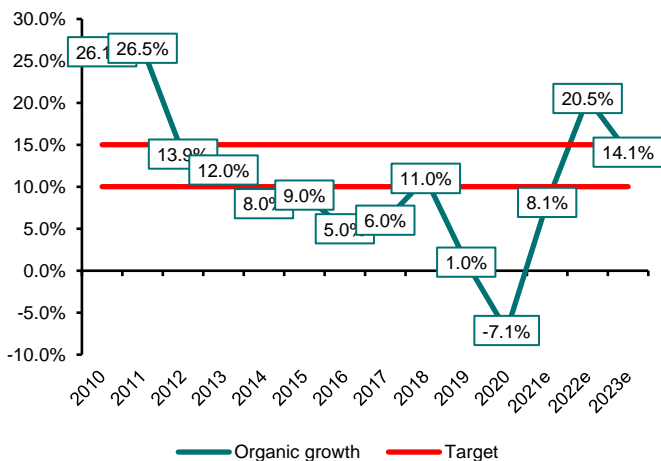
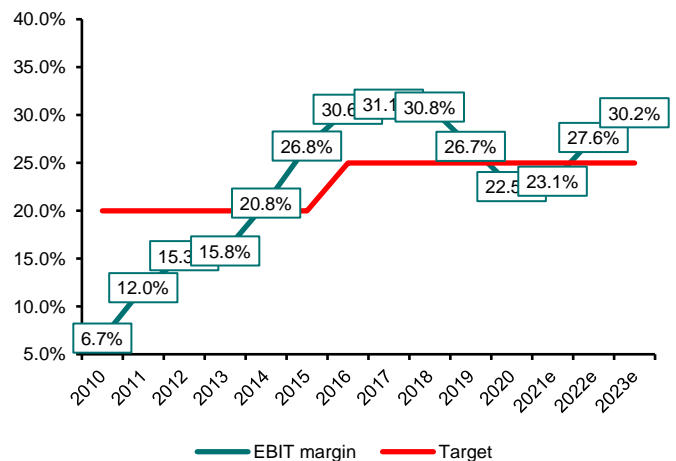


Figure 13: Adj. EBIT margin (2010–2023e)



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

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

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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 14: 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%	8.1%	20.5%	14.1%
EBIT margin	30.6%	31.1%	30.8%	26.7%	22.5%	>25%	22.6%	27.6%	30.2%
Payout ratio	113.3%	79.0%	74.9%	83.9%	0.0%	30-50%	0%	35%	40%

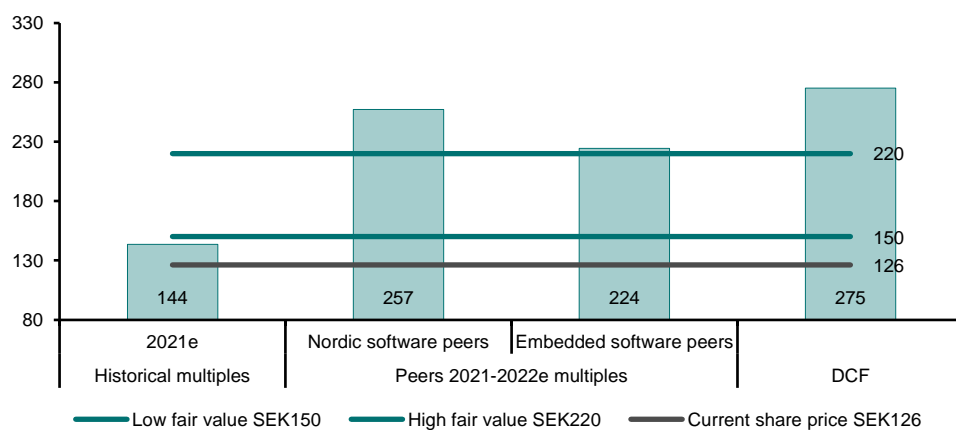
Source: DNB Markets (forecasts), company (historical data and targets)

We calculate a fair value of SEK150–220/share

Based on IAR Systems' historical valuation multiples (P/E of 27x, EV/EBIT of 20x), our group of Nordic software peers, embedded software peers, and our DCF model, we calculate a fair value of SEK150–220/share. At the current share price, our estimates calculate to a 2022e P/E of 19x, an EV/EBIT of 13x, and an EV/sales of 4x.

Fair value of SEK150–220/share

Figure 15: 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 6% in 2016–2019, 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

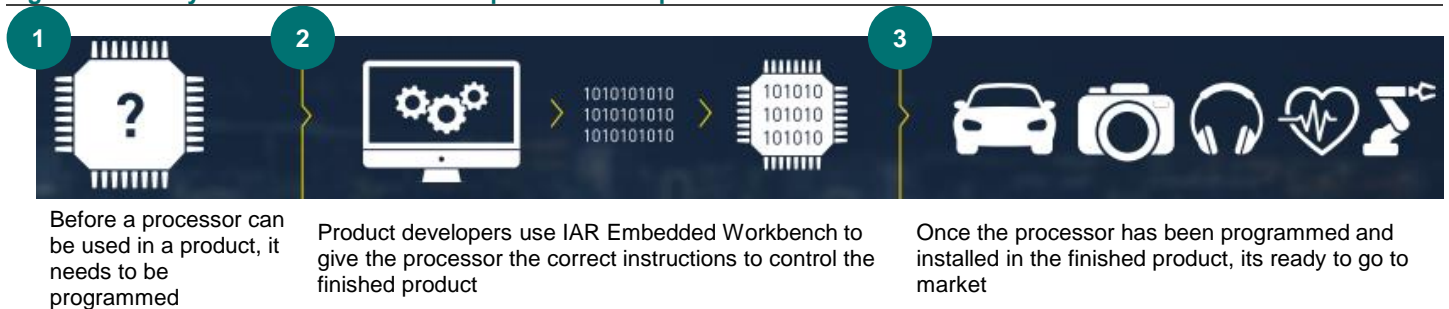
Retaining talented employees is key

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 16: 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 216. 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.

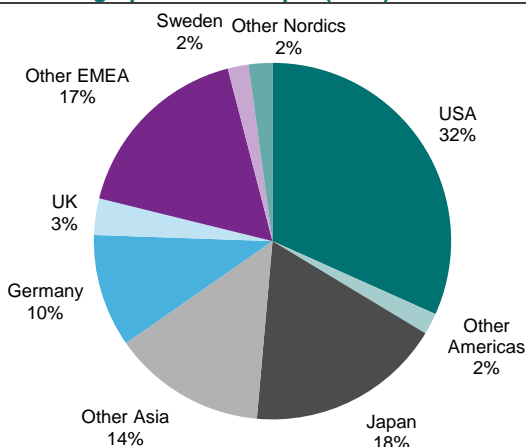
40% global market share with 57% licence-based revenues, which are flexible for customers and leverage the number of programmers using its licence...

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

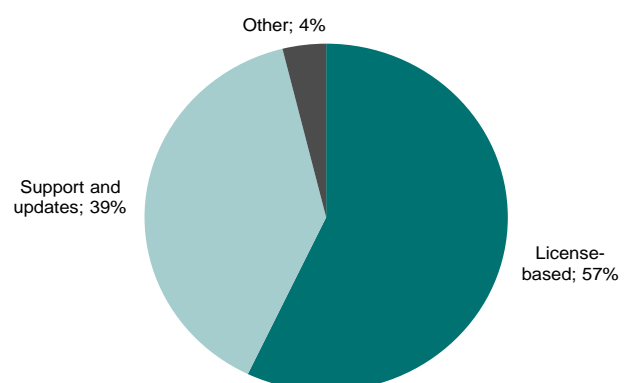
- **IAR Embedded Workbench (99% of 2020 sales)**, based on the number of licence users (perpetual software keys) of the IAR Embedded Workbench sold when a developer programmes a product. The traditional licence costs cSEK30,000–50,000 (upfront), while the customer can add support and updates for an annual 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.

Figure 17: Geographical sales split (2020)



Source: Company

Figure 18: Sales by business model (2020)



Source: Company

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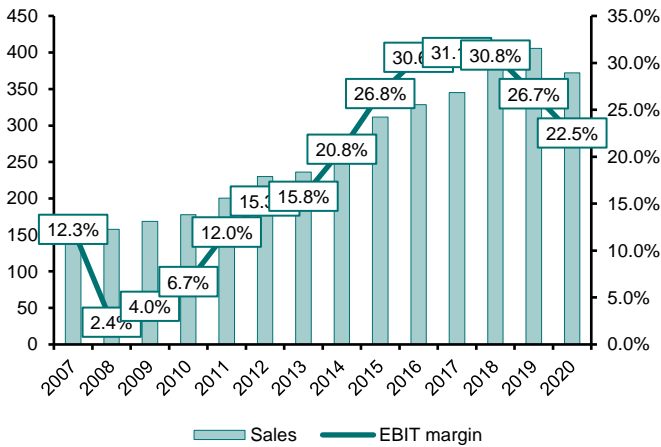
IAR Systems was acquired by IT conglomerate Nocom in 2005. However, by 2010, Nocom (then known as Intoi) wanted to focus on proprietary software and create a more specialised company, so it kept only IAR Systems and took on that name.

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).

From an IT conglomerate to a streamlined proprietary software provider...

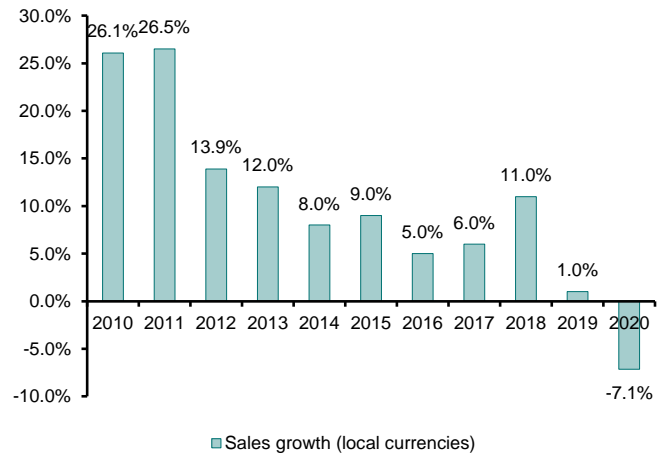
...with profitable growth, a sales CAGR of 8%, and an adj. EBIT CAGR of 22% in the past 10 years

Figure 19: IAR Systems – sales (SEKm) and adj. EBIT margin



Source: Company

Figure 20: 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 21: 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	383	465	530	409	491	549	-26	-26	-19
Cost of sales	-13	-15	-15	-14	-16	-17	1	1	2
Gross profit	370	450	515	394	475	532	-25	-25	-17
Operating expenses	-230	-259	-284	-234	-265	-289	3	6	5
EBITDA	139	191	231	161	210	243	-22	-19	-12
EBITDA adj	139	191	231	161	210	243	-22	-19	-12
EBITDA margin (%)	36.3	41.1	43.5	39.3	42.7	44.2	-3.0	-1.6	-0.7
Depreciation	-3	-4	-5	-3	-4	-4	0	-1	-1
Amortisation	-49	-58	-65	-50	-58	-64	1	0	-1
EBIT	86	129	160	108	148	175	-21	-19	-15
EBIT adj	88	129	160	108	148	175	-19	-19	-15
Net financial items	-4	-6	-8	-4	-6	-9	1	0	1
PBT	83	123	152	103	141	166	-20	-19	-14
Taxes	-19	-30	-37	-25	-35	-41	6	5	3
Minorities	0	0	0			0			0
Net profit	63	93	115	78	107	126	-15	-14	-11
Adjustments to net profit	-1	0	0	0	0	0	-1	0	0
Net profit adj	62	93	115	78	107	126	-16	-14	-11
<i>Per share data (SEK)</i>									
EPS	4.65	6.80	8.43	5.74	7.83	9.21	-1.09	-1.03	-0.78
EPS adj	4.80	6.80	8.43	5.74	7.83	9.21	-0.94	-1.03	-0.78
DPS ordinary	0.00	2.40	3.40	0.00	2.87	3.92	0.00	-0.47	-0.52
DPS	0.00	2.40	3.40	0.00	2.87	3.92	0.00	-0.47	-0.52
<i>Other key metrics (%)</i>									
Revenue growth	3.0	21.4	14.1	9.9	20.1	11.9	-6.9	1.3	2.2
EBIT adj growth	5.5	45.4	24.8	28.4	37.1	18.5	-22.9	8.2	6.2
EPS adj growth	10.1	41.6	24.1	31.7	36.5	17.6	-21.6	5.2	6.5
Avg. number of shares (m)	14	14	14	14	14	14	0	0	0
Capex	-76	-81	-88	-79	-78	-83	3	-3	-6
OpFCF	63	110	142	82	131	160	-19	-21	-18
Working capital	61	103	153	92	144	201	-31	-41	-48
NIBD adj	-59	-83	-128	-60	-101	-150	1	17	22

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	8.15	20.54	14.11	15.23	20.15	11.93	-7.08	0.39	2.18
Structure impact % YOY	0.00	0.00	0.00			0.00			0.00
Currency impact % YOY	-5.19	0.83	0.00	-5.36	-0.09	0.00	0.18	0.92	0.00

Source: DNB Markets

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Quarterly numbers

(SEKm)	Q1 2020	Q2 2020	Q3 2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021e	Q4 2021e	Q1 2022e	Q2 2022e	Q3 2022e
Revenues	92	100	89	91	89	87	93	114	104	107	113
Cost of sales	-4	-3	-3	-4	-3	-3	-3	-5	-4	-3	-3
Gross profit	88	97	86	87	86	85	90	109	100	104	111
Operating expenses	-62	-60	-49	-54	-56	-59	-57	-59	-62	-65	-65
EBITDA	27	37	37	33	30	26	33	50	38	39	45
Depreciation	-1	-1	0	-1	-1	-1	-1	-1	-1	-1	-1
Amortisation	-12	-11	-11	-13	-12	-12	-12	-13	-13	-15	-15
EBIT	14	25	25	19	17	13	20	36	24	23	30
Net financial items	0	-2	-1	-5	-1	-1	0	-2	0	-2	0
PBT	14	23	25	15	16	12	20	35	24	21	29
Taxes	-3	-6	-6	-3	-4	-2	-5	-8	-6	-5	-7
Minorities	0	0	0	0	0	0	0	0	0	0	0
Net profit	11	18	19	12	13	9	15	26	18	16	22
Adjustments to net profit	0	0	0	0	0	-1	0	0	0	0	0
Net profit adj	11	18	19	12	13	8	15	26	18	16	22
Dividend paid	0	0	0	0	0	0	0	0	0	-33	0
Avg. number of shares (m)	14	14	14	14	14	14	14	14	14	14	14
<i>Per share data (SEK)</i>											
EPS	0.81	1.29	1.37	0.88	0.94	0.68	1.12	1.91	1.31	1.15	1.63
EPS adj	0.81	1.29	1.37	0.88	0.94	0.83	1.12	1.91	1.31	1.15	1.63
DPS ordinary	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	2.40	0.00
DPS	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	2.40	0.00
<i>Growth and margins (%)</i>											
Revenues, QOQ growth	-13.6	8.5	-11.2	2.0	-2.0	-1.7	6.0	23.0	-8.8	2.5	6.5
Revenues, YOY growth	-7.5	1.1	-11.1	-15.1	-3.7	-12.7	4.3	25.7	16.9	21.9	22.4
EPS adj, YOY growth	-50.4	7.8	-13.4	-40.0	15.4	-35.8	-18.1	117.9	40.2	38.8	45.3
Gross margin	95.7	96.6	97.0	95.6	96.2	96.9	97.2	95.8	96.5	97.2	97.5
EBITDA adj margin	28.8	36.8	41.4	35.8	33.5	29.7	36.0	43.8	36.7	36.4	39.9
Depreciation/revenues	-0.8	-1.2	-0.4	-0.9	-0.7	-1.1	-0.6	-0.9	-0.7	-1.2	-0.7
EBIT adj margin	15.6	25.0	28.6	20.9	19.1	16.8	22.0	31.9	23.3	21.3	26.0
Net profit margin	12.0	17.6	21.0	13.2	14.4	10.6	16.5	22.9	17.3	14.7	19.6

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

Adjustments to quarterly numbers

(SEKm)	Q1 2020	Q2 2020	Q3 2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021e	Q4 2021e	Q1 2022e	Q2 2022e	Q3 2022e
EBITDA	27	37	37	33	30	26	33	50	38	39	45
EBITDA adj	27	37	37	33	30	26	33	50	38	39	45
EBIT	14	25	25	19	17	13	20	36	24	23	30
Other EBIT adjustments	0	0	0	0	0	-2	0	0	0	0	0
EBIT adj	14	25	25	19	17	15	20	36	24	23	30
Net profit	11	18	19	12	13	9	15	26	18	16	22
Other EBIT adjustments	0	0	0	0	0	-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	11	18	19	12	13	8	15	26	18	16	22

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

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Quarterly numbers by segment and assumptions

(SEKm)	Q1 2020	Q2 2020	Q3 2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021e	Q4 2021e	Q1 2022e	Q2 2022e	Q3 2022e
Assumptions											
Revenue org. % YOY	-11.12	-0.81	-5.60	-10.77	5.96	-2.40	5.09	25.00	15.00	20.32	22.28
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	3.61	1.92	-5.50	-4.31	-9.64	-10.29	-0.84	0.71	1.93	1.57	0.12

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	383	465	530
Cost of sales	-13	-10	-12	-9	-9	-11	-14	-13	-15	-15
Gross profit	243	301	316	337	376	395	358	370	450	515
Operating expenses	-179	-203	-203	-209	-236	-249	-225	-230	-259	-284
EBITDA	64	98	113	127	140	146	133	139	191	231
Depreciation	-2	-3	-3	-2	-3	-3	-3	-3	-4	-5
Amortisation	-8	-12	-14	-17	-22	-34	-46	-49	-58	-65
EBIT	53	83	97	107	116	108	84	86	129	160
Net financial items	0	0	0	-2	-2	-1	-7	-4	-6	-8
PBT	54	83	100	106	117	107	77	83	123	152
Taxes	-11	-20	-22	-26	-26	-26	-17	-19	-30	-37
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	63	93	115
Adjustments to net profit	0	0	-3	0	-2	0	0	-1	0	0
Net profit adj	42	63	75	80	88	81	59	62	93	115
Dividend paid	0	-63	-88	-63	-68	-68	0	0	-33	-46
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	4.65	6.80	8.43
EPS adj	3.34	5.02	6.18	6.33	6.67	5.96	4.36	4.80	6.80	8.43
DPS ordinary	0.00	5.00	7.00	5.00	5.00	3.00	0.00	0.00	2.40	3.40
DPS	0.00	5.00	7.00	5.00	5.00	3.00	0.00	0.00	2.40	3.40
<i>Growth and margins (%)</i>										
Revenue growth	8.3	21.9	5.4	5.1	11.7	5.3	-8.3	3.0	21.4	14.1
EPS adj growth	59.2	50.2	23.0	2.6	5.3	-10.6	-26.8	10.1	41.6	24.1
Gross margin	95.0	96.7	96.3	97.5	97.7	97.3	96.2	96.5	96.8	97.1
EBITDA margin	24.9	31.5	34.5	36.9	36.4	35.9	35.7	36.3	41.1	43.5
EBITDA adj margin	24.9	31.5	34.5	36.9	36.4	35.9	35.7	36.3	41.1	43.5
Depreciation/revenues	-0.9	-0.8	-0.8	-0.7	-0.7	-0.8	-0.8	-0.9	-0.9	-0.9
EBIT margin	20.8	26.8	29.4	31.1	30.0	26.7	22.5	22.6	27.6	30.2
EBIT adj margin	20.8	26.8	30.6	31.1	30.8	26.7	22.5	23.1	27.6	30.2
PBT margin	21.0	26.7	30.5	30.6	30.4	26.4	20.6	21.6	26.4	28.7
Net profit margin	16.5	20.3	23.8	23.2	23.6	20.0	16.0	16.6	19.9	21.7

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	139	191	231
EBITDA adj	64	98	113	127	140	146	133	139	191	231
EBIT	53	83	97	107	116	108	84	86	129	160
Other EBIT adjustments	0	0	-4	0	-3	0	0	-2	0	0
EBIT adj	53	83	101	107	119	108	84	88	129	160
Net profit	42	63	78	80	91	81	59	63	93	115
Other EBIT adjustments	0	0	-4	0	-3	0	0	-2	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	62	93	115
<i>Per share data (SEK)</i>										
EPS	3.34	5.02	6.18	6.33	6.67	5.96	4.36	4.65	6.80	8.43
Recommended adjustment	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.14	0.00	0.00
EPS adj	3.34	5.02	6.18	6.33	6.67	5.96	4.36	4.80	6.80	8.43

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	63	93	115
Depreciation and amortisation	10	15	17	20	25	37	49	53	62	70
Cash flow from operations (CFO)	70	99	114	124	93	106	118	116	138	179
Capital expenditure	-32	-19	-19	-19	-47	-84	-81	-76	-81	-88
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	-76	-81	-88
Free cash flow (FCF)	39	80	95	86	-125	4	37	40	57	91
Net change in debt	0	0	0	0	0	30	6	1	0	0
Dividends paid	0	-63	-88	-63	-68	-68	0	0	-33	-46
Share issue (repurchase)	-53	0	0	0	172	0	0	0	0	0
Other	0	0	0	0	4	-14	-30	-18	0	0
Cash flow from financing (CFF)	-53	-64	-88	-63	108	-52	-25	-18	-33	-46
Total cash flow (CFO+CFI+CFF)	-15	17	7	23	-17	-49	12	22	24	45
<i>FCFF calculation</i>										
Free cash flow	39	80	95	86	-125	4	37	40	57	91
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	18.5	30.2
CFI	-66.0	42.3	-3.3	-98.9	-478.5	53.0	20.4	6.4	-5.8	-9.7
FCF	78.7	108.3	18.5	-9.4	-244.7	102.8	957.1	8.4	42.5	59.2
CFF	-550.8	-19.5	-39.0	28.5	270.4	-148.3	52.7	28.5	-86.0	-41.6
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	913	973	1,042
Inventories	4	5	6	5	7	7	6	7	9	10
Trade receivables	39	44	48	51	63	67	59	66	81	87
Other receivables	11	20	19	12	38	52	64	60	60	60
Current financial assets	0	0	0	0	0	0	0	0	0	0
Cash and cash equivalents	71	89	99	120	106	61	68	91	115	160
Current assets	124	158	172	187	214	186	196	223	265	317
Property, plant and equipment	8	7	6	6	9	64	54	9	9	9
Other intangible assets	186	192	197	194	484	568	577	673	692	710
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	690	708	726
Total assets	375	399	396	410	722	825	834	913	973	1,042
Equity and liabilities	375	399	396	410	722	825	834	913	973	1,042
Total equity	289	291	280	290	550	592	613	701	761	830
Trade payables	5	5	5	6	7	9	5	9	8	9
Other payables and accruals	65	84	92	31	131	117	111	47	47	47
Short-term debt	1	1	1	1	2	38	35	18	18	18
Total current liabilities	71	90	99	102	140	164	150	163	162	163
Long-term debt	2	1	2	2	1	41	32	14	14	14
Deferred tax liabilities	15	17	15	14	30	27	37	34	34	34
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	49	49	49
Total liabilities	87	108	116	120	172	233	220	212	211	212
Total equity and liabilities	375	399	396	410	722	825	834	913	973	1,042
<i>Key metrics</i>										
Net interest bearing debt	-68	-88	-97	-117	-103	18	-2	-59	-83	-128

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	126.20	126.20	126.20
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	1,721	1,721	1,721
Net interest bearing debt	-68	-88	-97	-117	-103	18	-2	-59	-83	-128
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	-59	-83	-128
EV	876	1,807	2,505	2,270	3,206	2,554	1,904	1,662	1,638	1,593
EV adj	876	1,807	2,505	2,270	3,206	2,554	1,904	1,662	1,638	1,593
<i>Valuation</i>										
EPS	3.34	5.02	6.18	6.33	6.67	5.96	4.36	4.65	6.80	8.43
EPS adj	3.34	5.02	6.18	6.33	6.67	5.96	4.36	4.80	6.80	8.43
DPS ordinary	0.00	5.00	7.00	5.00	5.00	3.00	0.00	0.00	2.40	3.40
DPS	0.00	5.00	7.00	5.00	5.00	3.00	0.00	0.00	2.40	3.40
P/E	22.4	29.9	33.4	29.8	36.4	31.2	32.1	27.1	18.6	15.0
P/E adj	22.4	29.9	33.4	29.8	36.4	31.2	32.1	26.3	18.6	15.0
P/B	3.27	6.51	9.31	8.22	6.02	4.28	3.11	2.45	2.26	2.07
Average ROE	14.5%	21.9%	27.3%	28.1%	21.6%	14.2%	9.9%	9.7%	12.7%	14.5%
Earnings yield adj	4.5%	3.3%	3.0%	3.4%	2.7%	3.2%	3.1%	3.8%	5.4%	6.7%
Dividend yield	0.0%	3.3%	3.4%	2.6%	2.1%	1.6%	0.0%	0.0%	1.9%	2.7%
Free cash flow yield	4.1%	4.2%	3.7%	3.6%	-3.8%	0.1%	1.9%	2.3%	3.3%	5.3%
EV/SALES	3.42	5.80	7.63	6.58	8.32	6.30	5.12	4.34	3.52	3.00
EV/SALES adj	3.42	5.80	7.63	6.58	8.32	6.30	5.12	4.34	3.52	3.00
EV/EBITDA	13.8	18.4	22.1	17.8	22.9	17.5	14.3	11.9	8.6	6.9
EV/EBITDA adj	13.8	18.4	22.1	17.8	22.9	17.5	14.3	11.9	8.6	6.9
EV/EBIT	16.5	21.7	26.0	21.1	27.7	23.6	22.7	19.2	12.7	9.9
EV/EBIT adj	16.5	21.7	24.9	21.1	27.0	23.6	22.7	18.8	12.7	9.9
EV/capital employed	3.0	6.2	8.9	6.4	5.8	3.8	2.8	2.0	1.9	1.7
EV/NOPLAT	22.2	29.3	35.1	28.6	37.5	31.8	30.7	26.0	17.2	13.4
EV/OpFCF (taxed)	50.1	31.6	36.6	28.3	51.4	75.1	64.5	41.6	21.3	15.8

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	7.3	9.8	11.4
ROCE	18.1	28.5	34.9	33.6	26.1	17.7	12.4	11.8	15.1	17.5
ROCE after tax	13.4	21.1	25.8	24.8	19.3	13.1	9.2	8.7	11.2	12.9
<i>Return on invested capital (%)</i>										
Net PPE/revenues	3.1	2.1	1.9	1.8	2.3	15.7	14.6	2.4	2.0	1.7
Working capital/revenues	20.9	22.0	22.4	24.6	19.3	5.4	12.3	15.9	22.1	28.9
<i>Cash flow ratios (%)</i>										
FCF/revenues	15.1	25.8	29.0	25.0	-32.4	0.9	9.9	10.5	12.3	17.2
FCF yield (%)	4.1	4.2	3.7	3.6	1.4	0.9	1.9	2.3	3.3	5.3
CFO/revenues	27.5	31.7	34.8	35.9	24.0	26.1	31.8	30.4	29.6	33.8
CFO/market capitalisation	7.4	5.2	4.4	5.2	2.8	4.2	6.2	6.8	8.0	10.4
CFO/capex	217.6	508.8	614.0	652.1	197.9	126.4	145.5	152.6	170.9	202.9
CFO/current liabilities	99.4	110.2	115.8	121.1	66.2	64.4	78.9	71.4	84.8	109.8
Cash conversion ratio	91.5	126.8	122.2	107.9	-137.6	4.3	62.3	63.2	61.6	79.1
Capex/revenues	12.6	6.2	5.7	5.5	12.1	20.6	21.9	19.9	17.3	16.7
Capex/depreciation	1404.3	776.0	744.0	791.7	1800.0	2696.8	2625.8	2322.4	1896.1	1757.8
OpFCF margin	12.2	25.3	28.8	31.4	24.2	15.3	13.8	16.4	23.7	26.9
Total payout ratio	0.0	99.6	113.3	78.9	75.0	50.4	0.0	0.0	35.3	40.3
<i>Leverage and solvency (x)</i>										
Net debt/EBITDA	-1.08	-0.89	-0.85	-0.92	-0.74	0.13	-0.01	-0.42	-0.44	-0.55
Total debt/total capital (BV)	0.01	0.00	0.01	0.01	0.00	0.10	0.08	0.03	0.03	0.03
LTD / (LTD + equity (MV))	0.00	0.00	0.00	0.00	0.00	0.02	0.02	0.01	0.01	0.01
<i>Cash conversion cycle</i>										
Inventory turnover days	104.7	180.7	167.5	223.3	267.7	223.1	147.6	195.1	215.9	230.0
Receivables turnover days	70.9	74.5	74.7	66.2	96.1	106.8	120.2	119.5	110.6	101.2
Credit period	147.1	170.1	158.6	244.8	296.1	310.9	129.4	240.9	207.8	223.5
Cash conversion cycle	28.5	85.1	83.7	44.8	67.7	18.9	138.3	73.7	118.7	107.6

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

18 August 2021

Important Information

Company: IAR Systems
 Coverage by Analyst: Joachim Gunell
 Date: 17/08/2021

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DNB Markets client	24%	11%	3%	4%	119

18 August 2021

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