

IAR SYSTEMS

'Top 7 must-see' for IoT security

We remain upbeat on IAR Systems' position following the commercial launch of Embedded Trust and C-Trust. To reflect this, we have raised our Secure Thingz estimates by 25%, but have lowered our group 2019–2020 EBIT estimates by 2% owing to lower Renesas Synergy forecasts and higher opex. We maintain our fair value of SEK280–350/share.

Q4 in line with our EBIT estimates. Q4 sales were SEK103m (2% ahead of our estimates), while EBIT was SEK31m (in line with our forecast), corresponding to a 30.3% margin (-17bp YOY). A DPS of SEK5 was proposed for 2018 (in line with our expectation). Organic sales growth was +10% YOY (we expected +8), where the strong sales were mainly attributable to market share gains and larger EMEA customers.

Optimistic takeaways from the results presentation with IAR Systems CEO Stefan Skarin and the CEO of Secure Thingz, Haydn Povey: 1) the Embedded Trust licence at EUR15,000/seat will be an annually recurring subscription (current customer base of 46,000 OEMs); 2) intensified legislation is driving IoT security adoption for its products; and 3) RISC-V is taking off faster than expected (IAR support by Q2 2019).

What to look for in 2019? 2019 could potentially be a tipping point for IAR Systems, with: 1) the commercial launch of 'Security from Inception' ahead of the Embedded World conference 26–28 February (which we will attend), where Secure Thingz made the 'top 7 must-see' list for IoT security; and 2) RISC-V partnerships set to hit the market. If it is able to leverage, defend, and maintain its leading position in the emerging market of building a secure ecosystem from product design, support, to provisioning for processors, we believe there is potential upside to our fair value.

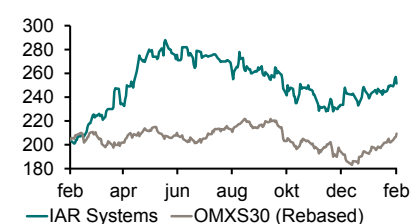
Estimate changes. We have lowered our 2019–2020e EBIT by 2%, related to higher growth assumptions for Secure Thingz (25% ahead of previous estimates) being offset by higher opex assumptions for new hires and lower Renesas Synergy forecasts.

Fair value maintained at SEK280–350. We believe the market is currently ascribing too little value to IAR Systems' new growth initiatives, especially Secure Thingz. Our estimates correspond to a 2019e P/E of 33x, and an EV/EBIT of 23x.

Year-end Dec	2015	2016	2017	2018	2019e	2020e	2021e
Revenue (SEKm)	312	328	345	385	462	563	656
EBITDA adj (SEKm)	98	113	127	140	178	243	299
EBIT adj (SEKm)	83	101	107	119	146	199	243
PTP (SEKm)	83	100	106	114	143	196	239
EPS rep (SEK)	5.02	6.18	6.33	6.58	7.70	10.52	12.85
EPS adj (SEK)	5.02	6.18	6.33	6.76	7.70	10.52	12.85
DPS (SEK)	5.00	7.00	5.00	5.00	5.00	5.50	5.50
Revenue growth (%)	21.9	5.4	5.1	11.7	20.0	21.8	16.7
EBITDA growth adj (%)	54.6	15.2	12.4	10.1	27.2	36.2	23.2
EPS growth adj (%)	50.2	23.0	2.6	6.7	13.9	36.6	22.2
EBITDA margin adj (%)	31.5	34.5	36.9	36.4	38.6	43.2	45.6
EV/Sales adj (x)	5.80	7.63	6.58	8.54	7.40	6.02	5.06
EV/EBITDA adj (x)	18.4	22.1	17.8	23.5	19.2	13.9	11.1
EV/EBIT adj (x)	21.7	24.9	21.1	27.7	23.5	17.0	13.6
P/E adj (x)	29.9	33.4	29.8	35.9	32.7	23.9	19.6
P/Book (x)	6.51	9.31	8.22	6.17	5.98	5.34	4.62
ROE (%)	21.9	27.3	28.1	20.8	18.9	23.6	25.3
ROCE (%)	28.5	34.9	33.6	24.0	22.4	28.3	30.8
Dividend yield (%)	3.3	3.4	2.6	2.1	2.0	2.2	2.2

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

IARB versus OMXS30 (12m)



Source: Factset

SUMMARY

Share price (SEK)	252
Tickers	IARB SS, IARB.ST

CAPITAL STRUCTURE

No. of shares (m)	14.0
No. of shares fully dil. (m)	14.0
Market cap. (SEKm)	3,513
NIBD adj end-2019e (SEKm)	-93
Enterprise value adj (SEKm)	3,420
Net debt/EBITDA adj (x)	-0.52
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

Q1 2019	24/02/2019
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ESTIMATE CHANGES (SEK)

Year-end Dec	2019e	2020e	2021e
Sales (old)	459.1	544.2	
Sales (new)	462.0	562.6	656.3
Change (%)	0.6	3.4	nm
EPS (old)	8.04	10.40	
EPS (new)	7.70	10.52	12.85
Change (%)	-4.2	1.1	nm

Source: DNB Markets.

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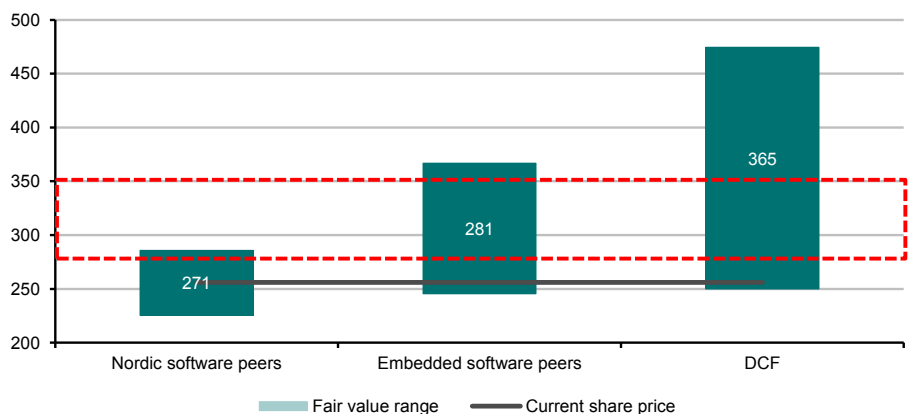
ANALYSTS

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 its ability to reinstate growth, it could trigger a devaluation of the shares, as in 2017.
- Disappointing disclosures regarding key strategic partnerships in terms of when they will materialise and fee structure. For instance, the Renesas Synergy agreement has yet to show itself in IAR Systems' sales. Thus, it would be negative if the Secure Thingz collaboration did not meet management 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

- We believe IAR 3.0 will be when the market stops seeing IAR Systems as a compiler supplier and instead starts to view it as the go-to tools partner for global players as they position their embedded systems ahead of the Internet of Things. We particularly highlight the market opportunity within secure embedded systems.
- A broad consensus has yet to emerge on IAR Systems' investment case; however, we particularly like the group's market opportunity, operating profile, financial outlook, and valuation.

Source: DNB Markets

Valuation methodology

- Blending our total peer group of Nordic software and embedded software peers with DCF suggests a fair value of SEK280–350 in our 12-month perspective (methodology unchanged.)
- Our estimates correspond to a 2019e P/E of 33x, an EV/EBIT of 23x, and an EV/sales of 7x.

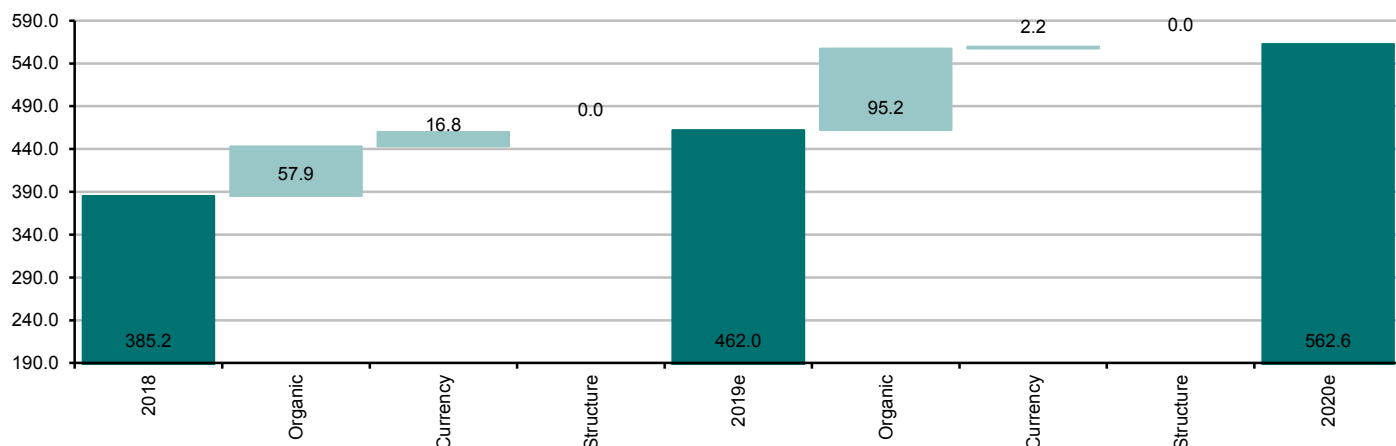
Source: DNB Markets

Upside risks to our fair value

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

Source: DNB Markets

Sales bridge 2018–2020e (SEKm)



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

17 February 2019

Q4 2018 results review

Q4 in line with our EBIT estimates. Q4 sales were SEK103m (2% ahead of our estimates) while EBIT was SEK31m (in line with our forecast), corresponding to a 30.3% margin (-17bp YOY). A DPS of SEK5 was proposed for 2018 (in line with our expectation). Organic sales growth was +10% YOY (we expected +8), where the strong sales were mainly attributable to market share gains and larger EMEA customers, with a positive surprise in Secure Thingz reporting sales of SEK3.5m (Secure Deploy contract).

We also note increased capitalisation of development costs (mainly from Secure Thingz), which partly drove the EBIT growth. Still, as the company is in an investment phase, we believe investors are willing to overlook this as long as the growth opportunity, in Secure Thingz, remains on track.

Results presentation takeaways

- Security is the leading barrier for IoT, and we note legislation that is driving IoT security adoption, which should drive demand for its Embedded Thrust and C-Trust products.
- IAR Systems is building a secure ecosystem from product design and support, to provisioning, which will extend the addressable market considerably. The Embedded Trust licence at EUR15,000/seat will be an annually recurring subscription (customer base of 46,000 OEMs), whereas its C-Trust will be a perpetual licence priced at EUR3,000 (current user base of 150,000 developers).
- Secure Thingz has made a 'top 7 must-see' list for IoT security at Embedded World 2019 (28 February), which further highlights that 2019 looks set to be a pivotal year for IAR Systems.
- IAR Systems has launched a business incubator to boost security innovation in IoT (Ymir). This should extend IAR Systems' security value and its engineering foothold to help it defend its frontrunner position, we argue. With a net cash position of SEK103m (end-2018) and a credit margin of SEK200m, it has ample financial muscle and management comments that it is currently evaluating the first set of candidates.

Figure 1: Q4 2018 results versus expectations

Key highlights (SEKm, except per share data)	Q4 2018		Deviation (%)	Deviation, Abs	Q4 2017	DNBe
	Actual	DNB	DNB	DNB	Actual	2018e
Sales	102.8	100.9		1.9	87.6	462.0
EBIT adjusted	31.1	30.7		0.4	26.8	145.5
Margin	30.3%	30.4%		-17bp	30.6%	31.5%
One-offs	0.0	0.0		0.0	0.0	0.0
EBIT	31.1	30.7	1%	0.4	26.8	145.5
Margin	30.3%	30.4%		-17bp	30.6%	31.5%
EPS	1.56	1.61	-3%	-0.1	1.56	7.70
Growth YOY						
Sales growth	17.4%	15.2%		215bp	3.1%	19.4%
-of which organic	10.0%	8.1%		195bp	8.5%	15.0%
-of which FX	7.3%	7.1%		21bp	-5.4%	4.3%
Divisions (SEKm)	Q4 2018				Q4 2017	DNBe
		DNB			DNB	DNB
Sales						
Legacy IAR Systems	97.8	98.1	0%	-0.3	86.4	416.5
Royalty-based revenue	1.5	1.6	-6%	-0.1	1.2	8.3
Secure Thingz	3.5	1.3	169%	2.2	0.0	37.2
Group	102.8	100.9	2%	1.9	87.6	462.0
EBIT adjusted						
Legacy IAR Systems + Secure Thingz	29.6	29.1	2%	0.5	25.6	137.5
Royalty-based revenue	1.5	1.6	-6%	-0.1	1.2	8.0
Group	31.1	30.7	1%	0.4	26.8	145.5
FX impact						
Sales	7.3%	7.1%		21bp	-5.4%	4.3%
EBIT	15.7%	18.5%		-283bp	-13.1%	11.0%

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

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Estimate revisions

We have lowered our 2019–2020 EBIT estimates by 2% as we pencil in a slower uptick in Renesas Synergy sales (100% EBIT margin), while new hirings of software developers (we forecast net 30 hires in 2019) are set to drive opex increases. Still, these factors are almost offset by our brighter forecasts for Secure Thingz, where we have raised our sales estimates by 25% for 2019–2020.

We now forecast that IAR Systems should generate a 2018–2021 EBIT CAGR of 27%, with the true potential beyond our forecast period.

Figure 2: Estimate changes

(SEKm, except per share data)	Old			New			Change		
	2019e	2020e	2021e	2019e	2020e	2021e	2019e	2020e	2021e
Sales									
Legacy IAR Systems	410.5	443.6		416.5	446.6	475.4	1%	1%	
Royalty-based revenue	16.5	26.5		8.3	19.7	38.1	-50%	-26%	
Secure Thingz	32.1	74.2		37.2	96.3	142.8	16%	30%	
Group Total	459.1	544.2		462.0	562.6	656.3	1%	3%	
					21%	25%			
EBIT adjusted									
Legacy IAR Systems + Secure Thingz	134.2	174.3		137.5	180.2	206.3	2%	3%	
Royalty-based revenue	16.0	25.8		8.0	19.0	37.0	-50%	-26%	
Group Total	150.3	200.1		145.5	199.2	243.3	-3%	0%	
EBIT adjusted margin									
Legacy IAR Systems + Secure Thingz	30.3%	33.7%		30.3%	33.2%	33.4%	-2bp	-48bp	
Royalty-based revenue	100.0%	100.0%		100.0%	100.0%	0.0%	0bp	0bp	
Group Total	32.7%	36.8%		31.5%	35.4%	37.1%	-123bp	-137bp	
Organic growth									
Legacy IAR Systems	7.5%	7.2%		6.7%	6.3%	5.2%	-86bp	-94bp	
Royalty-based revenue	2.7%	2.1%		0.6%	2.3%	3.1%	-207bp	21bp	
Secure Thingz	7.3%	8.8%		7.7%	12.0%	7.9%	46bp	320bp	
Group Total	17.5%	18.1%		15.0%	20.6%	16.2%	-248bp	247bp	
Group									
Sales	459.1	544.2		462.0	562.6	656.3	1%	3%	
Sales growth	19.4%	18.2%		19.4%	21.1%	16.2%	-1bp	288bp	
Organic	17.5%	18.1%		15.0%	20.6%	16.2%	-248bp	247bp	
Structure	0.0%	0.0%		0.0%	0.0%	0.0%	0bp	0bp	
Currency	1.9%	0.1%		4.3%	0.5%	0.0%	247bp	41bp	
Gross profit	447.4	530.2		451.3	549.4	641.0	1%	4%	
Margin	97.4%	97.4%		97.7%	97.7%	97.7%	23bp	21bp	
EBIT adjusted	150.3	200.1		145.5	199.2	243.3	-3%	0%	
Margin	32.7%	36.8%		31.5%	35.4%	37.1%	-123bp	-137bp	
Adjustments	0.0	0.0		0.0	0.0	0.0			
EBIT	150.3	200.1		145.5	199.2	243.3	-3%	0%	
Margin	32.7%	36.8%		31.5%	35.4%	37.1%	-123bp	-137bp	
Net financial items	-2.5	-3.7		-2.1	-3.2	-3.9			
Pretax profit	147.8	196.4		143.5	195.9	239.4	-3%	0%	
Tax	-35.5	-51.1		-35.9	-49.0	-59.8	1%	-4%	
Tax rate	24.0%	26.0%		25.0%	25.0%	25.0%	100bp	-100bp	
Net profit	112.3	145.3		107.6	146.9	179.5	-4%	1%	
EPS adjusted	8.04	10.40		7.70	10.52	12.85	-4%	1%	
EPS	8.04	10.40		7.70	10.52	12.85	-4%	1%	
DPS	5.00	5.50		5.00	5.50	5.50	0%	0%	

Source: DNB Markets

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Figure 3: Quarterly estimates by division

(SEKm, except per share data)	Q1'17	Q2'17	Q3'17	Q4'17	Q1'18	Q2'18	Q3'18	Q4'18	Q1'19e	Q2'19e	Q3'19e	Q4'19e
Sales												
Legacy IAR Systems	83.5	85.4	82.9	86.4	87.6	93.8	95.5	97.8	100.4	104.4	104.7	107.4
Royalty-based revenue	2.9	1.4	1.3	1.2	1.3	1.3	1.4	1.5	1.4	1.9	2.5	2.6
Secure Thingz	0.0	0.0	0.0	0.0	0.0	0.5	1.0	3.5	1.9	3.6	9.0	22.3
Group Total	86.4	86.8	84.2	87.6	88.9	95.6	97.9	102.8	103.7	109.9	116.2	132.3
EBIT adjusted												
Legacy IAR Systems + Secure Thingz	23.3	24.4	27.3	25.6	28.2	25.6	29.9	29.6	30.7	32.7	33.7	40.1
Royalty-based revenue	2.9	1.4	1.3	1.2	1.3	1.3	1.4	1.5	1.4	1.9	2.5	2.6
Group Total	26.2	25.8	28.6	26.8	29.5	26.9	31.3	31.1	32.1	34.6	36.2	42.7
¹ FX												
EBIT adjusted margin												
Legacy IAR Systems + Secure Thingz	27.9%	28.6%	32.9%	29.6%	32.2%	27.3%	31.3%	30.3%	30.6%	31.3%	32.2%	37.4%
Royalty-based revenue	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Group Total	30.3%	29.7%	34.0%	30.6%	33.2%	28.1%	32.0%	30.3%	31.0%	31.4%	31.2%	32.3%
Organic growth												
Legacy IAR Systems	2.6%	0.6%	8.3%	8.4%	4.9%	7.9%	6.5%	9.6%	6.9%	6.9%	6.8%	7.1%
Royalty-based revenue	0.1%	0.0%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.0%	0.5%	1.0%	1.0%
Secure Thingz	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.1%	0.3%	2.0%	3.1%	7.9%	17.9%
Group Total	2.7%	0.6%	8.4%	8.5%	5.0%	8.1%	6.7%	10.0%	8.9%	10.5%	15.8%	26.0%
Group												
Sales	86.4	86.8	84.2	87.6	88.9	95.6	97.9	102.8	103.7	109.9	116.2	132.3
Sales growth	7.3%	6.1%	3.8%	3.1%	2.9%	10.1%	16.3%	17.4%	16.6%	15.0%	18.6%	28.6%
Organic	2.7%	0.6%	8.4%	8.5%	5.0%	8.1%	6.7%	10.0%	8.9%	10.5%	15.8%	26.0%
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	4.6%	5.5%	-4.6%	-5.4%	-2.1%	2.1%	9.6%	7.3%	7.8%	4.5%	2.9%	2.7%
Gross profit	84.0	85.2	82.3	85.0	86.1	93.7	95.8	100.6	100.4	107.8	113.7	129.4
Margin	97.2%	98.2%	97.7%	97.0%	96.9%	98.0%	97.9%	97.9%	96.9%	98.0%	97.9%	97.9%
EBIT adjusted	26.2	25.8	28.6	26.8	29.5	26.9	31.3	31.1	32.1	34.6	36.2	42.7
Margin	30.3%	29.7%	34.0%	30.6%	33.2%	28.1%	32.0%	30.3%	31.0%	31.4%	31.2%	32.3%
Adjustments	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
EBIT	26.2	25.8	28.6	26.8	29.5	26.9	31.3	31.1	32.1	34.6	36.2	42.7
Margin	30.3%	29.7%	34.0%	30.6%	33.2%	28.1%	32.0%	30.3%	31.0%	31.4%	31.2%	32.3%
Net financial items	-0.8	-0.1	-0.4	-0.4	-0.4	-1.7	-0.3	0.6	-0.6	-0.8	-0.4	-0.2
Pretax profit	25.4	25.7	28.2	26.4	29.1	22.0	31.0	31.7	31.5	33.7	35.8	42.5
Tax	-6.6	-4.5	-7.9	-6.7	-6.3	-5.8	-4.2	-9.9	-7.9	-8.4	-8.9	-10.6
Tax rate	26.0%	17.5%	28.0%	25.4%	21.6%	26.4%	13.5%	31.2%	25.0%	25.0%	25.0%	25.0%
Net profit	18.8	21.2	20.3	19.7	22.8	16.2	26.8	21.8	23.6	25.3	26.8	31.8
EPS adjusted	1.49	1.68	1.61	1.56	1.81	1.43	1.97	1.56	1.69	1.81	1.92	2.28
EPS	1.49	1.67	1.61	1.56	1.81	1.20	1.97	1.60	1.69	1.81	1.92	2.28
DPS	0.00	5.00	0.00	0.00	0.00	5.00	0.00	0.00	0.00	5.00	0.00	0.00

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

Figure 4: Peer group (%)

	Sales growth			GM	EBIT margin			EBIT growth			EPS growth			2018–2021e CAGR		
	2019e	2020e	2021e	2018	2019e	2020e	2021e	2019e	2020e	2021e	2019e	2020e	2021e	Sales	EBIT	EPS
IAR Systems (DNBe)	19.4	21.1	16.2	97.7	30.8	31.5	35.4	22.5	36.8	22.2	22.8	36.6	22.2	19.4	27.0	27.0
IAR Systems vs. total peer group	3.7	7.3	5.2	27.5	6.5	6.2	8.6	2.5	3.9	4.9	2.6	-6.6	2.9	5.7	3.6	-0.8
Nordic software peers																
HMS Networks	18.2	15.2	14.9	61.1	18.5	19.3	21.4	23.4	27.7	21.7	32.2	23.3	22.3	16.1	24.2	25.9
SimCorp	10.2	8.3	9.4	58.1	26.6	27.5	27.9	14.2	9.7	15.3	15.4	10.5		9.3	13.1	
F-Secure	15.6	8.7	8.3	79.4	3.5	3.0	7.2	-0.9	161.3	41.2	-3.0	283.6	43.8	10.8	54.1	74.9
INVISIO Communications	24.2	27.9	15.1	58.9	18.0	20.6	22.9	42.2	41.8	20.9	46.8	43.1	20.5	22.3	34.6	36.3
Fortnox	28.6	22.7	18.1	n.a.	27.2	30.0	32.5	41.7	32.9	25.3	43.2	32.5	25.5	23.1	33.1	33.6
Vitec Software	6.7	2.5	2.3	n.a.	13.2	14.9	15.5	20.9	6.2	4.1	12.3	7.8	5.7	3.8	10.1	8.6
Average of the above	17.3	14.2	11.3	64.4	17.8	19.2	21.2	23.6	46.6	21.4	24.5	66.8	23.6	14.2	28.2	35.8
DNBe vs. peer group	2.1	6.9	4.9	33.3	13.0	12.3	14.2	-1.1	-9.7	0.8	-1.7	-30.3	-1.4	5.2	-1.2	-8.8
Embedded software peers																
Cadence Design Systems	6.8	7.5	4.7	87.8	29.9	29.9	30.6	7.1	10.0	-9.6	7.4	9.9	5.5	6.3	2.1	7.6
ANSYS	9.6	9.5	6.0	86.3	45.2	44.2	45.3	7.4	12.2	10.2	6.1	10.4	7.7	8.4	9.9	8.0
Xilinx	11.7	10.0		70.0	31.6	31.8	33.4	12.3	15.5		10.8	13.6				
Altium	26.4	23.1	20.5	44.4	30.3	32.0	33.5	33.1	28.9	26.2	37.6	22.1	23.6	23.3	29.4	27.6
Red Hat	14.6	15.6		85.3	23.9	24.6	24.9	18.3	16.7		13.1	17.9				
Average of the above	13.8	13.1	10.4	74.8	32.2	32.5	33.5	15.6	16.7	8.9	15.0	14.8	12.3	12.7	13.8	14.4
DNBe vs. peer group	5.5	7.9	5.8	22.9	-1.3	-1.0	1.9	6.9	20.2	13.2	7.8	21.8	9.9	6.8	13.2	12.6
Average of total peer group	15.7	13.7	11.0	70.1	24.4	25.3	26.8	20.0	33.0	17.3	20.2	43.2	19.3	13.7	23.4	27.8
Median of total peer group	14.6	10.0	9.4	70.0	26.6	27.5	27.9	18.3	16.7	20.9	13.1	17.9	21.4	10.8	24.2	26.7

Source: Factset (15 February 2019)

Note (GM = gross margin)

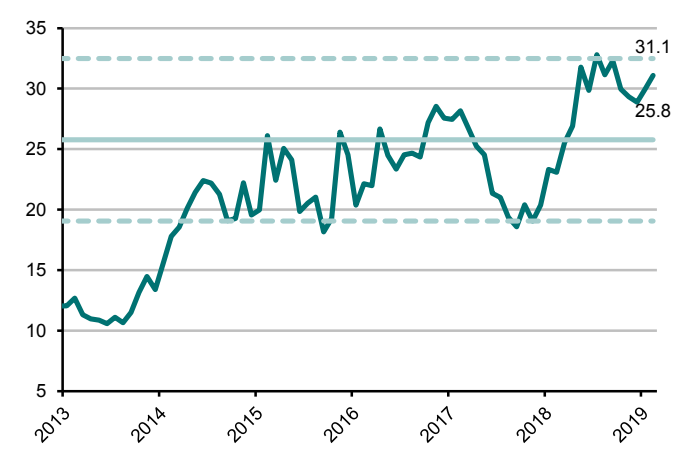
Figure 5: Peer group (x/%)

	M Cap (SEKbn)	P/E (x)			EV/EBITDA (x)			EV/EBIT (x)			FCF Yield 19e	RoE 19e	Div. yield 19e	Performance (%)		
		19e	20e	21e	19e	20e	21e	19e	20e	21e				-1M	-3M	-12M
IAR Systems (DNBe)	3.4	31.6	23.1	18.9	18.8	13.8	12.6	23.0	16.8	15.3	2.3%	18.3%	2.1%	5.2	3.9	23.3
Premium (+) / discount (-)		-28%	-26%	-28%	-26%	-32%	-26%	-27%	-28%	-20%						
Nordic software peers																
HMS Networks	6.8	29.9	24.2	19.8	19.3	15.3	12.4	22.4	17.2	13.7	3.4%	22.7%	1.5%	18.9	8.4	14.0
SimCorp	30.3	36.8	31.9	28.9	27.1	23.7	21.5	28.3	24.6	22.3	1.9%	50.8%	1.3%	10.2	25.4	47.9
F-Secure	4.1	118.2	30.8	21.4	25.3	13.2	10.0	59.1	22.3	15.2	5.3%	4.7%	0.5%	-1.8	2.9	-30.8
INVISIO Communications	2.6	36.6	25.6	21.2	24.1	16.5	13.4	27.0	19.0	15.6	4.2%	21.5%	1.9%	-2.2	-1.0	-18.2
Fortnox	4.9	43.6	32.9	26.2	27.4	20.7	16.0	32.1	23.5	17.9	2.3%	39.5%	0.6%	15.6	12.4	75.7
Vitec Software	2.4	22.5	20.9	19.8	9.0	8.4	7.9	17.6	16.0	14.8	6.1%	15.2%	1.5%	6.3	5.0	-0.2
Average of the above		47.9	27.7	22.9	22.0	16.3	13.5	31.1	20.4	16.6	3.9%	25.7%	1.2%	7.8	8.8	14.7
Premium (+) / discount (-)		-34%	-17%	-17%	-15%	-15%	-7%	-26%	-18%	-8%						
Embedded software peers																
Cadence Design Systems	137.8	28.8	26.8	24.4	21.8	19.9	16.0	23.1	20.8	18.0	3.3%	39.8%	0.0%	16.1	15.5	34.6
ANSYS	135.5	32.8	31.0	28.0	23.2	21.1	18.3	24.0	21.8	19.0	3.0%	17.9%	0.0%	11.7	8.9	7.4
Altium	280.6	34.5	31.2	27.4	27.4	24.2	20.9	29.8	26.1	22.4	3.1%	31.7%	1.2%	30.8	34.8	77.5
Xilinx	23.3	50.0	40.9	33.1	40.2	31.4	24.8	44.5	34.3	27.0	2.0%	44.6%	1.4%	15.3	22.6	80.0
Red Hat	297.2	51.2	45.3	38.4	33.6	28.6	24.6	37.5	30.9	25.3	3.1%	38.9%	0.0%	3.1	4.1	29.2
Average of the above		39.5	35.0	30.3	29.3	25.0	20.9	31.8	26.8	22.3	2.9%	34.6%	0.5%	15.4	17.2	45.7
Premium (+) / discount (-)		-20%	-34%	-38%	-36%	-45%	-40%	-28%	-37%	-31%						
Average of total peer group		44.1	31.0	26.2	25.3	20.3	16.9	31.4	23.3	19.2	3.4%	29.8%	0.9%	11.3	12.6	28.8
Median of total peer group		36.6	31.0	26.2	25.3	20.7	16.0	28.3	22.3	18.0	3.1%	31.7%	1.2%	11.7	8.9	29.2

Source: Factset
Note: Share prices correct as of 17.30.00 CET on 15 February 2019

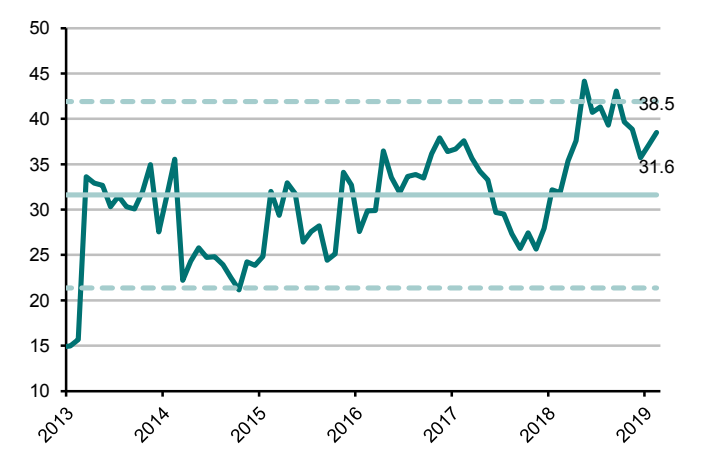
Valuation

Figure 6: IAR Systems EV/EBIT LTM



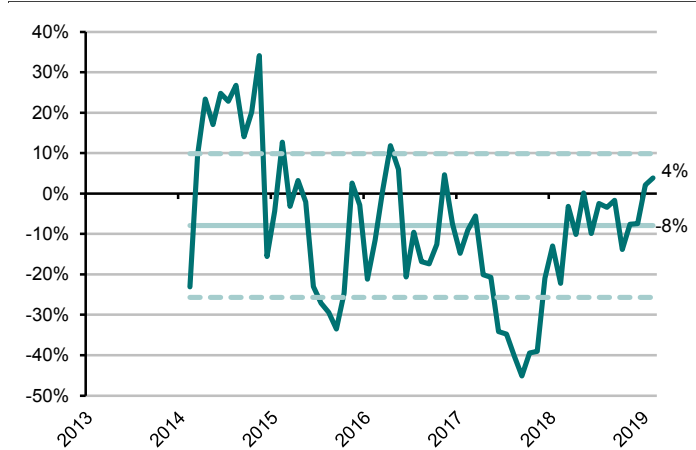
Source: Factset (underlying data), DNB Markets (further calculations)

Figure 7: IAR Systems P/E LTM



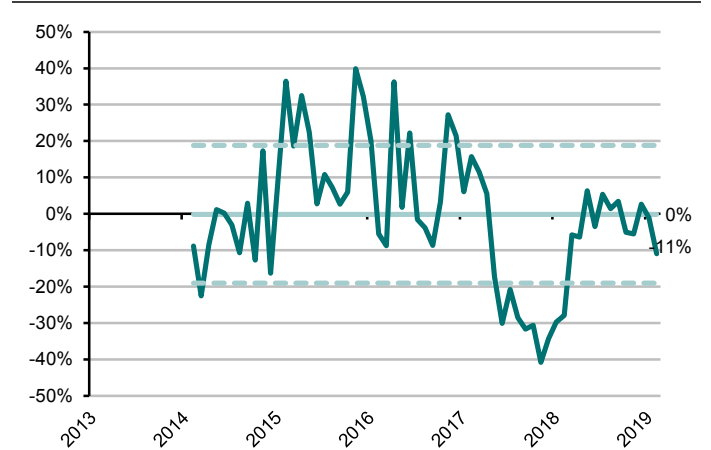
Source: Factset (underlying data), DNB Markets (further calculations)

Figure 8: Premium/discount EV/EBIT LTM IAR Systems to Nordic software peers



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

Figure 9: Premium/discount EV/EBIT LTM IAR Systems to embedded software peers



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

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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 in end-markets underpinned by growing demand for digital technology. We believe IAR Systems has a resilient business model selling flexible right-to-use licences to access its wholly owned software tool-chain (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 to take control of digital products from day one) has made IAR Systems the frontrunner ahead of the paradigm shift associated with security solutions for embedded systems in the Internet of Things (IoT).

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

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

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 ~50% global market share, as: 1) it is a unique line-up of a complete tool-chain for product developers; 2) being independent, IAR Systems supports a wide range of design architecture, meaning customers can choose the programming environment and tools according to their own needs, regardless of processor or project, which avoids locking customers in to one technical platform; 3) superior quality as its commercial customers cannot compromise on tools' code performance, reliability, user-friendliness, or time-to-market using inferior technologies such as open-source alternatives; 4) it is now 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 Systems owns the market for software development tools with c50% global market share

Key competitive strengths:

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

IAR 3.0

IAR Systems has gone through various phases since 2010, having: 1) streamlined itself towards proprietary software, creating a more specialised company; and 2) shifted its project-based business model to scalable licence sales, which has substantially improved margins. In our view, it is now heading into its third phase: the growth story. We believe that IAR 3.0 (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 Internet of Things (IoT).

Setting the scene for the growth story

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 all indicate a continuation of the solid industry growth of the past decade. Global Market Insights estimates a 7% market CAGR until 2023e, and we believe the factors that should affect growth for IAR Systems are likely to be: 1) continued increase in the number (and complexity) of embedded systems driven by 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) market consolidation and participants becoming too dominant; and 5) untapped potential in security solutions for embedded systems.

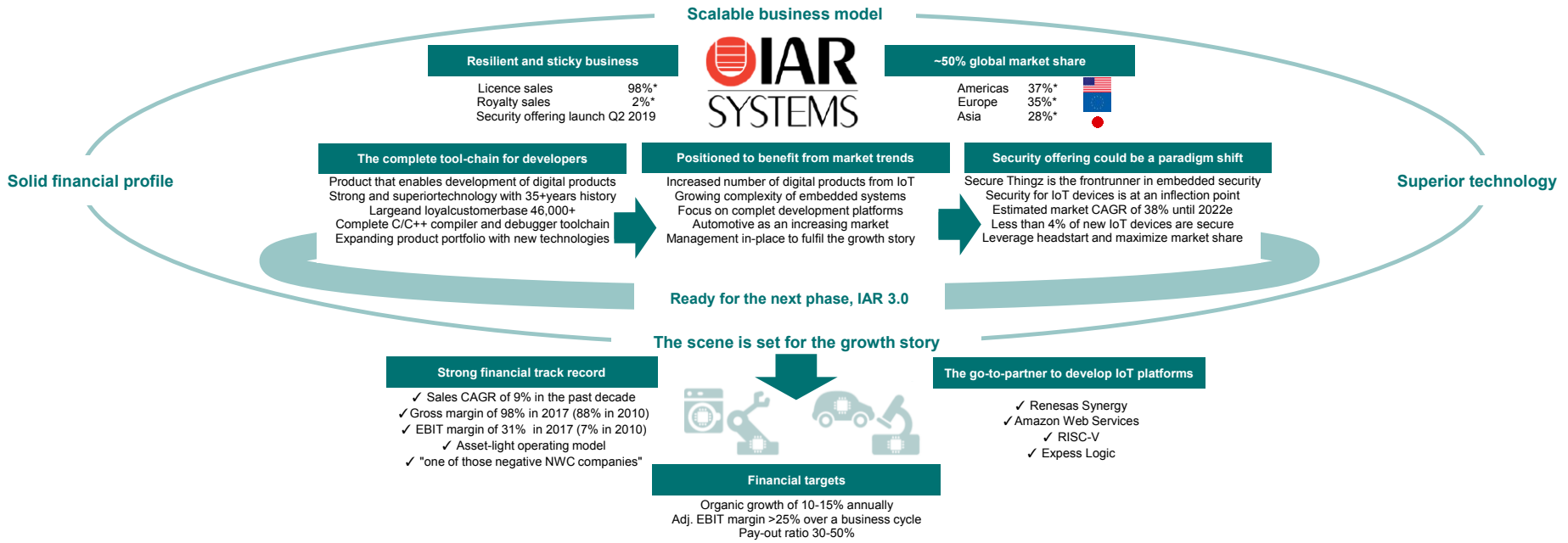
Numerous market drivers indicate a continuation of the solid industry growth

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

Following the acquisition of Secure Thingz, IAR Systems is now the frontrunner in offering secure embedded systems. We believe IAR Systems identified Secure Thingz as a takeover candidate before the market had valued its demand growth opportunity. The security market for embedded systems is in its inception phase but we expect it to grow rapidly through 2022e as the share of secure new embedded products is set to grow from 4% today to almost 20% by 2022e, according to ABI Research. There are no real competitors in this market yet, and if IAR Systems were to capture considerable market share, we believe it could be a paradigm shift for the company. However, to be prudent, we have included minimal sales from its security offering in our estimates, preferring to see sales materialise.

Untapped potential in security offering

Figure 10: IAR Systems' in one picture



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

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We forecast 2018–2021e sales and EBIT CAGRs of 19% and 27%

We forecast a 2018–2021 sales CAGR of 19% and EBIT CAGR of 27% 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) royalties from Renesas Electronics. Moreover, we see additional prospects and untapped potential in security solutions for embedded systems.

This should be driven by an 7% organic sales CAGR for its legacy licensing business (99% of 2018 sales) 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 addition, increased penetration from existing and new technologies in the IAR Embedded Workbench should drive add-on sales.

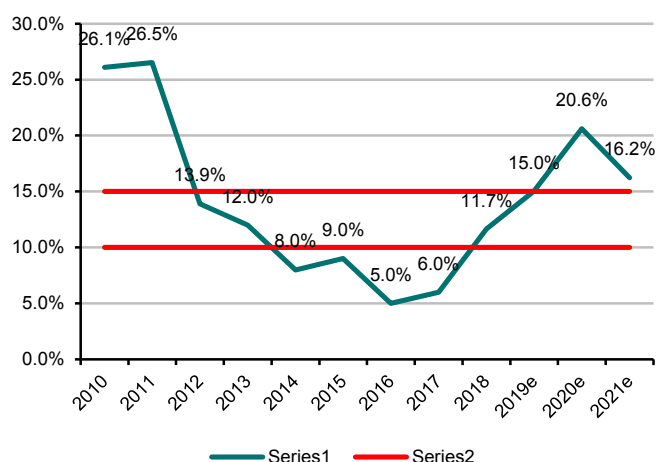
We estimate that revenues stemming from the royalty-based agreement with Renesas Electronics (1%) should contribute to a 3% organic sales CAGR for IAR Systems until 2021. However, as the dynamics of this agreement have not been disclosed, we take a conservative approach for estimating the revenue impact.

We forecast a 2018–2021 EBIT CAGR of 27%, implying a margin gain from 30% in 2018 to 37% in 2021e, driven by: 1) solid organic volume growth; and 2) ample operational leverage (hurt in 2018 by the integration of Secure Thingz) in 2019–2021e as we believe IAR Systems should continue to benefit from economies of scale due to its large fixed cost base.

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

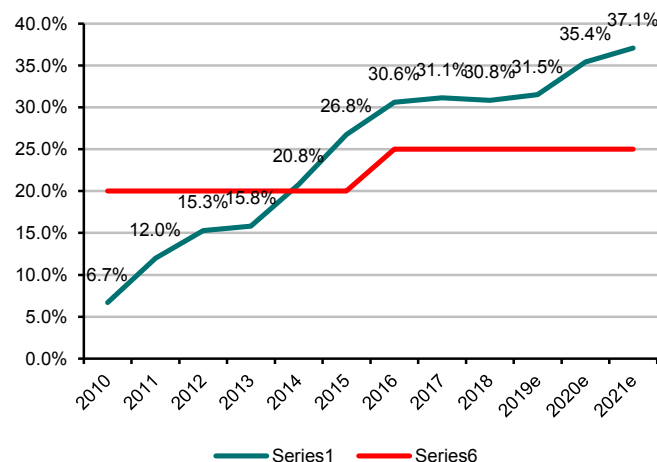
We expect Secure Thingz to contribute to group sales with 10% organic growth CAGR in 2018–2021

Figure 11: Organic sales growth (2010–2020e)



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

Figure 12: Adj. EBIT margin



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. Our estimates are above IAR Systems throughout our forecast period.

Figure 13: IAR Systems’ financial targets – reported and DNB Markets’ estimates

	Reported fiscal years					IAR target	DNB Markets’ estimates		
	2013	2014	2015	2016	2017		2018e	2019e	2020e
Organic growth	12.0%	8.0%	9.0%	5.0%	6.0%	10–15%	11.7%	15.0%	20.6%
EBIT margin	15.8%	20.8%	26.8%	30.6%	31.1%	>25%	30.0%	31.5%	35.4%
Pay-out ratio	88.0%	149.3%	99.7%	113.3%	79.0%	30–50%	78%	65%	52%

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

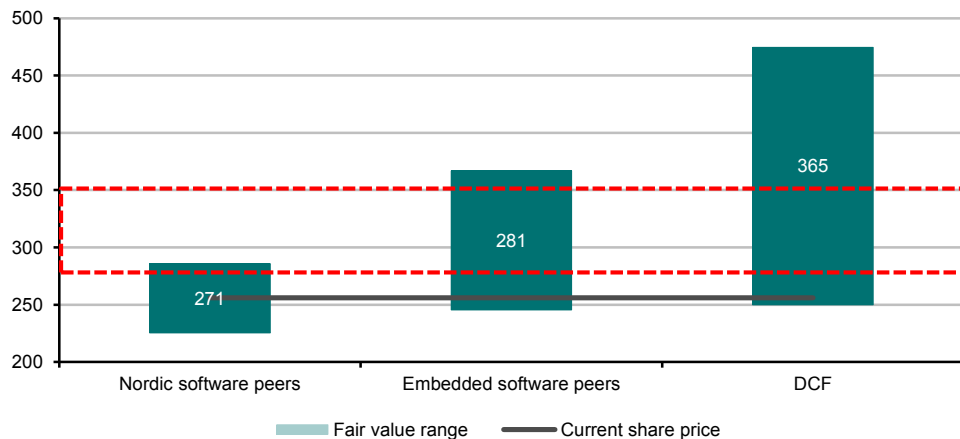
We calculate a fair value of SEK280–350/share

Based on our group of Nordic software peers (6), embedded software peers (5), and our DCF model, we calculate a fair value of SEK280–350/share. We believe the market has been valuing

Fair value of SEK280–350/share suggests potential of 10–40%

IAR Systems relative to Nordic Software peers, whereas in our view embedded software peers better reflect its operating environment, business model, and growth prospects. On the current share price, our estimates suggest a 33x 2019e P/E, 23x EV/EBIT, and 7x EV/sales, while our fair value suggests share price potential of 10–40%.

Figure 14: Valuation summary (SEK/share)



Source: DNB Markets

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Summary of negatives

The key risks that could affect our fair value are: 1) IAR Systems' inability to resurrect the growth story, e.g. if it 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 from large and well-resourced participants that until now have 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 >98% of sales from markets outside Sweden but 58% of its cost base in SEK).

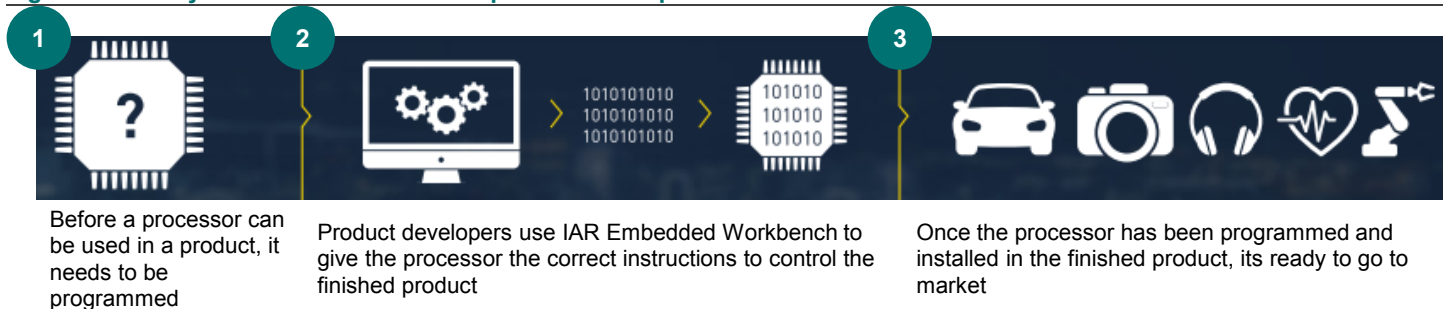
- **Failure to resurrect the growth story.** Having reported average local currency growth of 20% in 2010–2013, 9% in 2014–2015, and 6% in 2016–2017, we believe the key risk to the valuation is a failure to resurrect the organic growth story. While we have identified numerous market drivers that should 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.** With >98% of sales from markets outside Sweden, while the vast majority of the fixed cost base is denominated in SEK (we estimate ~58%), IAR Systems is fairly sensitive to fluctuations to the SEK. If the SEK were to strengthen by 10% against its most important currencies (USD, EUR, JPY) as well as the GBP and KRW in 2018, we estimate a ~10% FX headwind on sales and a ~30% headwind on 2018 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 the 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 today, any success of 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. Moreover, if the acquisitions of embedded software companies continue, it could cap IAR Systems' ability to integrate new technologies to its product offering. If it fails to acquire new technologies or create strategic alliances to integrate into IAR Systems' offering, this could impede its ability to address new market trends that should contribute to growth.
- **Large company 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 tools companies and given away the products 'free' to reduce costs. As many competitors in the semiconductor industry (particularly processor vendors) but 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 constantly retain 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 program the chips.

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 so they can fulfil their function in the embedded system for developers of smart products. The customer base of 150,000+ programmers (users) is found mainly in end-markets underpinned by growing demand for digital technology and embedded systems, such as industrial automation, medical technology, telecommunication, 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 15: IAR Systems' role in customers' product development



Source: Company

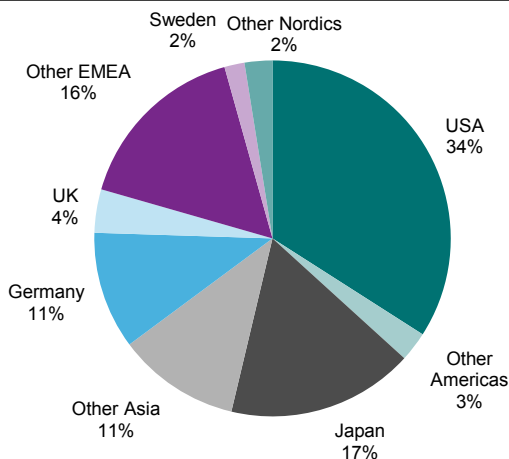
Headquartered in Uppsala (Sweden), the company holds a leading global market share of ~50% with 95%+ of sales stemming from markets outside the Nordics and a market presence in 50+ countries and head count of 163. With a history of adapting to meet customer demand, IAR Systems' business model is primarily 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 (~30% recurring revenues). Also, to position itself more towards the Internet of Things (IoT), the company complemented its licence-based model in 2016 with an exclusive royalty-based agreement with world-leading process vendor Renesas Electronics.

50% global market share with 98% licence-based revenues, which are flexible for customers and leverage the number of programmers using its licence...

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

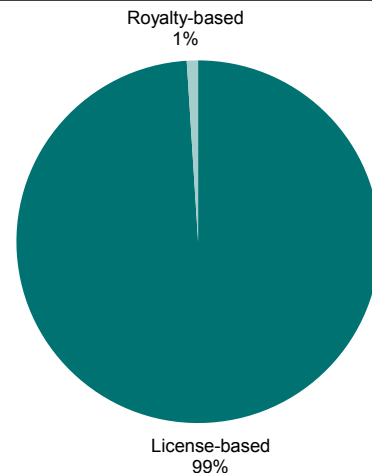
- **Licence-based revenue (99% of 2018 sales)** based entirely on the number of licence users (perpetual software keys) of the IAR Embedded Workbench sold when a developer programs a product. The licence cost is ~SEK30,000 (upfront) while the customer can add a support and update agreement for an annual cost of 20% of the licence price.
- **Royalty-based revenue (1%)** based on the number of microprocessors produced in Renesas Synergy series. Unlike the licence-based model, IAR Systems receives revenue throughout the entire production period.

Figure 16: Geographical sales split (2017)



Source: Company

Figure 17: Sales by business model (2018)



Source: Company

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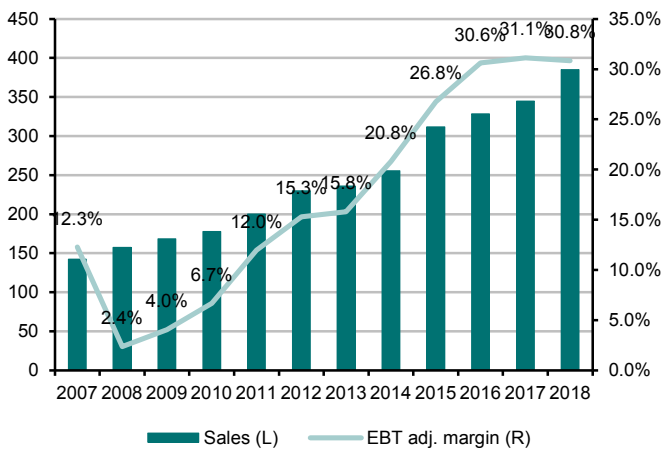
IAR Systems was acquired by IT conglomerate Nocom in 2005. However, by 2010 Nocom (known as Intoi by then) wanted to focus more on proprietary software and create a more specialised company, so it kept only IAR Systems and took on that name.

With 2018 net sales of SEK385m, IAR Systems is 3x larger than the company acquired in 2005. While generating a sales CAGR of 9% over the past 10 years, it was able to significantly boost its underlying profitability from an adj. EBIT margin of 12.3% in 2007 to 30.0% in 2018, which we attribute to: 1) the scalability of its high gross-margin standardised software; 2) more focus on proprietary products; and 3) increased cost efficiency (given the large fixed cost base where personnel costs compose 44% of sales).

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

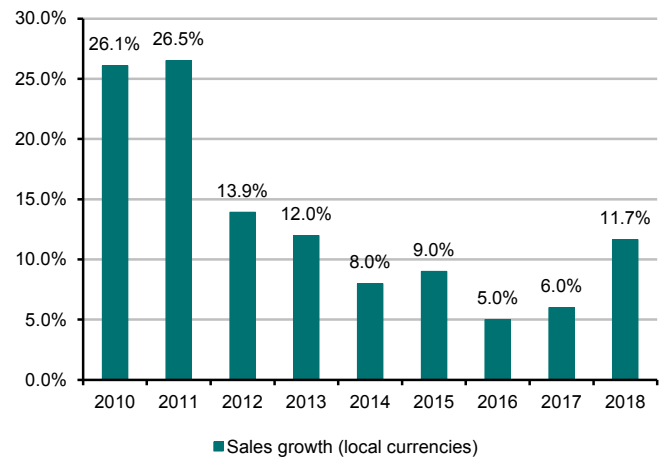
...with profitable growth, sales CAGR of 9% and adj. EBIT CAGR of 40% in the past 10 years

Figure 18: IAR Systems – sales (SEKm) and adj. EBIT margin



Source: Company

Figure 19: IAR Systems – sales growth local currencies



Source: Company

IAR Systems' key competitive advantage in our view is its flagship product, the IAR Embedded Workbench, which is a complete tool-chain for customers. Being independent, the software supports 12,000+ 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 in to 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 offering a complete solution...

Over the past few years, IAR Systems has expanded its product portfolio and now offers several adjacent products integrated in 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) through its acquisition of Secure Thingz, as well as support for Amazon FreeRTOS (IoT Microcontroller Operating System). In addition to driving add-on sales, this has – combined with a comprehensive support organisation – translated into impressive customer retention (95% recurring customers) and strengthened IAR Systems' competitiveness. The customer base is very broad as none of the 46,000+ customer organisations accounts for more than 3% of group sales.

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

Figure 20: IAR Embedded Workbench ® sold to >46,000 customer organisations

IDE Tools	Build Tools	C-SPY Debugger
<ul style="list-style-type: none"> - Editor - Project manager - Library Tools 	<ul style="list-style-type: none"> - IAR C/C++ Compiler - Assembler - Linker 	<ul style="list-style-type: none"> - Simulator driver - Hardware debugging - Power debugging - RTOS plugins

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

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Forecast changes – P&L

(SEKm)	New			Old			Change		
	2019e	2020e	2021e	2019e	2020e	2021e	2019e	2020e	2021e
Revenues	462	563	656	459	544		3	18	
Cost of sales	-11	-13	-15	-12	-14		1	1	
Gross profit	451	549	641	447	530		4	19	
Operating expenses	-273	-307	-342	-265	-289		-8	-18	
EBITDA	178	243	299	182	241		-4	1	
EBITDA adj	178	243	299	182	241		-4	1	
EBITDA margin (%)	38.6	43.2	45.6	39.7	44.4	nm	-1.2	-1.2	nm
Depreciation	-4	-5	-6	-3	-4		-1	-1	
Amortisation	-29	-39	-49	-29	-38		0	-1	
EBIT	146	199	243	150	200		-5	-1	
EBIT adj	146	199	243	150	200		-5	-1	
Net financial items	-2	-3	-4	-2	-4		0	0	
PBT	143	196	239	148	196		-4	0	
Taxes	-36	-49	-60	-35	-51		0	2	
Minorities	0	0	0	0	0		0	0	
Net profit	108	147	180	112	145		-5	2	
Adjustments to net profit	0	0	0	0	0		0	0	
Net profit adj	108	147	180	112	145		-5	2	
<i>Per share data (SEK)</i>									
EPS	7.70	10.52	12.85	8.04	10.40		-0.34	0.12	
EPS adj	7.70	10.52	12.85	8.04	10.40		-0.34	0.12	
DPS ordinary	5.00	5.50	5.50	5.00	5.50		0.00	0.00	
DPS	5.00	5.50	5.50	5.00	5.50		0.00	0.00	
<i>Other key metrics (%)</i>									
Revenue growth	20.0	21.8	16.7	19.8	18.5	nm	0.2	3.2	nm
EBIT adj growth	22.5	36.8	22.2	26.9	33.2	nm	-4.4	3.7	nm
EPS adj growth	13.9	36.6	22.2	19.0	29.4	nm	-5.1	7.2	nm
Avg. number of shares (m)	14	14	14	14	14		0	0	
Capex	-64	-72	-74	-52	-67		-12	-6	
OpFCF	115	171	225	131	175		-16	-4	
Working capital	81	123	207	105	149		-24	-26	
NIBD adj	-93	-127	-193	-115	-150		22	22	

Source: DNB Markets

Forecast changes – By segment and assumptions

(SEKm)	New			Old			Change		
	2019e	2020e	2021e	2019e	2020e	2021e	2019e	2020e	2021e
Assumptions									
Revenue org. % YOY	15.03	20.61	16.23	17.51	18.14		-2.48	2.47	
Structure impact % YOY	0.00	0.00	0.00	0.00	0.00		0.00	0.00	
Currency impact % YOY	4.35	0.47	0.00	1.88	0.07		2.47	0.41	

Source: DNB Markets

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Quarterly numbers

(SEKm)	Q2 2017	Q3 2017	Q4 2017	Q1 2018	Q2 2018	Q3 2018	Q4 2018e	Q1 2019e	Q2 2019e	Q3 2019e	Q4 2019e
Revenues	87	84	88	89	96	98	103	104	110	116	132
Cost of sales	-2	-2	-3	-3	-2	-2	-2	-3	-2	-2	-3
Gross profit	85	82	85	86	94	96	101	100	108	114	129
Operating expenses	-54	-49	-53	-51	-64	-58	-63	-62	-65	-69	-78
EBITDA	31	34	32	35	30	38	38	39	43	45	52
Depreciation	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1
Amortisation	-5	-5	-5	-5	-6	-6	-6	-6	-7	-8	-8
EBIT	26	29	27	30	24	31	31	32	35	36	43
Net financial items	0	0	0	0	-2	0	1	-1	-1	0	0
PBT	26	28	26	29	22	31	32	32	34	36	42
Taxes	-5	-8	-7	-6	-6	-4	-10	-8	-8	-9	-11
Minorities	0	0	0	0	0	0	0	0	0	0	0
Net profit	21	20	20	23	16	27	22	24	25	27	32
Adjustments to net profit	0	0	0	0	-2	0	0	0	0	0	0
Net profit adj	21	20	20	23	14	27	22	24	25	27	32
Dividend paid	-63	0	0	0	-68	0	0	0	-70	0	0
Avg. number of shares (m)	13	13	13	13	14	14	14	14	14	14	14
<i>Per share data (SEK)</i>											
EPS	1.67	1.61	1.56	1.81	1.20	1.97	1.60	1.69	1.81	1.92	2.28
EPS adj	1.68	1.61	1.56	1.81	1.43	1.97	1.56	1.69	1.81	1.92	2.28
DPS ordinary	5.00	0.00	0.00	0.00	5.00	0.00	0.00	0.00	5.00	0.00	0.00
DPS	5.00	0.00	0.00	0.00	5.00	0.00	0.00	0.00	5.00	0.00	0.00
<i>Growth and margins (%)</i>											
Revenues, QOQ growth	0.5	-3.0	4.0	1.5	7.5	2.4	5.0	0.9	6.0	5.6	13.9
Revenues, YOY growth	6.1	3.8	3.1	2.9	10.1	16.3	17.4	16.6	15.0	18.6	28.6
EPS adj, YOY growth	25.4	-6.9	-2.0	21.3	-15.1	22.5	0.1	-6.2	27.0	-2.5	46.1
Gross margin	98.2	97.7	97.0	96.9	98.0	97.9	97.9	96.9	98.0	97.9	97.9
EBITDA adj margin	35.6	40.1	36.4	39.0	31.4	38.6	36.6	37.5	38.8	38.6	39.3
Depreciation/revenues	-0.7	-0.7	-0.7	-0.6	-0.6	-0.7	-0.8	-0.7	-0.7	-0.8	-0.9
EBIT adj margin	29.7	34.0	30.6	33.2	28.1	32.0	30.3	31.0	31.4	31.2	32.3
Net profit margin	24.4	24.1	22.5	25.6	16.9	27.4	21.2	22.8	23.0	23.1	24.1

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

Adjustments to quarterly numbers

(SEKm)	Q2 2017	Q3 2017	Q4 2017	Q1 2018	Q2 2018	Q3 2018	Q4 2018e	Q1 2019e	Q2 2019e	Q3 2019e	Q4 2019e
EBITDA	31	34	32	35	30	38	38	39	43	45	52
EBITDA adj	31	34	32	35	30	38	38	39	43	45	52
EBIT	26	29	27	30	24	31	31	32	35	36	43
Other EBIT adjustments	0	0	0	0	-3	0	0	0	0	0	0
EBIT adj	26	29	27	30	27	31	31	32	35	36	43
Net profit	21	20	20	23	16	27	22	24	25	27	32
Other EBIT adjustments	0	0	0	0	-3	0	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	21	20	20	23	14	27	22	24	25	27	32

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

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Quarterly numbers by segment and assumptions

(SEKm)	Q2 2017	Q3 2017	Q4 2017	Q1 2018	Q2 2018	Q3 2018	Q4 2018e	Q1 2019e	Q2 2019e	Q3 2019e	Q4 2019e
Assumptions											
Revenue org. % YOY	0.61	8.38	8.47	4.98	8.06	6.65	10.05	8.87	10.53	15.77	25.98
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	5.50	-4.56	-5.41	-2.08	2.07	9.62	7.31	7.78	4.48	2.88	2.67

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

Annual P&L

(SEKm)	2012	2013	2014	2015	2016	2017	2018	2019e	2020e	2021e	
Revenues	230	236	256	312	328	345	385	462	563	656	
Cost of sales	-23	-15	-13	-10	-12	-9	-9	-11	-13	-15	
Gross profit	207	222	243	301	316	337	376	451	549	641	
Operating expenses	-165	-171	-179	-203	-203	-209	-236	-273	-307	-342	
EBITDA	42	51	64	98	113	127	140	178	243	299	
Depreciation	-2	-2	-2	-3	-3	-2	-3	-4	-5	-6	
Amortisation	-4	-7	-8	-12	-14	-17	-22	-29	-39	-49	
EBIT	35	41	53	83	97	107	116	146	199	243	
Net financial items	0	0	0	0	0	-2	-2	-2	-3	-4	
PBT	35	37	54	83	100	106	114	143	196	239	
Taxes	-22	-12	-11	-20	-22	-26	-26	-36	-49	-60	
Effective tax rate (%)	63	31	21	24	22	24	23	25	25	25	
Minorities	0	0	0	0	0	0	0	0	0	0	
Net profit	13	26	42	63	78	80	88	108	147	180	
Adjustments to net profit	0	3	0	0	-3	0	-2	0	0	0	
Net profit adj	13	29	42	63	75	80	85	108	147	180	
Dividend paid	-11	-23	0	-63	-88	-63	-68	-70	-77	-77	
Avg. number of shares	11	12	13	13	13	13	14	14	14	14	
<i>Per share data (SEK)</i>											
EPS	1.14	2.10	3.34	5.02	6.18	6.33	6.58	7.70	10.52	12.85	
EPS adj	1.14	2.10	3.34	5.02	6.18	6.33	6.76	7.70	10.52	12.85	
DPS ordinary	0.98	1.85	0.00	5.00	7.00	5.00	5.00	5.00	5.50	5.50	
DPS	0.98	1.85	0.00	5.00	7.00	5.00	5.00	5.00	5.50	5.50	
<i>Growth and margins (%)</i>											
Revenue growth	14.8	2.7	8.3	21.9	5.4	5.1	11.7	20.0	21.8	16.7	
EPS adj growth	-53.2	83.4	59.2	50.2	23.0	2.6	6.7	13.9	36.6	22.2	
Gross margin	89.9	93.9	95.0	96.7	96.3	97.5	97.7	97.7	97.7	97.7	
EBITDA margin	18.2	21.4	24.9	31.5	34.5	36.9	36.4	38.6	43.2	45.6	
EBITDA adj margin	18.2	21.4	24.9	31.5	34.5	36.9	36.4	38.6	43.2	45.6	
Depreciation/revenues	-1.0	-0.9	-0.9	-0.8	-0.8	-0.7	-0.7	-0.8	-0.9	-1.0	
EBIT margin	15.3	17.5	20.8	26.8	29.4	31.1	30.0	31.5	35.4	37.1	
EBIT adj margin	15.3	15.8	20.8	26.8	30.6	31.1	30.8	31.5	35.4	37.1	
PBT margin	15.3	15.8	21.0	26.7	30.5	30.6	29.5	31.0	34.8	36.5	
Net profit margin	5.6	11.0	16.5	20.3	23.8	23.2	22.7	23.3	26.1	27.4	

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

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Adjustments to annual P&L

(SEKm)	2012	2013	2014	2015	2016	2017	2018	2019e	2020e	2021e
EBITDA	42	51	64	98	113	127	140	178	243	299
EBITDA adj	42	51	64	98	113	127	140	178	243	299
EBIT	35	41	53	83	97	107	116	146	199	243
Other EBIT adjustments	0	4	0	0	-4	0	-3	0	0	0
EBIT adj	35	37	53	83	101	107	119	146	199	243
Net profit	13	26	42	63	78	80	88	108	147	180
Other EBIT adjustments	0	4	0	0	-4	0	-3	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	13	29	42	63	75	80	85	108	147	180
<i>Per share data (SEK)</i>										
EPS	1.14	2.10	3.34	5.02	6.18	6.33	6.58	7.70	10.52	12.85
Recommended adjustment	0.00	0.00	0.00	0.00	0.00	0.00	0.18	0.00	0.00	0.00
EPS adj	1.14	2.10	3.34	5.02	6.18	6.33	6.76	7.70	10.52	12.85

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

Cash flow

(SEKm)	2012	2013	2014	2015	2016	2017	2018	2019e	2020e	2021e
Net profit	13	26	42	63	78	80	88	108	147	180
Depreciation and amortisation	7	9	10	15	17	20	25	33	44	56
Cash flow from operations (CFO)	38	41	70	99	114	124	93	124	183	217
Capital expenditure	-22	-21	-32	-19	-19	-19	-47	-64	-72	-74
Acquisitions/Investments	0	0	0	0	0	0	-1	0	0	0
Divestments	0	0	0	1	0	0	0	0	0	0
Cash flow from investing (CFI)	-18	-19	-32	-18	-19	-38	-217	-64	-72	-74
Free cash flow (FCF)	20	22	39	80	95	86	-125	60	111	142
Net change in debt	0	0	0	0	0	0	1	0	0	0
Dividends paid	-11	-23	0	-63	-88	-63	-68	-70	-77	-77
Share issue (repurchase)	0	22	-53	0	0	0	172	0	0	0
Other	12	12	0	0	0	0	3	0	0	0
Cash flow from financing (CFF)	1	12	-53	-64	-88	-63	108	-70	-77	-77
Total cash flow (CFO+CFI+CFF)	21	33	-15	17	7	23	-17	-10	34	65
<i>FCFF calculation</i>										
Free cash flow	20	22	39	80	95	86	-125	60	111	142
Less: tax shields/other	0	0	0	0	0	0	0	0	0	0
Less: acquisitions	0	0	0	0	0	0	1	0	0	0
Less: divestments	0	0	0	-1	0	0	0	0	0	0
Growth (%)										
CFO	10.1	6.3	72.7	40.4	15.7	8.5	-25.3	33.5	48.1	18.3
CFI	30.1	-5.5	-66.0	42.3	-3.3	-98.9	-478.2	70.7	-13.2	-2.9
FCF	127.0	6.9	78.7	108.3	18.5	-9.4	-244.6	148.0	85.1	28.2
CFF	-92.2	1866.7	-550.8	-19.5	-39.0	28.5	270.7	-164.7	-10.0	0.0
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)	2012	2013	2014	2015	2016	2017	2018	2019e	2020e	2021e
Assets	324	370	375	399	396	410	722	760	831	936
Inventories	4	3	4	5	6	5	7	8	9	11
Trade receivables	29	34	39	44	48	51	63	78	86	105
Other receivables	14	15	11	20	19	12	38	38	38	38
Current financial assets	3	1	0	0	0	0	0	0	0	0
Cash and cash equivalents	49	82	71	89	99	120	106	96	130	196
Current assets	98	135	124	158	172	187	214	220	263	350
Property, plant and equipment	6	6	8	7	6	6	9	17	25	33
Other intangible assets	152	164	186	192	197	194	484	507	527	538
Deferred tax assets	62	59	51	37	16	3	13	13	13	13
Non-current financial assets	5	5	6	5	5	20	2	2	2	2
Non-current assets	226	235	251	241	224	223	508	539	568	586
Total assets	324	370	375	399	396	410	722	760	831	936
Equity and liabilities	324	370	375	399	396	410	722	760	831	936
Total equity	254	295	289	291	280	290	550	588	658	761
Trade payables	6	6	5	5	5	6	7	7	8	11
Other payables and accruals	53	54	65	84	92	31	52	52	52	52
Short-term debt	1	1	1	1	1	1	2	2	2	2
Total current liabilities	61	61	71	90	99	102	140	139	141	143
Long-term debt	1	1	2	1	2	2	1	1	1	1
Deferred tax liabilities	9	13	15	17	15	14	30	30	30	30
Other non-current liabilities	0	0	0	1	1	2	2	2	2	2
Total non-current liabilities	10	14	16	18	18	17	32	32	32	32
Total liabilities	70	75	87	108	116	120	172	172	173	175
Total equity and liabilities	324	370	375	399	396	410	722	760	831	936
<i>Key metrics</i>										
Net interest bearing debt	-47	-79	-68	-88	-97	-117	-103	-93	-127	-193

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

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Valuation ratios

(SEKm)	2012	2013	2014	2015	2016	2017	2018	2019e	2020e	2021e
<i>Enterprise value</i>										
Share price (SEK)		39.77	74.75	150.00	206.00	189.00	243.00	251.50	251.50	251.50
Number of shares (m)	11.36	12.34	12.63	12.63	12.63	12.63	13.97	13.97	13.97	13.97
Market capitalisation		491	944	1,895	2,602	2,387	3,394	3,513	3,513	3,513
Net interest bearing debt	-47	-79	-68	-88	-97	-117	-103	-93	-127	-193
Adjustments to NIBD	0	0	0	0	0	0	0	0	0	0
Net interest bearing debt adj	-47	-79	-68	-88	-97	-117	-103	-93	-127	-193
EV		411	876	1,807	2,505	2,270	3,291	3,420	3,386	3,320
EV adj		411	876	1,807	2,505	2,270	3,291	3,420	3,386	3,320
<i>Valuation</i>										
EPS	1.14	2.10	3.34	5.02	6.18	6.33	6.58	7.70	10.52	12.85
EPS adj	1.14	2.10	3.34	5.02	6.18	6.33	6.76	7.70	10.52	12.85
DPS ordinary	0.98	1.85	0.00	5.00	7.00	5.00	5.00	5.00	5.50	5.50
DPS	0.98	1.85	0.00	5.00	7.00	5.00	5.00	5.00	5.50	5.50
P/E		18.9	22.4	29.9	33.4	29.8	36.9	32.7	23.9	19.6
P/E adj		18.9	22.4	29.9	33.4	29.8	35.9	32.7	23.9	19.6
P/B		1.66	3.27	6.51	9.31	8.22	6.17	5.98	5.34	4.62
Average ROE	5.3%	9.4%	14.5%	21.9%	27.3%	28.1%	20.8%	18.9%	23.6%	25.3%
Earnings yield adj		5.3%	4.5%	3.3%	3.0%	3.4%	2.8%	3.1%	4.2%	5.1%
Dividend yield		4.6%	0.0%	3.3%	3.4%	2.6%	2.1%	2.0%	2.2%	2.2%
Free cash flow yield		4.4%	4.1%	4.2%	3.7%	3.6%	-3.7%	1.7%	3.2%	4.0%
EV/SALES		1.74	3.42	5.80	7.63	6.58	8.54	7.40	6.02	5.06
EV/SALES adj		1.74	3.42	5.80	7.63	6.58	8.54	7.40	6.02	5.06
EV/EBITDA		8.1	13.8	18.4	22.1	17.8	23.5	19.2	13.9	11.1
EV/EBITDA adj		8.1	13.8	18.4	22.1	17.8	23.5	19.2	13.9	11.1
EV/EBIT		10.0	16.5	21.7	26.0	21.1	28.5	23.5	17.0	13.6
EV/EBIT adj		11.0	16.5	21.7	24.9	21.1	27.7	23.5	17.0	13.6
EV/capital employed		1.4	3.0	6.2	8.9	6.4	5.2	5.1	4.6	3.9
EV/NOPLAT		13.5	22.2	29.3	35.1	28.6	38.5	31.8	23.0	18.4
EV/OpFCF (taxed)		20.8	50.1	31.6	36.6	28.3	52.7	44.6	28.5	20.6

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

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Key accounting ratios

	2012	2013	2014	2015	2016	2017	2018	2019e	2020e	2021e
<i>Profitability (%)</i>										
ROA	4.1	7.5	11.3	16.4	19.6	19.9	15.5	14.5	18.5	20.3
ROCE	14.0	13.4	18.1	28.5	34.9	33.6	24.0	22.4	28.3	30.8
ROCE after tax	10.4	9.9	13.4	21.1	25.8	24.8	17.8	16.6	20.9	22.8
<i>Return on invested capital (%)</i>										
Net PPE/revenues	2.7	2.6	3.1	2.1	1.9	1.8	2.3	3.7	4.5	5.0
Working capital/revenues	16.4	31.2	20.9	22.0	22.4	24.6	19.3	17.5	21.8	31.5
<i>Cash flow ratios (%)</i>										
FCF/revenues	8.8	9.1	15.1	25.8	29.0	25.0	-32.4	13.0	19.7	21.7
FCF/market capitalisation		4.4	4.1	4.2	3.7	3.6	-3.7	1.7	3.2	4.0
CFO/revenues	16.6	17.2	27.5	31.7	34.8	35.9	24.0	26.8	32.5	33.0
CFO/market capitalisation		8.3	7.4	5.2	4.4	5.2	2.7	3.5	5.2	6.2
CFO/capex	171.0	192.9	217.6	508.8	614.0	652.1	197.9	194.0	253.8	291.6
CFO/current liabilities	63.3	66.8	99.4	110.2	115.8	121.1	66.2	88.7	130.1	151.4
Cash conversion ratio	155.4	83.4	91.5	126.8	122.2	107.9	-142.5	55.7	75.5	79.2
Capex/revenues	9.7	8.9	12.6	6.2	5.7	5.5	12.1	13.8	12.8	11.3
Capex/depreciation	973.9	959.1	1404.3	776.0	744.0	791.7	1800.0	1788.3	1493.1	1185.3
OpFCF margin	8.4	12.5	12.2	25.3	28.8	31.4	24.2	24.8	30.3	34.2
Total payout ratio	85.4	88.0	0.0	99.7	113.3	79.0	75.9	64.9	52.3	42.8
<i>Leverage and solvency (x)</i>										
Net debt/EBITDA	-1.12	-1.57	-1.08	-0.89	-0.85	-0.92	-0.74	-0.52	-0.53	-0.65
Total debt/total capital (BV)	0.01	0.01	0.01	0.00	0.01	0.01	0.00	0.00	0.00	0.00
LTD / (LTD + equity (MV))		0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
<i>Cash conversion cycle</i>										
Inventory turnover days	61.1	83.1	104.7	180.7	167.5	223.3	267.7	283.0	248.3	262.7
Receivables turnover days	67.7	75.3	70.9	74.5	74.7	66.2	96.1	91.6	80.4	79.5
Credit period	95.6	143.5	147.1	170.1	158.6	244.8	296.1	234.6	226.4	249.6
Cash conversion cycle	33.3	14.8	28.5	85.1	83.7	44.8	67.7	140.0	102.3	92.6

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

17 February 2019

Important Information

Company: IAR Systems
 Coverage by Analyst: Joachim Gunell
 Date: 17/02/2019

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17 February 2019

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