

Swemet AB (SWEM B)

Sweden | Smart electricity meters | MCAP SEK 30.5mn

19 December 2020

Buy

Target price: SEK 3.22
 Current price: SEK 2.16
 Upside: 49.2%

Swemet – Strategically positioned on a sparking market

Swemet AB (“Swemet” or “the company”) is a supplier of smart grid and smart metering technology for electricity companies in Sweden and internationally. In 2018 the Swedish Energy Markets Inspectorate decided on new functioning requirements obliging the electricity companies to replace the existing meters before 2025. Through consulting, Swemet has built strong customer relationships to gain a competitive advantage. The central purchasing entity for infrastructure in Sweden (SINFRA) rewarded Swemet with the highest evaluation among all competitors in the procurements of 2020, indicating its quality. The company has been profitable since 2019 and is expected to double its number of annual sold smart meters from a value of SEK 18.6mn in 2019 to SEK 37.2mn in 2022 due to the regulation. Together with the stable consulting business and the future recurring revenue from service and data analysis, the company is estimated to increase EBIT with a CAGR of 61.5% between 2019 and 2021, implying an EV/EBIT multiple of 5.5x for 2021. This is significantly lower than its peers trading at an average of EV/EBIT 8.0x, implying a target price of SEK 3.22 and an upside of 49.2%.

Key takeaways

- Swemet offers a complete range of services:** Among the smart metering competitors, Swemet has unique knowledge in smart grid analysis, and therefore the electricity companies only need one service partner. The company will increase its recurring revenue from service and data analysis with every installed smart electricity meter. The aftermarket sales will constitute an essential and stable part of the future income where service and data analysis generate 50.0% of the lifetime value of an electricity meter. The segment is estimated to grow from SEK 1.7mn in 2019 to SEK 13.4mn in 2023 and constitute 20.9% of total sales.
- Market regulations enforce all Swedish electricity companies to replace their smart meters before 2025:** Increased demand for Swemet’s products results in an estimated CAGR for the revenue of 21.4% between 2019 and 2023. Swemet currently has a handful of stable Swedish customers with planned rollouts until 2025, generating a steady income flow. Also, several new customers are expected to be announced shortly, including international deals postponed by Covid-19, which could be a trigger for the stock price. The company has delivered pilot projects to customers in Finland and Denmark, who are expected to follow up with continuous orders in the coming years. The orders indicate an international demand for Swemet’s offer, facilitating opportunities for international growth. In addition to the smart meters, Swemet sells its own developed electrical grid analysis equipment worldwide. Though the volume is expected to stay low, this is an opportunity to develop new customer relationships in order to sell electricity meters later on.
- Trades at a 33.0% discount despite having the best product and service offered on the market:** Based on estimates for 2021, Swemet is trading at EV/EBIT 5.5x, with comparable companies trading at 8.0x. Based on the high potential growth and the transformation to a more considerable part of recurring revenue, it is justified that the company trades at par with its peers, indicating a target price of SEK 3.22 and an upside of 49.2%. Every new customer and order will increase the stability and profitability, driving a higher valuation going forward.

Analysts

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Market Data, SEK

Exchange	Nordic Growth Market		
Shares (mn)	14.1		
MCAP (mn)	30.5		
EV (mn)	33.2		

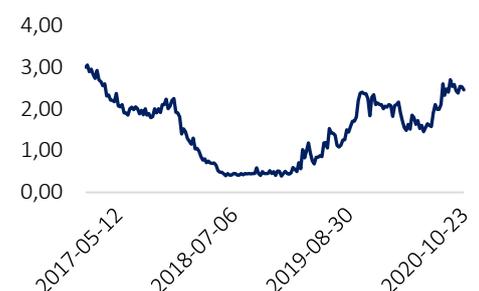
Metrics & Drivers	19A	20E	21E
EV/EBIT	14.4x	9.0x	5.5x
EV/EBITDA	7.7x	6.8x	5.2x
EV/S	1.1x	1.1x	0.7x
P/E	13.7x	8.9x	5.5x
ND/EBITDA	0.6x	0.6x	0.5x

Forecast, SEKmn	19A	20E	21E
Total revenue	29.8	31.6	45.6
Rev. growth y/y	103.7%	5.8%	44.6%
Gross Profit	17.9	18.9	27.7
Gross Margin	59.9%	59.8%	60.6%
EBITDA	4.3	4.9	6.4
EBITDA Margin	14.5%	15.5%	14.0%
EBIT	2.3	3.7	6.0
EBIT Margin	7.7%	11.7%	13.1%

Major Shareholders

Jan Axelsson	37.9%
Avanza Pension	6.0%
Martin Axelsson	3.6%

Price Development, SEK



Investment thesis

Future revenue ensured by strong customer relationships and high switching costs

Swemet is a supplier of smart electricity meters and due to a new Swedish regulation, there will be a substantial demand for the product. In preparation for this regulation, the company has operated primarily within consultancy to build customer relationships and secure future orders. High switching costs characterize the business model once the product is installed, which will entail continuous income from existing customers.

A new market regulation induces high demand until 2025 along with growth possibilities

The customers on the market for smart electricity meters are electricity companies, where the three largest companies (Eon, Fortum and Vattenfall) have almost half of the market share. The remaining customers are small and medium-sized electricity companies and constitute Swemet's serviceable obtainable market. In 2018 the Swedish Energy Markets Inspectorate (Energimarknadsinspektionen) decided on new functioning requirements for all electricity meters in Sweden. The regulation obliges the electricity companies to replace the existing meters at the latest 1 January 2025. The market regulation requires about 5mn electricity meters to be replaced and the total value for the meters is estimated to be SEK 6 450mn. Swemet is estimated to capture a market share of 2% of this market along with a stable consultancy business generating a revenue of approximately SEK 10mn. There are numerous competitors on the market, where Swemet would be classified as a new and small company in the growth phase, gaining market share from larger, established companies. Regulatory driven demand is expected internationally, particularly in the Nordics, where Swemet already has a small, although growing, customer base.

Substantial economic moat from high switching costs result in EBIT growing with a CAGR of 61%

A key value driver is Swemet's business model with recurring revenue derived from previous orders. The continuous income, approximately 10% of the initial price of the meter annually, is ensured by high switching costs during the technical lifetime of the meter. The switching costs originate from a high initial cost of SEK 1290.0 each, resulting in a low incentive to replace the meter before it's technical lifetime of 10-15 years is due. Competitors have similar pricing, and therefore the continuous costs are inevitable for the customer. This results in practically no incentive to switch supplier during the technical lifetime and thereby a considerable economic moat for Swemet. Furthermore, Swemet has been operating with a calculated loss in order to establish customer relationships in advance of the new regulation. Smart grid solutions and the possibility of measuring consumption are vital for a sustainable society. A significant value driver is that the company's overall business is aligned with the megatrend of climate change by reducing electricity consumption through awareness and control. An additional key value driver is that Swemet's offer was ranked number one among the competition by the central purchasing entity for infrastructure in Sweden SINFRA, in charge of the majority of the procurements. The combination of significant economic moats, alignment with megatrends and strong customer relationships result in EBIT growing with a CAGR of 61% between 2019 and 2021, reaching an EBIT of SEK 6.0mn and an attractive EBIT margin of around 13%. Potential triggers are primarily announcements of new orders and clients, especially internationally, as each order significantly affects the revenue.

High switching costs reduce risks of large, infrequent orders

Swemet is an order-driven company, and the main risk is the effect each customer and order have. The customer base consists of a few customers who place relatively large, infrequent orders. Therefore, the loss of orders and particularly customers, have a considerable effect on the revenue. Whilst the high switching costs may protect Swemet from this risk, the switching costs also complicate the process of finding new customers. The financing activities in Swemet pose a risk as it contains a high management involvement. Low creditworthiness has led to management involvement in loans, and Swemet has a substantial claim on a company owned by the CEO. The cash and cash equivalents are notably low, although increasing to SEK 363tn in 2020 and expected to grow along with higher profitability in the future. The hardware supplier is a Chinese manufacturer, as is custom amongst the competitors, which could be a security issue and should therefore be considered a risk.

Overview of the company

Jan Axelsson, the CEO, founded Swemet during the last regulation round for smart electricity meters ending in 2009. Together with his colleagues, also experienced within the industry, he built a consulting business to gain trust and reputation among the electricity companies. Besides the consulting business, Swemet has developed several types of electrical grid analysis equipment used by their consultants in the field and sold to customers. Swemet first developed their own electricity meter but then changed the business model and has worked together with manufacturing partners for the last couple of years.

Increased product sales to drive future recurring revenue

Swemet is expected to generate SEK 29.4mn in revenue from selling electricity meters in 2021 and SEK 1mn from selling electrical grid analysis equipment. Along with the sale of products, the company has started to build a customer base from where they will profit from service and data analysis as continuous income, expected at SEK 6.2mn in 2021. Swemet's consulting business will keep contributing to a stable cash flow and revenues of around SEK 10mn annually. Furthermore, Swemet has announced an increased collaboration with the Chinese company STAR Instruments in 2020 and will not only distribute STAR Instruments products but also be their agent in larger procurements.

Transformed business model reduces development costs

Personnel costs as % of sales will decrease from 32.7% in 2019 to 22.5% in 2021 as the smart metering segment grows compared to the consulting business. The increased revenue from hardware will result in a higher cost of goods sold of SEK 18.0mn and a gross margin of 60.6% in 2021. The new business model with manufacturing partnerships has reduced the need for large development costs.

Increased activity outside Sweden ensure future growth

The two possible ways to continue growing for Swemet after 2025, will be to either broaden the consultancy services or be successful internationally. The company has pilot projects abroad and is expected to announce deals, postponed by Covid-19, in 2021.

Overview of the market

The serviceable obtainable market in Sweden consists of small and medium-size electricity companies and the vast majority, about 150, are members of SINFRA (Swedish Purchase Central for Infrastructure Economical Association). This organization manages the procurement of products and services within the supply sector. Swemet has negotiated a framework agreement with SINFRA intended for each of its members. SINFRA has similar framework agreements with numerous competitors.

A high market value with steadier revenue streams

The government-mandated replacements of electricity meters have historically been aligned with the technical lifetime of the meters. The previous regulation required new electricity meters in Sweden by 2009 and the present regulation requires new meters by 2025. However, the market expects a structural change with ongoing, continuous updates and electricity meter purchases, contrasting to the current sporadic and comprehensive replacements. The value of the current extensive regulatory-driven installations is, according to SINFRA and analyst estimates, worth SEK 6.45bn. The meters' new functions create an opportunity for Swemet to broaden their offer within data analysis and maintenance, which will be an essential driver for growth in the coming years and adds recurring revenue.

Increasing market share internationally

Swemet has a large potential market in the rest of Europe, particularly in the Nordics, where similar regulations are presented with different timelines. In particular, Finland has a similar rollout plan to Sweden's, currently replacing the previous meters installed before 2013. Swemet sells its own developed instrument for electrical grid analysis internationally, inducing vital customer relationships to increase sales of smart electricity meters in the future. Swemet has already received initial orders of meters after selling its electrical grid analysis equipment internationally.

Financial forecast breakdown

International customers contribute with a considerable growth

The vast majority of the revenue is generated from a few existing long-term clients and their orders of meters will contribute with additional continuous income. Most existing clients are based in Sweden and have a rollout plan with meters until the year 2025, ensuring a stable, essential income for the upcoming years. Additionally, there are currently a few occasional clients in Europe and specifically in the Nordics, adding to the sale of products. The estimated future orders for Swemet's existing customer base are based on whether customers have placed initial orders, how many meters the customers need to replace and how similar projects in the area turned out. The potential market with new customers is estimated similarly, along with data from Swemet's pilot projects, marketing efforts and presence in the area. As seen in the table below, the customer base in Sweden is expected to stagnate in the upcoming years whilst the international orders are expected to increase.

Estimated orders of meters SEKtn	2020 E	2021 E	2022 E	2023 E
Current Swedish customers	18 150	18 400	17 750	17 750
Current international customers	900	3 283	3 283	3 283
Potential Swedish customers	0	6 586	6 586	6 586
Potential international customers	0	1 129	9 597	11 855
Total estimated order value	19 050	29 398	37 216	39 474

Significant growth in recurring revenue

Although the hardware segment constitutes the core part of Swemet's revenue, there are two additional revenue generating activities. One of them is the continuous income from service and analysis that the product orders generate. This annual repetitive income is approximately 10% of the initial product cost for the customers and extends over the meter's technical lifetime of 10-15 years. As seen in the estimated income table below, the recurring revenue will increase immensely and eventually constitute 21% of the total revenue in 2023.

Stable revenue generated from consulting

Initially, Swemet operated primarily within consultancy, which historically has generated a stable revenue of SEK 7-10mn annually. As shown in the estimated income table below, the future consultancy business is expected to have a negligible growth compared to the substantial growth in product sales and continuous income from service and analysis. The total revenue is estimated to increase with a CAGR of 21.4% from 2019 to 2023.

Estimated income SEKtn	2020E	2021E	2022E	2023E
Product sales	19 050	29 398	37 216	39 474
Service and analysis	3 502	6 237	9 699	13 371
Consultancy	9 000	10 000	10 000	11 000
Total estimated income	31 552	45 635	56 914	63 844

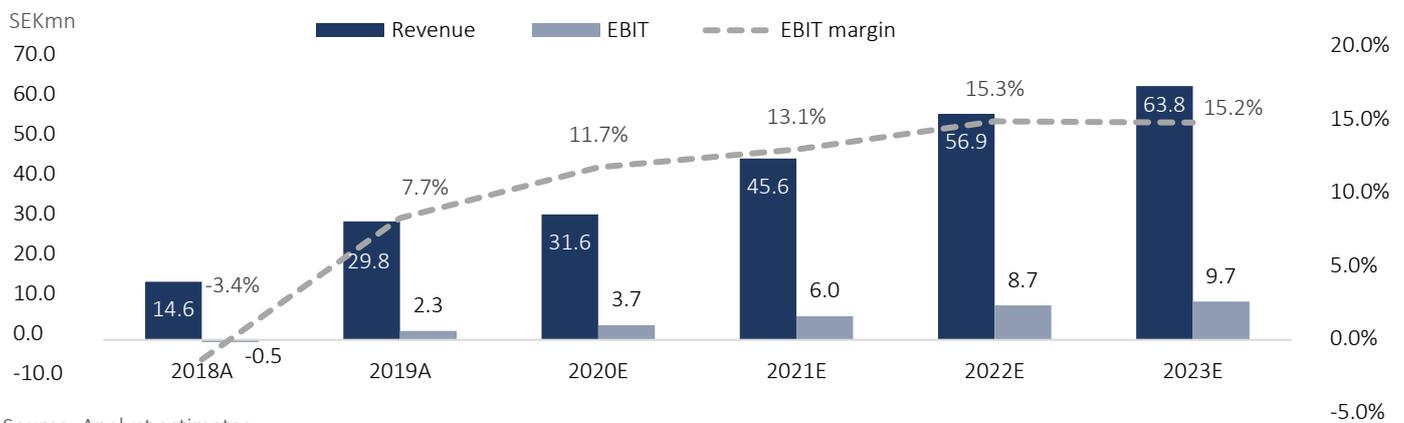
Gross margin remains attractive

The current and future business model focusing on product sales and aftermarket, in contrast to historical operations mainly within consultancy, has had a massive impact on the cost of goods sold. The substantial growth in product sales has increased the cost of goods sold significantly, resulting in a declining gross margin from 94.9% in 2018 to 59.9% in 2019. The gross margin is estimated to remain constant going forward as cost of goods sold is expected to consist of the same product mix of the electricity meter and grid analysis equipment. The decreased gross margin is still attractive and has no negative effect on profits since costs have moved up in the income statement rather than increased.

EBITDA and EBIT margin increasing to 15.2% in 2023 along with written down amortization

Along with a stagnated revenue generated from the consultancy business, the associated personnel costs will have a negligible growth. The number of employees is expected to increase slightly, expanding the team with a new employee every second year. The EBITDA margin of 14.5% in 2019 will at first increase and then decline slightly in the following years, to stagnate at 15.2% in 2023. The EBIT margin of 7.7% in 2019 is estimated to increase and coincide the EBITDA margin after 2021, as there are no plans for future capital expenditures, and the residuary amortization of SEK 400tn will be written down in the year 2021.

Profitability is increasing up until 2022 along with revenue growth.



Source: Analyst estimates

Reduced debts and a tax loss carryforward concludes a promising net income margin of 12.2% in 2021

The interest income originates from the claim Swemet has on a another company owned by the CEO, which has a current interest rate of 4.0% and has decreased from SEK 4.5mn 2019 to SEK 3.4mn H1 2020. The claim is planned to continue to decline, and therefore also the interest income. The interest expense is also expected to decrease along with scheduled repayments of loans. The loan from the CEO fluctuates between insignificant minor sums and relatively larger amounts like the current loan of SEK 154.0tn. The interest rate of the loan varies between a market interest rate and no interest rate. There is no exact time plan for the repayment of loans, although there is an ambition to end internal involvement in loans as well as to continue paying off the external loans. Since Swemet has recently gone profitable, there is a considerable tax loss carryforward enabling the company to reduce taxable income until 2021. The resulting net income margin is 7.5% in 2019 and will peak in 2021 at 12.2% and is then expected to stagnate at 11.8% in 2022 and 2023.

Valuation

Peer valuation indicating a potential upside of 49.2%

Based on the expected improved margins, results from the new business model and less depreciation and amortization, an EV/EBIT target multiple is the most suitable valuation metric. The peer group average EV/EBIT estimated for 2021 is 8.0x. With EBIT growing by a CAGR of 61.5% between 2019 and 2021 combined with increased stability and recurring revenue, Swemet is trading at an unreasonable discount of 33.0% compared to the peer group. The estimated EV/S multiple for Swemet of 0.7x in 2021, compared with the peer's average of 0.9x, strengthens the thesis that the company is undervalued. Trading at par with the peer group, a target multiple of 8.0x implies a price per share of SEK 3.22, indicating a potential upside of 49.2%.

Peer table	MCAP SEKmn	EV/EBIT		EV/S		ROIC
		2020E	2021E	2020E	2021E	2019
Allgon	459.9	16.1	8.4	1.3	1.1	5.0%
Eurocon	196.3	15.3	9.9	0.8	0.7	25.1%
Waystream	113.8	6.9	5.8	1.1	1.0	28.3%
Peer average	256.7	12.3	8.0	1.1	0.9	19.5%
Swemet	30.5	9.0	5.5	1.1	0.7	32.7%

Higher growth and ROIC than comparable companies

There are no apparent public peers to Swemet, but the companies in the table above have the same market characteristics or income models. Waystream operates within the network infrastructure business, a market similar to the electricity meters market, where the products are rolled out for the fiber and 5G markets within a specific timetable. Waystream also offers services in network optimization, and the total revenue is expected to grow with a CAGR of 20.7% between 2019 and 2022. Allgon delivers solutions for radio remote control and connectivity to industrial customers. Allgon's revenue growth between 2019 and 2022 is expected to increase with a CAGR of 3.6%. To reflect Swemet's consultancy and service incomes, the company is also compared with Eurocon, a consulting firm offering its services within energy, forestry, mining, and chemistry. The revenue of Eurocon is expected to grow with a CAGR of 3.9% between 2019 and 2022. The distinctively higher CAGR for the revenue of 24.0% between 2019 and 2022 and the ROIC of 32.7% justifies Swemet to be valued in line with its peers despite the lower market cap.

Increased profitability, stability and growth priced at 5.5x EV/EBIT 2021E

Swemet has had a positive EBITDA since 2018, positive EBIT since 2019 and is in the process of establishing itself as a profitable company. Roll out plans for existing customers ensure steady future product sales. Ongoing pilot projects in Sweden and internationally, together with deals postponed by Covid-19, are expected to generate new customers announced shortly. The revenue is expected to grow with a CAGR of 23.7% between 2019 and 2021 due to a higher number of electricity meters sold and the increasing aftermarket with higher margins than Swemet's existing business. An estimated larger customer base in the coming years, increased profitability, stability and growth will drive a higher valuation going forward. The traded forward-looking EV/EBIT multiple for 2021E is 5.5x compared to the peer average of 8.0x, indicating a price per share of SEK 3.22 and a potential upside of 49.2%, when valued in line with comparable companies.

Management and board

Anders Sagadin, Chairman of the board

Sagadin has over 20 years of international leadership experience, mainly within information technology but also in Energy and Utility. Among other external board positions, Sagadin is the CEO and chairman of the IT-company Bluerange.

Ownership: 0 shares (0%)



Jan Axelsson, CEO, Founder & Member of the board

Axelsson started Swemet in 2005 and has been the CEO and a member of the board since. He observed the market regulations taking form while in positions as chief of measurement equipment at Tekniska verken and marketing manager at Telvent (now part of Schneider Electric). At these larger corporations, Axelsson gained his experience within electricity meters, setting the foundation for Swemet's operations today.

Ownership: 5 840 391 shares (37.9 %)



Andreas Rydbäck, CIO & Member of the board

Rydbäck has 20 years of experience as a technical project manager in the Energy sector, especially with smart meters, both from Swemet's competitors Kamstrup and Metrima Energy, and today's largest customer Växjö Energi.

Ownership: 81 563 shares (0.6%)



Eric Tholén, Marketing and Sales Manager

Tholén has previously handled procurements with Swedish energy companies for Metrima Energy and has experience in project management and Sales from MiLAB.

Ownership: 67 000 shares (0.5%)



Bengt-Ove Blomkvist, CFO

Blomkvist, with 35 years of experience as CFO and controller, works part-time as the CFO for Swemet. He is also CFO for the traded company Willak AB, as well as CAO for Usify AB.

Ownership: 27 040 shares (0.2%)



Appendix

Income statement, SEKtn	2019A	2020E	2021E	2022E	2023E
Net Sales	29 827	31 552	45 632	56 914	63 844
Other income	1	0	0	0	0
Total revenue	29 827	31 552	45 635	56 914	63 844
COGS	(11 954)	(12 678)	(17 975)	(23 651)	(25 813)
Gross profit	17 874	18 874	27 660	33 263	38 031
Gross margin	59.9%	59.8%	60.6%	58.4%	59.6%
Other external costs	(3 779)	(4 471)	(11 001)	(14 114)	(17 093)
Personnel costs	(9 768)	(9 510)	(10 259)	(10 464)	(11 255)
EBITDA	4 327	4 893	6 400	8 685	9 683
EBITDA margin	14.5%	15.5%	14.0%	15.3%	15.2%
Depreciation & Amortization	(2 026)	(1 200)	(400)	0	0
EBIT	2 301	3 693	6 000	8 685	9 683
EBIT margin	7.7%	11.7%	13.1%	15.3%	15.2%
Net financial items	(69)	(268)	(233)	(198)	(163)
EBT	2 232	3 425	5 767	8 487	9 520
Taxes	0	0	(184)	(1 748)	(1 961)
Net income	2 232	3 425	5 583	6 738	7 559
Net income margin	7.5%	10.9%	12.2%	11.8%	11.8%

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