

# XMReality

Sector: Human Interaction

## Improved Outlook Offers Greater Upside

Redeye raises its valuation of XMReality after the recent Q2 report. We see several factors in favor of a higher share price going forward, including improved fundamental performance driven by accelerating market maturity and increased transparency from the company. We raise our estimates substantially both in the short and long term, increasing our base case valuation and fair value range.

### Q2'20 above expectations

XMReality performed better than we expected in Q2. Sales beat our expectations by 50% and amounted to SEK 5.5m (SEK 3.0m). OPEX was slightly higher than our estimate, putting EBIT at SEK -7.1. (SEK -7.6m), which was in line with our expectations. Order intake was also strong, generating a total order backlog of SEK 10.3m at the end of the quarter.

### High Activity Driven by Corona

XMReality has had an intense quarter. Orders have been flowing in from both new and existing customers at the same time as the company has refined its strategy and formed several partnerships. The Corona crisis has clearly sped up the market's adoption of AR technology in the field service market. We see the last six months as a breakthrough period for the company.

### We raise our base case valuation to SEK 7 per share

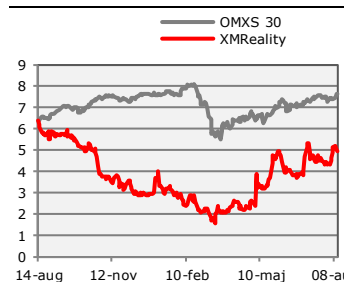
With the substantial boost that XMReality has received from an accelerating market maturity and the Corona crisis, we feel justified in raising our outlook for the company. We increase our sales estimates substantially, with around 35-89% over the forecast period. Our new base case valuation is SEK 7 per share, with an adjusted fair value range of SEK 3 to SEK 10 per share. Despite that the share has performed well over the last few months, we see an upside of around 30% from current levels.

KEY FINANCIALS (SEKm)	2018	2019	2020E	2021E	2022E	2023E
Net sales	10	12	21	37	63	100
EBITDA	-25	-23	-18	-13	-4	12
EBIT	-29	-27	-22	-17	-9	8
EPS (adj.)	-1.7	-1.6	-0.7	-0.5	-0.3	0.1
EV/Sales	8.4	4.6	8.8	5.5	3.5	2.2
EV/EBITDA	-3.4	-2.4	-10.6	-16.1	-48.9	17.7
EV/EBIT	-2.9	-2.0	-8.3	-11.7	-24.0	26.2
P/E	-4.2	-2.3	-7.9	-9.7	-16.3	36.0

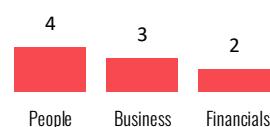
### FAIR VALUE RANGE

BEAR	BASE	BULL
3	7	10

### VERSUS OMXS30



### REDEYE RATING



### KEY STATS

Ticker	XMR.ST
Market	First North
Share Price (SEK)	5.4
Market Cap (MSEK)	184
Net Debt 20E (MSEK)	10
Free Float	76 %
Avg. daily volume ('000)	15

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## Q4'20: Corona Boost

XMReality's progress took a leap forward in Q2, thanks to the Corona crisis. In this update, we will cover XMReality's performance during the quarter, which was a promising one for the company. The increased interest for its Remote Guidance solution, which took off already in Q1, continued.

XMReality beat our financial forecasts substantially in the quarter. Down below, we look at the company's performance in detail and give you our updated view and estimates, as well as discuss the company's inflow of new orders and partners and the market development.

### Financial Performance in Q2'20

*Beat sales estimate of 50% and grew 85% y/y*

XMReality performed better than we expected in Q2 and had a strong sales development. Sales came in at SEK 5.5m (SEK 3.0m) and beat our forecast of SEK 3.7m with 50%. The company has received many orders from new customers, driven by an increased interest in remote solutions during the Corona crisis. However, the interest from existing customers has also been keen. CEO Rimmelg said in the report presentation that growth was driven by a healthy mix of existing and new customers.

XMReality: Actual vs estimates				
(SEKm)	Q2'19	Q2'20E	Q2'20A	Diff. (%)
Net sales	3.0	3.7	5.5	50%
Growth y/y	37%	24%	85%	
Gross margin	89%	92%	84%	
OPEX	-10.6	-10.8	-11.1	
<b>EBITDA</b>	<b>-6.6</b>	<b>-6.0</b>	<b>-5.8</b>	<b>3%</b>
D&A	-1.0	-1.1	-1.2	
<b>EBIT</b>	<b>-7.6</b>	<b>-7.1</b>	<b>-7.1</b>	<b>1%</b>
<b>Net income</b>	<b>-7.6</b>	<b>-7.1</b>	<b>-7.6</b>	<b>-7%</b>

Source: Redeye Research

The gross margin was marginally weaker compared to our estimate and Q2'19 and reached 84%. This was due to higher hardware sales in the quarter. OPEX remained stable, resulting in an EBIT 1% above our forecast, at SEK -7.1m (SEK -7.6m).

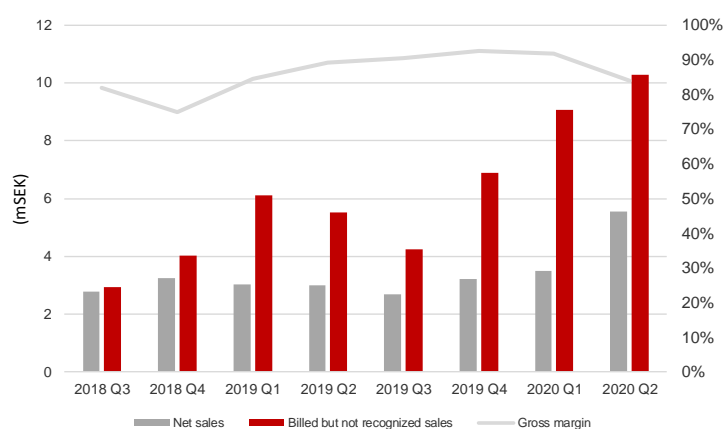
XMReality: Historical Financials								
(SEKm)	2018	Q1'19	Q2'19	Q3'19	Q4'19	2019	Q1'20	Q2'20
Net sales	10.2	3.0	3.0	2.7	3.2	11.9	3.5	5.5
CoGS	-3.0	-0.5	-0.3	-0.3	-0.2	-1.3	-0.3	-0.9
Gross margin (%)	70%	84%	89%	91%	93%	89%	92%	84%
Staff costs	-20.4	-5.0	-5.2	-4.2	-5.1	-19.5	-4.3	-5.8
External costs	-16.9	-3.9	-5.5	-4.7	-5.8	-19.9	-5.0	-5.3
EBITDA	-25.2	-4.8	-6.6	-5.3	-6.5	-23.1	-5.4	-5.8
D&A	-4.1	-0.9	-1.0	-1.1	-1.1	-4.2	-1.2	-1.2
EBIT	-29.2	-5.7	-7.6	-6.4	-7.7	-27.3	-6.6	-7.1
Growth (%) (y/y)	52%	55%	37%	-3%	-1%	17%	15%	85%

Source: XMReality reports

After having quite a flat sales development for some quarters, we can discern a significant sales growth improvement in Q2. As we pointed out after the Q1 report, the increase in billed

but not recognized sales over the last quarters is a positive signal going forward. In Q2, the trend continued, and the order backlog reached SEK 10.3m (SEK 5.5m).

**XMReality: Net sales, billed but not recognized sales and gross margin**



Source: XMReality reports

Overall, XMReality outperformed our expectations in Q2'20 and showed impressive progress. We believe that the Corona crisis is the main driver behind the sales growth, and we will delve deeper into the current market development further down below.

Lastly, XMReality has had a cash flow before financing of around SEK -30m over the last 12 months. However, the company had at the end of Q2'20 invoiced a majority of the order backlog in advance, putting cash flow from changes in working capital at SEK -4.9m in the quarter. XMReality has roughly SEK 27m in cash. Hence, the company is still in a strong financial position that enables continued growth and has sufficient cash for the coming year, roughly.

## Building and Communicating Corona Momentum

Q2 has been a rather intense quarter for XMReality with strong news flow and high activity. The company has:

- Reviewed its operational strategy, resulting in the closure of the German office and an increased focus on the U.S. market
- Released a "freemium" version of Remote Guidance
- Received a number of orders from new customers
- Formed several new partnerships

We will discuss each of these points more in detail, and also highlight how XMReality has chosen to disclose additional key figures in the Q2 report.

During the quarter, XMReality announced that it had received orders from Electrolux, IMI Plc, Kingdom Housing Association, Nestlé, Norwegian Emergency Medical Services and Alfasigma. The orders are rather small in value – up to SEK 1m in total order value each, and often include both hardware and software. For three of the announced orders, the order value is not disclosed, and we conclude that these orders are rather small.

XMReality: Q2 Software Orders		
Date	Customer	ARR* (SEKm)
01-04-2020	Electrolux	0.33
02-04-2020	IMI Plc	0.4
08-04-2020	Kingdom Housing Association	ND
21-04-2020	Nestlé	1.2
12-05-2020	Norwegian Emergency Medical Services	ND
24-06-2020	Alfasigma	ND

\*Redeye estimate of ARR  
Source: XMReality & Redeye Research

In addition, we estimate that the orders entailed hardware sales of around SEK 0.4m. We view the steady order flow during the spring as a breakthrough period for the company. Previously, the company has announced orders, but it has not translated into any significant revenue growth. In this quarter, we see that the news flow generates a positive financial effect. This increases our conviction in the case, and that XMReality has a competitive offering, that creates value for its customers.

XMReality: Partners & Distributors	
Name	Description
myVR Software	Collaboration with the Hexagon company myVR Software. Integration into Hexagon's Xalt I Visualization AR platform
Atea	Partner and reseller agreement with IT infrastructure provider Atea, covering both hardware and software
Swipe Guide	Partnership agreement where Remote Guidance is integrated into SwipeGuide's work instruction software
SOCAPS	Food & Beverage packaging - SOCAPS, which will offer Remote Guidance to its customers

Source: XMReality

In addition to the strong order inflow, XMReality has also announced several partnerships. The company has reached agreements with myVR Software and Swipe Guide to incorporate Remote Guidance into their products. Partnerships have also been formed with Atea and SOCAPS, which will offer XMReality's solution to their customers and act as resellers. These deals are summarized in the table above. We view it as positive that XMReality forms new partnership and increase the number of resellers since it will give the company more distributional leverage.

We also think XMReality's communication in the Q2'20 report is noteworthy. The company disclosed some interesting facts and key indicators, including:

- Number of billable licenses doubled during Q2'20
- Number of enterprise customers reached 82 companies
- Churn was less than 2% in Q2'20

We want to highlight this more elaborate communication, not only because the numbers paint a favorable picture, but because of the increased transparency itself. The stock market rewards companies that are transparent, and hence, we see it as positive for the share performance that the company seems more prone to disclose additional key indicators.

Only 2% churn in Q2'20

## AR Adoption Accelerating

In our Corona update during the spring, we argued that the crisis would accelerate the adoption of digital, remote solutions. We incorporated this view in our forecast primarily by boosting our 2020 estimates, and we maintain the view that the Corona crisis will positively affect 2020. In XMReality's Q2'20, we were proven right.

Several industry reports confirm that the Corona crisis has affected the field service market, which is XMReality's primary market, significantly. Although the market still is expected to have a CAGR of 11-16% up until 2025-26, depending on the source, the reports note several changes in the market. The number of physical visits has gone down, and the demand for technical solutions to manage field service operations has increased.

Also, the competitive landscape is changing. We note that Ubimax, one of XMReality's competitors, is being acquired by TeamViewer, another competitor.<sup>1</sup> Ubimax focuses solely on AR solutions, like XMReality, and had billings of EUR 9.1m during the last 12 months, which are forecasted to grow with a CAGR of 45-50% until 2024 in the presentation published by TeamViewer.

*Competitor transaction with EV/S 15x*

The price paid amounts to EUR 136.5m on a cash and debt-free basis. Hence, this corresponds to a transaction EV/S multiple of roughly 15x. Although we do not primarily see XMReality as an acquisition target, we think it is interesting to observe the forecasted growth rate of Ubimax and the valuation in the transaction. We believe this shows that the market is, and also *is viewed*, as attractive.

All in all, the Corona crisis has had a positive effect on XMReality's market. Given the recent development with regional virus outbreaks and recurring restrictions in several countries, we believe that the recovery will be somewhat slower than we previously expected. This means that what we saw as a temporary increased interest in digital solutions will continue during the fall.

We argue that a more extended period of restrictions should increase the likelihood that changes in behavioral patterns become permanent. The longer people and organizations must use and adapt to new, digital solutions, the more likely that they continue to use them when Corona is no longer an issue. Hence, we believe that the Corona crisis should speed up the overall adoption of remote solutions and have a positive impact on XMReality's sales growth, both in the short and long term.

## Forecast & Valuation

Per our reasoning above, we update our view and financial forecast. In our ordinary fashion, we model bear, base and bull case scenarios that are outlined in detail further down below. However, we begin by focusing on our base case scenario.

We believe that the interest for remote solutions will continue throughout 2020, translating into several orders from new and existing customers. Hence, we increase our quarterly estimates from around SEK4m to SEK 6m in 2020.

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<sup>1</sup>

<https://ir.teamviewer.com/download/companies/teamviewer/Presentations/200715TeamViewerUbimaxAcquisition.pdf>

XMReality: Estimates in Base case								
(SEKm)	2019	Q1'20	Q2'20	Q3'20E	Q4'20E	2020E	2021E	2022E
Net sales	11.9	3.5	5.5	6.0	6.0	21.0	36.8	62.6
CoGS	-1.3	-0.3	-0.9	-0.5	-0.5	-2.1	-3.7	-6.3
Gross margin (%)	89%	92%	84%	92%	92%	90%	90%	90%
Staff costs	-19.5	-4.3	-5.8	-4.5	-5.1	-19.7	0.0	0.0
External costs	-19.9	-5.0	-5.3	-5.0	-5.8	-21.1	0.0	0.0
EBITDA	-23.1	-5.4	-5.8	-2.5	-3.9	-17.6	-12.5	-4.5
D&A	-4.2	-1.2	-1.2	-1.1	-1.1	-4.7	-4.7	-4.6
EBIT	-27.3	-6.6	-7.1	-3.6	-5.0	-22.3	-17.2	-9.1
Sales growth (%) y/y	17%	15%	85%	123%	86%	76%	75%	70%

Source: Redeye Research

Increasing sales estimates with 35-89%

Furthermore, we expect that the AR market will mature more quickly due to the Corona crisis and the enduring restrictions. Thus, we increase our sales estimates over the rest of the forecast period, with between 35% to 89%.

Given the scalability of XMReality's business model, this generates a significant increase in EBIT estimates, despite that we maintain our assumptions regarding margins. The accelerated growth also entails that breakeven is reached already in 2023, instead of 2024. Otherwise, we keep our DCF assumptions.

XMReality: Estimate changes in base case						
(SEKm)	2020E	2021E	2022E	2023E	2024E	2025E
Net sales (new)	21	37	63	100	145	203
Net sales (old)	16	21	33	58	95	138
Change (%)	35%	78%	89%	73%	52%	47%
EBIT (new)	-22.3	-17.2	-9.1	8.3	27.7	46.3
EBIT (old)	-25.6	-31.1	-27.1	-13.2	7.0	28.7

Source: Redeye Research

Our key valuation assumptions can be summarized as:

- With 82 paying customers in Q2'20, including large companies such as ABB, we believe that there is room for substantial growth going forward.
- ARR for some of these customers could amount to SEK 10m annually.
- We expect sales growth to begin to take off 2021 and onwards, driven by a maturing market. This process has accelerated substantially due to the Corona crisis.
- The number of active users increases up to around 50,000 users at the end of the forecast period.
- The scalable business model, based on mostly software, yields high gross margins of 90%.
- Breakeven is reached in 2023.
- EBIT-margin increases and peaks at 23% at the end of the forecast period.
- Terminal growth rate is 2%.
- Terminal EBIT-margin is 18%.
- Tax rate is 21%.
- We use a WACC of 13%.

<b>XMReality: Base case assumptions</b>				
<b>Assumptions:</b>	<b>2020-22</b>	<b>2023-28</b>	<b>DCF-value</b>	
CAGR Sales	74%	30%	WACC	13%
EBIT-margin (avg.)	-56%	20%	NPV of FCF	101
			NPV of Terminal Value	124
<b>Terminal</b>			Sum of NPV	225
Sales growth	2%		Net debt	-26
EBIT-margin	18%		<b>DCF-value</b>	<b>251</b>
			<b>Fair value per share</b>	<b>7</b>
			Current share price	5.4

Source: Redeye Research

We value XMReality to SEK 7 per share in a base case scenario and estimate a fair value range to SEK 3 to SEK 10 per share. The share price has increased by more than 50% since our latest update, with the market reacting positively on the order news flow. The share has recently been trading around SEK 5 per share. Thus, we argue that there is an additional upside of around 30%.

### Bear Case 3 (1) SEK

The bear case reflects the scenario where the expected breakthrough is delayed due to a general reluctance to invest in new AR-technology. We have also incorporated tougher competition and a general price pressure on AR solutions for remote guidance.

We assume a slower adoption of XMReality's Remote Guidance, leading to lower sales growth. However, we still expect some larger orders within a few years.

*Sales CAGR '20-'22E: 42%*

*Sales CAGR '23-'28E: 27%*

*Avg. EBIT-margin '20-'22E: -83%*

*Avg. EBIT-margin '23-'28E: 12%*

*Terminal growth: 2%*

*Terminal EBIT-margin: 14%*

### Base Case 7 (3) SEK

The base case assumes that the AR market matures faster than in the bear case. XMReality's customers adopt the Remote Guidance solution at a more rapid pace, and we also expect fewer competitors to appear posing as serious threats to the company. This leads to that there is less price pressure in the market, translating into higher growth for XMReality.

The forecasts in the base case imply that several companies reach larger numbers of active users, generating revenue of up to SEK 10m annually per customer.

The higher growth results in high margins for the company, due to the scalability of the software and that additional users can be added to its platform at negligible marginal costs.

*Sales CAGR '20-'22E: 74%*

*Sales CAGR '23-'28E: 30%*

*Avg. EBIT-margin '20-'22E: -56%*

*Avg. EBIT-margin '23-'28E: 20%*

*Terminal growth: 2%*

*Terminal EBIT-margin: 18%*

### Bull Case 10 (7) SEK

The bull scenario is based on that XMReality's Remote Guidance solutions remains competitive for many years and that it attracts many large customers. These large customers find the Remote Guidance solution to be useful, resulting in a large number of software licenses sold.

We assume that few competitors with similar offerings emerge and that XMReality hence maintains its technological advantage over a longer period. This translates into higher pricing power for the company, as well as a lower churn. Together this yields high and sustainable margins for the company.

*Sales CAGR '20-'22E: 79%*

*Sales CAGR '23-'28E: 32%*

*Avg. EBIT-margin '20-'22E: -57%*

*Avg. EBIT-margin '23-'28E: 24%*

*Terminal growth: 2%*

*Terminal EBIT-margin: 22%*



## Investment Case

**Highly scalable offering with potential customer lock-in.** XMReality targets industrial players that incorporate its software in their service offerings. The company faces negligible marginal costs of adding additional licensed users to the platform, and the potential to achieve high profitability is reflected by the gross margins exceeding 90%. The use case further opens up for lock-in effects as customers incorporate XMReality's solution in their large-scale service operations.

**XMReality's technique is unique** in combining hand overlay, excellent functionality in areas of weak network capacity, and that you can invite customers to new sessions through a weblink, i.e., eliminating the need to run sessions through an installed app on the customer side. Not having to download software is an important feature mitigating the potential problem of this new technique being perceived as complicated and complex. The company launched this new feature rather recently, and with sales cycles often exceeding a year, we believe that the full scope of this introduction is yet to be seen.

**Corona crisis accelerating AR adoption.** XMReality has experienced an explosion in customer interest since the onset of the Corona crisis. With the pandemic increasing the interest in digital, remote technical solutions, the company's sales development has taken off. The crisis has increased the speed at which the market is adopting the new technology, and we now see a quickly maturing market.

Since the Corona crash, XMReality's share has outperformed the market and surged by more than 200% and is trading at around SEK 5 per share. With the company's fundamental performance quickly improving, the outlook going forward is excellent. We currently see an upside to our base case of SEK 7 per share of roughly 30%. We still deem additional, and especially larger (>SEK 2m), software orders to be the most critical share catalysts over the coming year as it would reveal the potential within the rapidly growing customer base.

## Key Catalysts

**Announcement of large agreement.** We see great potential in an extensive roll-out of XMReality's Remote Guidance solution throughout a large client's service organization after running tests for an extended period. Apart from yielding recurring revenues and high margins, it would indicate that the industry truly is ready to adopt the solution and use it on a larger scale.

**New channel partner(s).** There is further potential for a new channel partner(s) that incorporate XMReality's solution in their offering toward clients. We, however, believe this to be more relevant as the company has shown larger volumes of software sales.

## Counter Points

**Slow adoption brings uncertainty.** The adoption of Remote Guidance has so far been slow. One of the reasons could be that the service personnel are reluctant to change their way of working. The customers of XMReality's customers may also be unwilling to receive service through an AR-based solution that requires some work by themselves, instead of someone physically coming over and conducting all work for them.

**New competitor(s) with superior solution.** There is a risk of superior solutions introduced by competitors emerging on the market. For the company to keep its competitive edge, it is vital to continue to invest in R&D.

**Price pressure.** XMReality applies a premium price strategy that could be difficult to retain if new competitors can offer solutions with a similar value proposition as XMReality. It becomes even more relevant in the long run if the technology becomes a standardized solution within industrial service operations. It is, therefore, essential that XMReality retains its technological advantage through continuing to develop its software.

## Summary Redeye Rating

The rating consists of three valuation keys, each constituting an overall assessment of several factors that are rated on a scale of 0 to 1 points. The maximum score for a valuation key is 5 points.

### Rating changes in the report

#### People: 4

Management shows a solid understanding of the market and is focused on the field service industry, although the areas of application are boundless. XMReality's board possesses a broad area of expertise covering experience from start-ups, the IT industry, and management positions for large global companies. With the recent rights issue, the company's main owner, Investment AB Spiltan also increased its holdings, strengthening the ownership structure. The management team, however, comprises a relatively new constellation where a majority of the positions have been appointed from 2017 and onwards. We also would like to see management own more shares.

#### Business: 3

XMReality is active in a rapidly growing market, where numerous globally leading industrials are showing interest in technologies that can rationalize their service operations. Although the company has several direct competitors, its product offering seems very competitive so far. XMReality business model is scalable, and the company applies a licensing model for its software offering, which opens up for recurring revenues and high margins.

#### Financials: 2

XMReality is currently exhibiting negative earnings and cash flow. Hitherto, the customers have seemed hesitant to adopt the company's AR solution. However, the field service market has started to mature more rapidly, driven by the Corona crisis, and therefore we forecast break-even to be reached already in 2023. Still, given the company's cash burn, XMReality may have to raise additional capital. We see room for an increased rating as the company starts generating positive cash flows and reach positive earnings.



## Redeye Rating and Background Definitions

### Company Quality

Company Quality is based on a set of quality checks across three categories; PEOPLE, BUSINESS, FINANCE. These are the building blocks that enable a company to deliver sustained operational outperformance and attractive long-term earnings growth.

Each category is grouped into multiple sub-categories assessed by five checks. These are based on widely accepted and tested investment criteria and used by demonstrably successful investors and investment firms. Each sub-category may also include a complementary check that provides additional information to assist with investment decision-making.

If a check is successful, it is assigned a score of one point; the total successful checks are added to give a score for each sub-category. The overall score for a category is the average of all sub-category scores, based on a scale that ranges from 0 to 5 rounded up to the nearest whole number. The overall score for each category is then used to generate the size of the bar in the Company Quality graphic.

### People

At the end of the day, people drive profits. Not numbers. Understanding the motivations of people behind a business is a significant part of understanding the long-term drive of the company. It all comes down to doing business with people you trust, or at least avoiding dealing with people of questionable character.

The People rating is based on quantitative scores in seven categories:

- Passion, Execution, Capital Allocation, Communication, Compensation, Ownership, and Board.

### Business

If you don't understand the competitive environment and don't have a clear sense of how the business will engage customers, create value and consistently deliver that value at a profit, you won't succeed as an investor. Knowing the business model inside out will provide you some level of certainty and reduce the risk when you buy a stock.

The Business rating is based on quantitative scores grouped into five sub-categories:

- Business Scalability, Market Structure, Value Proposition, Economic Moat, and Operational Risks.

### Financials

Investing is part art, part science. Financial ratios make up most of the science. Ratios are used to evaluate the financial soundness of a business. Also, these ratios are key factors that will impact a company's financial performance and valuation. However, you only need a few to determine whether a company is financially strong or weak.

The Financial rating is based on quantitative scores that are grouped into five separate categories:

- Earnings Power, Profit Margin, Growth Rate, Financial Health, and Earnings Quality.

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## Disclaimer

### Important information

Redeye AB ("Redeye" or "the Company") is a specialist financial advisory boutique that focuses on small and mid-cap growth companies in the Nordic region. We focus on the technology and life science sectors. We provide services within Corporate Broking, Corporate Finance, equity research and investor relations. Our strengths are our award-winning research department, experienced advisers, a unique investor network, and the powerful distribution channel redeye.se. Redeye was founded in 1999 and since 2007 has been subject to the supervision of the Swedish Financial Supervisory Authority.

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### Recommendation structure

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### Redeye Rating (2020-08-17)

Rating	People	Business	Financials
5p	16	12	3
3p - 4p	107	84	33
0p - 2p	6	33	93
Company N	129	129	129

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### CONFLICT OF INTERESTS

Erika Madebrink owns shares in the company : No

Forbes Goldman owns shares in the company : No

Redeye performs/have performed services for the Company and receives/have received compensation from the Company in connection with this.