Solteq

Extensive report

2/2021

Inderes Corporate customer

This report is a summary translation of the report "Matkalla kaupan alan IT-konsultista tuotetaloksi" published on 02/03/2021 at 8:03

Extensive report 02/03/2021 at 8:00

On its way from a retail sector IT consultant to a product house

We raise our target price for Solteq to EUR 3.4 (previously 3.0) reflecting updated estimates and we also raise our recommendation to Accumulate (previous Reduce). The 2010s were challenging for IT service and industry solution supplier Solteq. Solteq changed its strategy in 2016 and started building a new base for a growth strategy based on its own products and internationalization. Last year, we saw the first signs of a result turnaround and success in the transformation of the product business. Despite modest estimates for the product business, we expect strong earnings growth over the next few years. Valuation is attractive from many angles with our estimates.

On its way from a retail sector consultant more towards a product and software company

Solteq's background is as a retail sector IT service provider that specializes in business digitalization and industry-specific software. Solteq's products cover the entire life cycle of cloud-based IT solutions. In the past 5 years, Solteq has built a base for international expansion, extended its product portfolio, and modified its offering more towards a product house. Solteq's strengths lie in the retail sector, the manufacturing industry, the energy sector, and hotels and restaurants. Last year, Solteq divided its business into two segments Solteq Digital and Solteq Software. The segment structure better corresponds Solteq's business structure and earnings model, and facilitates management and improves transparency. Solteq Software generated some one-third and international operations one-fifth of revenue in 2020e.

Solteq Software and internationalization at the core of the strategy

Solteq began its transformation towards a software and product business in 2017 driven by the current CEO. The company has expanded and developed its product portfolio through product development and acquisitions. In recent years, Solteq has focused heavily on 3 product businesses. Heaviest investments have been made in robotics, that is still in a commercialization stage and has been slowed down by COVID. Solteq's Utilities and Retail businesses already have a good market position in Finland, and these will be internationalized more heavily in coming years. In order to take a growth leap and prove its international competitiveness, Solteq needs to succeed in exporting its products.

Basis for international and software business built

Throughout the last decade, Solteq was the underperformer in the sector and the company has built the basis for a new growth stage. The first signs of a result turnaround and progress in the software transformation was seen in 2020. In 2021, we expect the positive trend to continue and will keep an eye on the success of internationalization in particular. Our current, relatively modest estimates expect earnings growth to be ~15% on average in 2021 to 2023. In our estimates, the expectations for the software businesses are still clearly below the strategic growth and operating profit % targets (≥20% and ≥25%).

Valuation is attractive from many angles

In terms of its investment profile, Solteq is a transition company and if the result turnaround and transformation continue, we also accept a higher valuation for the company than for its peers. The valuation indicators are on average 9% below Finnish peers for 2021e and the valuation is attractive. A sum of parts calculation also indicates a higher EUR 3.6 value. The key risks are related to product commercialization and internationalization.

Analysts

Joni Grönqvist
+358 40 515 3113
joni.gronqvist@inderes.fi

Recommendation

Accumulate
(previous Reduce

EUR 3.40
(previous EUR 3.00

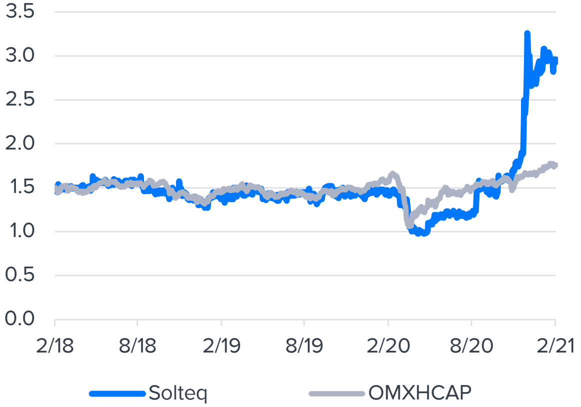
Share price:
2.96

Key indicators

	2019	2020e	2021e	2022e
Revenue	58.3	60.1	65.1	70.1
Growth %	3%	3%	8%	8%
EBIT adjusted	3.5	5.3	6.5	7.3
EBIT % adjusted	6.0%	8.9%	10.0%	10.4%
Net profit	2.8	2.0	3.8	4.7
EPS (adjusted)	0.05	0.13	0.20	0.24
P/E (adjusted)	28.2	23.3	15.0	12.1
P/B	1.2	2.2	1.9	1.7
Dividend yield %	0.0%	1.0%	1.7%	2.4%
EV/EBIT (adjusted)	15.2	15.3	12.0	10.0
EV/EBITDA	5.4	8.0	6.7	5.7
EV/Revenue	0.9	1.4	1.2	1.0

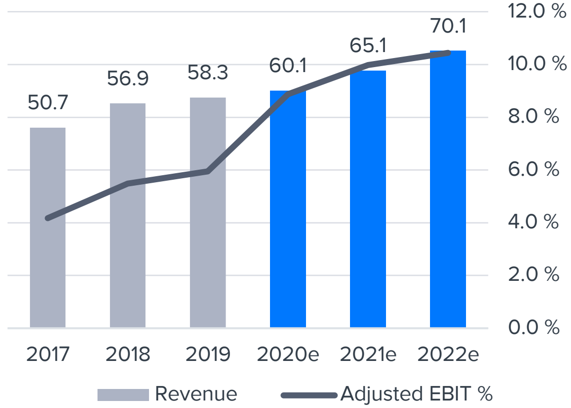
Source: Inderes

Share price



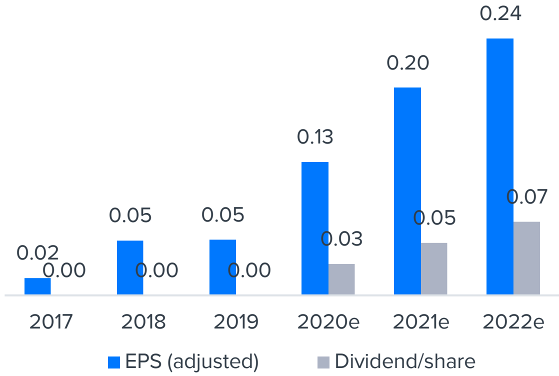
Source: Thomson Reuters

Revenue and EBIT %



Source: Inderes

EPS and dividend



Source: Inderes

MCAP
57
EUR million

EV
82
EUR million

EV/EBIT
15.3
2020e

P/E (adjusted)
23.3
2020e

Value drivers

- Success in product business
- Profitability improvement
- Improved visibility
- Organic and acquisition-driven growth
- Improved sales structure
- Improved cash flow and lighter financing costs

Risk factors

- Unsuccessful result turnaround
- Weak organic growth
- Unsuccessful acquisitions and R&D investments
- Relatively high gearing
- Uncertainty linked to rearrangement of financing
- Effects of the corona pandemic on customer demand and/or ability for deliveries

Valuation

- Share valuation is attractive from many angles
- We accept higher valuation indicators than sector average if the positive trend in products continues
- Sum of parts indicates higher valuation than currently for the share in light of the product business
- If Solteq's product strategy is successful there is still a lot of upside in the share

Contents

Solteq in brief

Solteq is a Nordic IT service and software solution provider that specializes in business digitalization and industry-specific software.

CAGR 9 % **Revenue growth in the 2010s**
Driven by 12 M&A transactions

1/3 & 2/3
Own software products and digital services in revenue

EUR 60 million **(+3.2% vs. 2019)**
Revenue 2020e

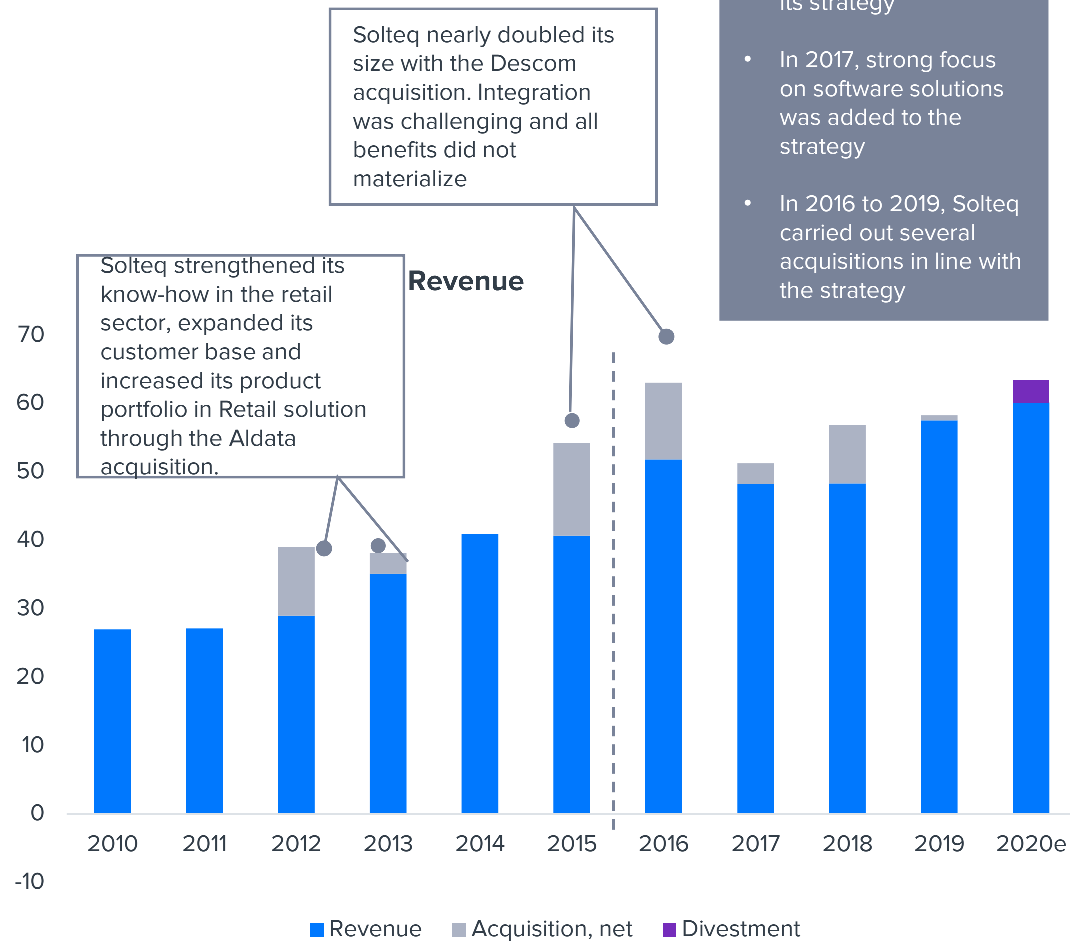
EUR 5.3 million **(8.9% of net sales)**
Operating profit 2020e

EUR 2.3 to 3.9 million **2018 to 2020**
Annual investments in product development (capitalized in the balance sheet)

594
Personnel Q3'20

14 offices in 6 countries
Finland, Sweden, Norway, Denmark, Great Britain and Poland

- In 2016, Solteq started to focus on internationalization in its strategy
- In 2017, strong focus on software solutions was added to the strategy
- In 2016 to 2019, Solteq carried out several acquisitions in line with the strategy



Source: Solteq / Inderes

Company description and business model 1/3

Company description

IT service company with own industry solutions

Solteq is a Nordic IT service and software solution provider. The company was established in 1982 and listed on the Helsinki Stock Exchange in 1999. Solteq specializes on business digitalization and industry-specific software. Solteq's services cover the entire life cycle of cloud-based IT solutions, from consulting on electronic business and service design to implementation and maintenance. The company has divided its business into two segments Solteq Digital and Solteq Software.

Solteq is known as an IT supplier in the retail sector but the company's solutions are also suitable for the manufacturing industry, the energy sector, and hotels and restaurants. In addition to Finland, the company currently operates in Sweden, Norway, Denmark, Poland and Great Britain. Solteq expanded to Norway and Denmark with an acquisition in 2018.

Solteq employs nearly 600 IT professionals. In 2020, Solteq's estimated revenue was EUR 60 million of which software solutions stood for around one-third and the service business for some two-thirds.

Transformation from a retail sector service company towards digital solutions and own products

In 2015, Solteq began focusing more strongly on digital commerce through the Descom acquisition that nearly doubled Solteq in size. In 2016, the company added an international growth element to its strategy. In 2017, the CEO was replaced and Solteq began boosting the transformation towards digital solutions and international growth. The company also wanted to diversify its customer portfolio beyond the retail sector. The biggest change from the new CEO was, however, focusing more strongly on the software and product business. In recent years, Solteq has invested some 5% of revenue on product development. Before his current job, CEO Väätäinen was a member of Solteq's Board since 2015 and a member of Descom's Board since 2009.

Solteq has accelerated the change towards digital solutions and software and expanded the customer portfolio with several acquisitions. The company has carried out 12 M&A transactions in the 2010s, 9 acquisitions and 3 divestments. Of these, 10 have taken place after 2016. Measured in net, Solteq has acquired an estimated EUR 50 million in revenue in the 2010s. Based on figures, Solteq has, however, struggled to integrate the acquisitions, especially the two large acquisitions carried out prior to 2017. Solteq has been more successful in integrating the two more significant acquisitions carried out after 2017, and these businesses have grown.

Solteq has conventionally been strong among retail sector customers. The revolution in the retail sector and the bargaining power of large customers have, however, depressed Solteq's development. The retail sector in Finland is highly concentrated and customers have adopted in-house value added IT services. Thus, IT service providers have had a smaller slice and produced lower value added services, which has been visible in Solteq's challenges in the 2010s. In recent years, the company has expended its customer portfolio and is less dependent on the retail sector. The company now seeks industries whose conventional operating models are being shook by the digital revolution.

Business model

From the beginning of 2020 Solteq divided its business into two segments that better corresponds with the company's business structure and earnings model, and that facilitates management. The new structure and financial reporting clearly improved transparency outside the company and depicts the divergent development of the segments.

There are not many clear connections or synergies between the segments. The service business includes a small unit that produces BI and analytics, which also produces services for Utilities customers. In the medium term, the main link between the segments comes from cross-selling. Solteq aims for Solteq Software's international expansion through Solteq Digital's international country presence. In the longer term, we believe the aim of the segments is to be completely independent and, thus, they could also be separated from one another.

Geographically, Solteq's focus is still strongly in Finland, where we estimate Solteq employs some 450 experts. Abroad in Denmark the company has 50 employees, in Sweden 20, a few in Great Britain, and some 70 employees in the "nearshore" unit in Poland. In the service business, sales and delivery mainly operates locally, but in Sweden delivery is supported from Finland and Denmark. Deliveries in Norway are made from Denmark and Finland.

Company description and business model 2/3

Solteq Digital - Service business

Solteq's digital services consist of online store systems delivered to customers, information management solutions and operative systems. The service business covers the entire life cycle of cloud-based IT solutions and includes consulting, implementation of customer systems, continuous development services and maintenance. Solteq has modified its digital service portfolio with acquisitions and sold non-strategic business activities. At the end of 2019, Solteq sold its SAP business.

In its service business, Solteq widely uses different third-party technologies, the key ones being Microsoft, AWS, HCL, Informatica and Magento. The competitive advantage of the service business is based on the company's long-term experience, especially in the retail sector.

Solteq delivers digital services primarily to large and medium-sized companies. The ideal customer size is around millions in revenue to which the company can deliver its entire life cycle offering. Solteq delivers the entire offering to medium-sized customers. To large companies Solteq usually delivers stand-alone solutions such as extensive online store solutions.

The nature of the service business has over the years shifted from large fixed price projects to large entities that have been split into several smaller hourly billed projects. This has lowered Solteq's risk profile, which also shows in the company's profitability. We believe a majority of the service business is currently based on hourly billing.

Our 2020 revenue estimate for Solteq Digital is EUR 42 million, which corresponds with good two-thirds of the group's revenue. In Q3'20, digital business, commerce and business systems formed 78% of the segment's revenue. The remaining 22% consist of data and analytics, as well as customer-specific tailored solutions. The EBIT % of the service business was at the sector average at 8% in Q1 to Q3'20.

Solteq Software - Software and product business

Solteq Software includes the business based on the company's own products. The revenue of the segment is mainly based on user right and maintenance fees from own products and related services, like integration and implementation projects. Solteq Software stands for some one-third of the group's revenue. Two-thirds of revenue is based on new cloud-based own solutions and includes implementation. The remaining one-third is mainly older continuous software and product business. Own products are currently primarily sold in Finland, but the company aims for international growth. In recent years, Solteq has invested heavily in new cloud-based SaaS product openings.

The main new and growing product areas that drive the company's revenue and profitability development in the medium term are 1) Utilities, 2) Retail and 3) Robotics. In Finland, Utilities and Retail solutions have progressed furthest in commercialization, while Robotics is still in a commercial pilot phase. The Utilities business grew strongly and represented together with the Retail business 63% of the segments activities in Q3'20.

The share of older businesses that are believed to have good cash flow is clearly under one-half. Next, we will review the main product areas:

The Utilities business offers cloud-based customer engagement systems and online services for energy sector customers. Solteq purchased this business in 2017. In 2020, Solteq was able to raise its previously stable market share when TietoEVRY ceased its own similar Utilities activities. Solteq responded well to the supply and has by Q3'20 reported EUR 22 million in new orders. Solteq's Utilities business currently has over 100 customers in Finland. The competitive advantages of the Utilities business are based on being cloud-based and compatibility with the new Datahub legislation. Last year, Solteq proved its solution is competitive also in large energy sector customers, which expanded the market potential of the product further. The clearest growth potential currently lies in Sweden, however, which is three times larger than the Finnish market and where the company is investing more heavily this year. Solteq already has one Utilities customer in Sweden. The product does not require much tailoring, only some tailoring must be carried out for large customers or in international sales. The sales cycles (some 12 months) in this business are long and thus one should not expect quick results. Typically, the contracts in the Utilities business are 5-year contracts but software typically continue for over 10 years as continuous subscriptions valid until further notice. Solteq's clearest competitors in this area in Finland are Hansel and Empower.

Company description and business model 3/3

The Retail business includes cloud-based CloudPOS cash register systems and the company's traditional Retail sector cash register and ERP solutions. The deliveries are continuous and scalable by nature. Solteq's competitiveness is best in small and medium-sized customers. Retail solutions are based on the company's long-term know-how in the retail sector, and have, for a longer time, proved their functionality commercially.

Solteq still has a relatively small number of customers that use the solution family more extensively and the company expects the cloud-based Retail solution to improve the competitive advantage and revenue growth. COVID has, however, slowed down the growth in this business. In Finland, the market for cash register systems is really big and so far, Solteq only has a market share of a few percent in these. The product still requires better recognition of Solteq abroad before the product can be expected to succeed internationally. In terms of the delivery model, the solution is fast and the sales cycle is from a few weeks to a few months. Once the "hardware" is delivered to the customer and has been hooked up, the software is installed from the cloud and the solution is ready to use. Thus, Solteq has much to gain in terms of efficiency through new products.

The Robotics business has an existing customer base in the retail sector and logistics in over 500 square meter stores, which is the area Solteq targets. Robotics solutions seek efficiency and cost benefits for customers, which depicts the company's price point. Robotics deliveries are highly tailored deliveries. If commercialization succeeds, the plan is that partners assemble the physical robots and deliver them to customers. For the customer, efficiency comes through working hours that can be clearly higher thanks to the robots. In addition, the customer gets access to the data and can thus make its operations more efficient. Solteq's competitive advantage against global robotics companies is tailoring and integration capability. To our understanding, robots will be sold through long RaaS contracts that include support and maintenance services. The company has invested heavily in robotics in recent years but COVID has slowed down the commercialization as the focus of the retail trade has shifted to online stores. In Robotics, Solteq has an ongoing commercial pilot with a smaller domestic retail chain. In our estimates, Robotics is still, however, an interesting option. In terms of the Robotics business, the company is currently pondering a possible spin off.

Our 2020 revenue estimate for Solteq Software is EUR 19 million or close on one-third of the company's revenue. Currently some 30% of the segment's revenue is continuous (ARR) revenue. Continuous earnings consist of user right, maintenance and support fees for software. The aim of the company is to increase the share of continuous earnings to 50% in three years.

In terms of profitability, we expect Solteq Software's operating profit % to have been 10% in 2020. The underlying profitability in the segment is, however, better depicted by the EBITDA margin due to high depreciation. Our EBITDA % estimate for 2020 is 22%.

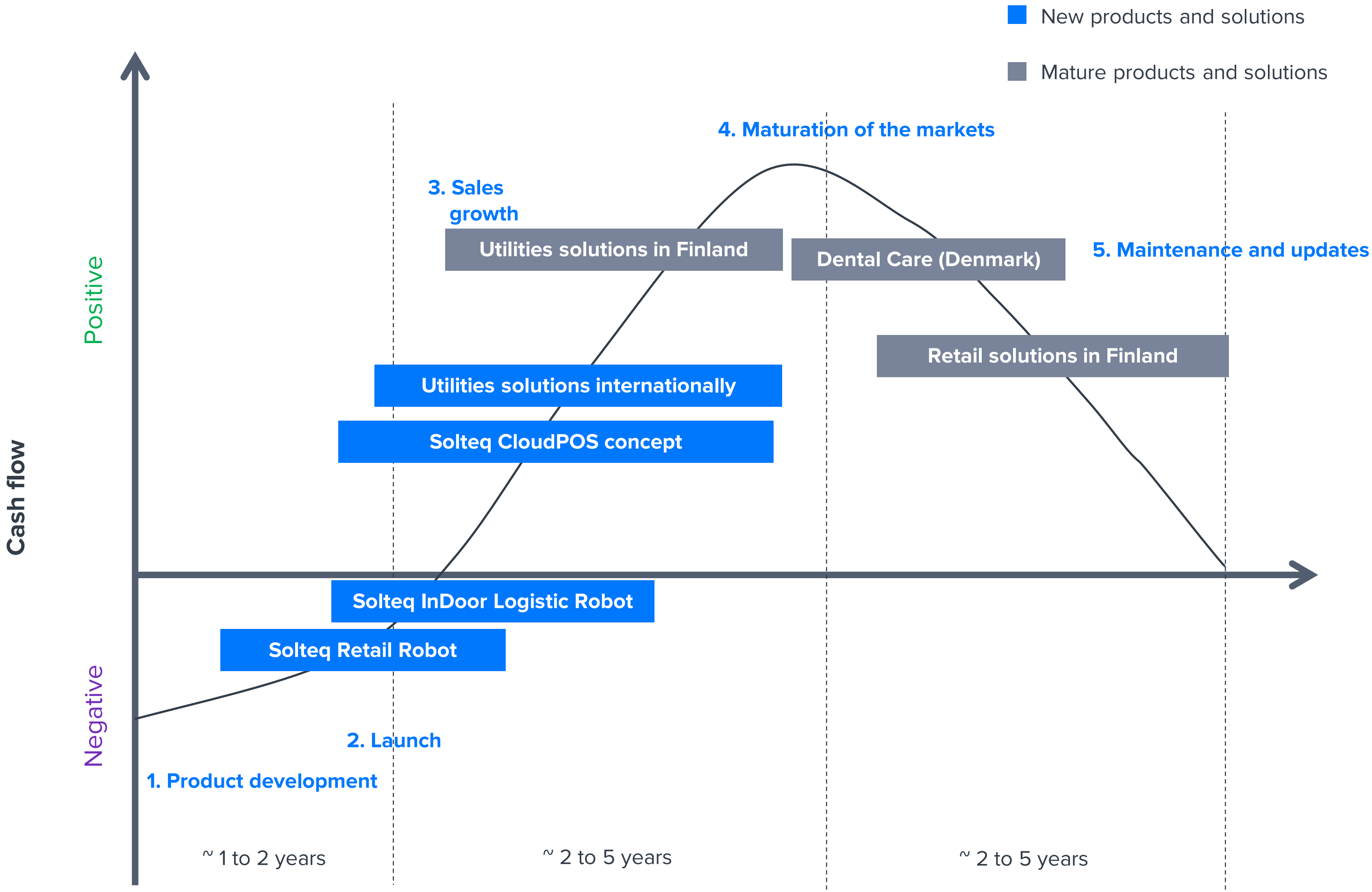
Product development

Solteq's product development strategy is built on the company's industry strengths and customers. The company has conventionally been strong in retail sector, manufacturing industry, energy sector and service sector customers. Thus, development projects are built around these areas and development often stems from customer needs. Development is carried out in cooperation with the customer, however, so that Solteq maintains IPR rights. In addition to Solteq's own development, the company uses subcontracting when necessary in some areas, like in robot assembly.

Over the past three years, Solteq has capitalized an estimated EUR 9 million of product development costs in the balance sheet or annually some 4 to 7% of revenue. In 2020, the company planned to capitalize EUR 3 million. We expect the capitalization to decrease gradually and the company's R&D costs to gradually transfer to the income statement. We believe the product development capitalization describes the company's willingness to turn more strongly into a product company. In the long term, the company says it will invest 10 to 15% of Solteq Software's revenue in product development.

To our understanding the largest investments, around one-half, have been made in the Robotics business and the rest in the Retail and Utilities businesses.

Life span of products and solutions



Source: Solteq and Inderes

Partners

Microsoft, Informatica, aws, Magento, HCL, IBM, Google, HubSpot, inRiver, Klarna., Paytrail by nets, zendesk

Technology suppliers and cooperation partners

Subcontractors, talent resourcers

Services

- BI & Analytics
- Digital experience
- Digital marketing
- Software development
- Integration services
- ERP
- Support and maintenance services
- Store, hotel and restaurant solutions and online stores

Products

New and large products:

Solteq CloudPOS
Solteq Retail Robot and InDoor Logistic robot
Utilities product family

Other products:

Dental Care in Denmark
Retail solutions in Finland

Business idea

Solteq is a Nordic IT service and software solution provider that specializes in business digitalization and industry-specific software.

SOLTEQ

- Business divided into digital and software businesses
- Strong investments in own software solutions
- Traditionally a strong IT supplier for the retail sector
- Established position on Finland's IT service market
- International growth potential especially in software solutions

Long term estimates

Solteq Digital's growth ≥ 5 % and EBIT % ≥ 8 %

Solteq Software's growth ≥ 20 % and EBIT ≥ 25 %

Competition

IT generalists: accenture, tieto, CGI, digia, SOLTEQ, GOFORE

Agile software developers: futurice, Reaktor, INNOFACTOR, VINCIT, BILOT, idean

Customer sectors

- Manufacturing
- Retail sector
- Service sector
- Energy sector

Cost structure

598 employees (2019)
EUR 55 million (2019)

- Personnel costs *(67% of costs)*
- Materials and services *(10%)*
- Other operating expenses *(16%)*
- *Depreciation* *(7%)*

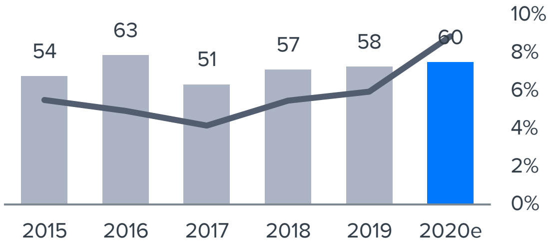
Income flow

Revenue EUR 58 million
EBIT (adjusted) EUR 3.5 million (2019)

Digital and software business

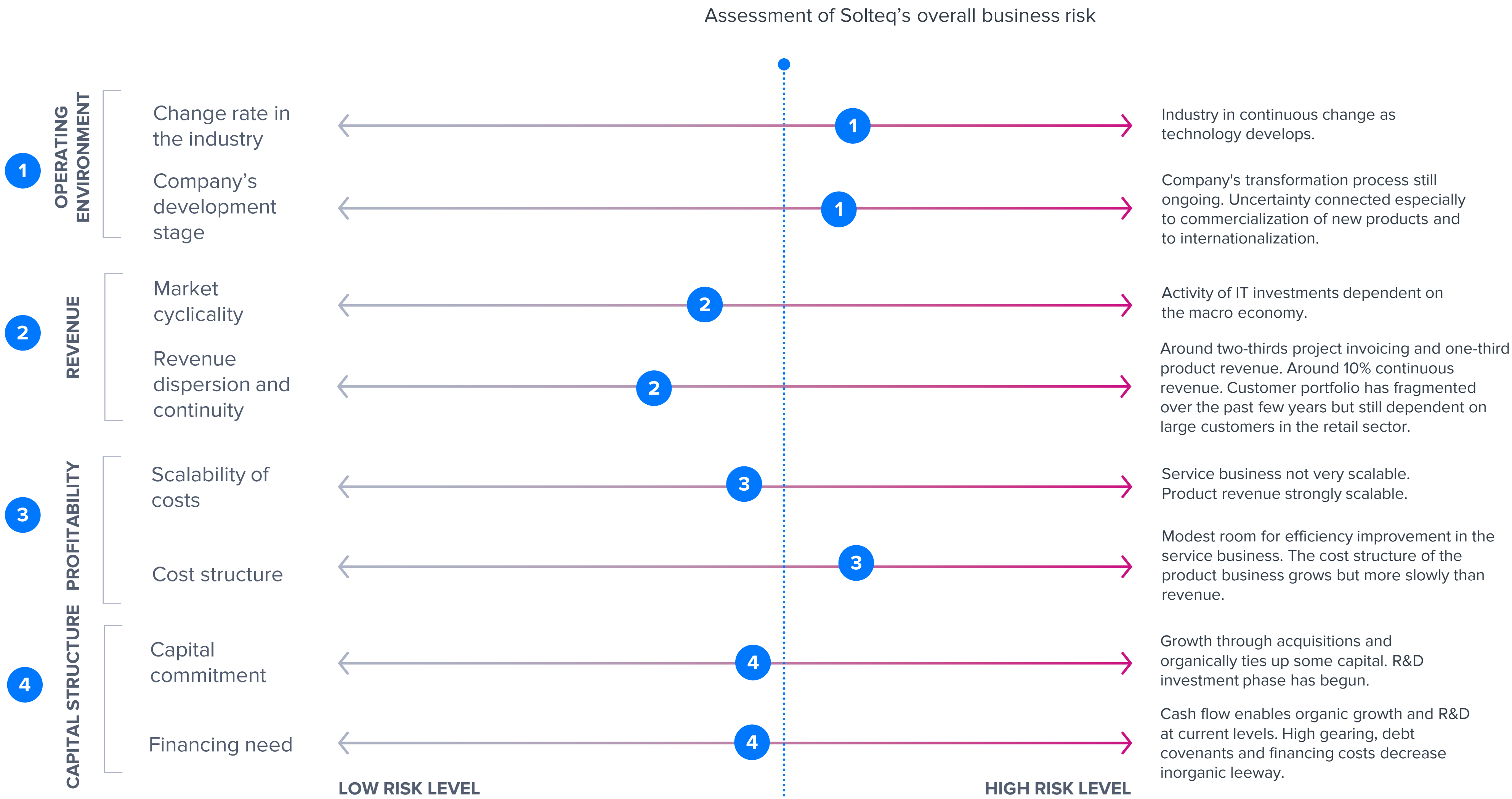
71%

29%



Source: Inderes, Solteq

Risk profile of the business model



Source: Inderes

IT service markets 1/5

Market size and definition

According to IDC, the size of the Nordic (Sweden, Norway, Finland, Denmark) IT service market was USD 24.4 billion in 2018. IDC has estimated that the Nordic market will grow by an average of 3.2% annually to USD 29.5 billion by 2023. According to the conventional definition of IT service markets, the market includes areas like IT consulting, software development services, integration and implementation services, outsourcing services, software maintenance and support, and IT infrastructure services. The IT service market and the definition of its euro-denominated size is becoming obscure as the role of IT and technology is becoming part of the operational core in various industries as a result of digitalization. Thus, the operating field of IT service companies crosses paths with new parallel markets that have not conventionally been considered part of the IT markets. These include, for example, strategy consulting, change management, design and service design.

Long-term growth outlook of the market

The digitalization of society requires a huge number of hands to build, integrate and maintain new applications, which leads us to believe that the long-term demand fundamentals of IT consulting companies are strong. Therefore, IT service companies offer investors a good chance to invest in the digitalization trend with the more limited risk profile of the service business. One can expect the market to grow more quickly than the macro economy in the long term.

Solteq has grown by an average of 9% per year in the 2010s. Organic revenue has been depressed by the revolution in the retail sector and acquisitions have supported growth. The change in Solteq's strategy and structure that has been shaped through acquisitions started generating result last year when the business started growing organically.

Effects of COVID and current market outlook

The corona pandemic causes a speed bump in the highly favorable cycle that has lasted for five years on the IT market. One could say that the market was overheated before the pandemic, especially in terms of the competition for talent, which means a slight stabilization is healthy for the market.

The corona pandemic affects the IT market through the weakening macro economy. The development of companies in this sector has so far been primarily good as existing projects have continued and organizations have easily adapted to telecommuting. Profitabilities have been strong nearly throughout the industry thanks to lower cost structures due to the coronavirus and reorganization measures. Negative effects have mainly been seen in customer industries that have suffered immediately from the situation, and in companies that focus on project business. In the public sector, existing budgets support demand and new large projects have been launched also during the pandemic. In our opinion, the situation already seems far better than in spring. There is naturally still uncertainty connected to 2021 but, as a whole, the sector will survive the COVID year with only small scratches.

According to an estimate by TietoEVRY, the IT markets will decline by 3 to 7% in 2020, which in our view is a pessimistic estimate in light of Finnish listed companies. As a whole, COVID did not affect Solteq much. COVID has, however, slowed down Retail solutions and especially the commercialization of robotics solutions.

When looking beyond the pandemic, we believe the growth fundamentals of the IT market will strengthen as the situation forces customers to invest in electronic business. For many customer organizations, the pandemic is probably the last push for a digital transformation, which for years remained a buzz word.

The pandemic also changes the working methods and cost structure of IT service companies. We believe that looking past the pandemic, especially network-like working methods and use of nearshore resources, will become more common. This improves Finnish companies' preconditions for internationalization on Central European markets where companies' digital maturity is clearly lower than in the Nordic countries. In addition, the efficiency of companies in this sector is supported by smaller office needs and lower travel costs.

Changing nature of IT investments divide the market

The continuously strengthening digitalization revolution launched a new era on the IT markets in the 2010s, which has redivided the market and generated new ways to operate on the market.

IT service markets 2/5

Thanks to the digitalization revolution IT purchases are changing, which requires IT companies to have the ability to adjust their offering constantly. In the 2010s, a shift was seen on the market towards IT investments that create new business and differentiating factors when the quest for cost efficiency was no longer enough in the competition. This means that the IT buyer is often a business unit or product development not data administration or support function. The desired expertise areas are increasingly linked to new digital services and less to background systems. The market revolution created a strong growth opportunity for many players that were born in the new era (like Futurice, Solita, Reaktor, Siili, Gofore and Vincit) that through their offering have profiled themselves as developers of new digital services.

Conventional players were initially slow to adapt their offering and culture to better correspond with the changing purchasing behavior and demand for service areas.

The change on the IT service markets in the 2010s can be illustrated in a simple way by dividing the market into new digital services that grow strongly and into the faltering traditional software system development. Dividing the market in two is, however, becoming irrelevant, as new digital services cannot be discussed separately from the core business systems.

A clear trend on the market now is that IT purchases become more serious as the customer organizations have realized that you cannot get a short cut to digitalization by buying digital applications bypassing data administration. Organizations' established data systems will not disappear, but they must be modernized to work as platforms for new digital services. IT investments are directed at new functionalities that are built with interface solutions on top of existing systems. Correspondingly, this trend has restored competitive advantage to more "conventional" players, while many, primarily digital service developers that have succeeded by acquiring talent, have faced clear challenges in recent years and have been forced to reassess their strategies. As a result of increasing digital maturity in customer organizations, they have also become more demanding buyers and active in building their own software development teams.

As a result of the above-described revolution, the IT service market has undergone a considerable change over the past 10 years. Over the coming 10 years the change rate on the market will accelerate further and due to the complexity of technology and rapid development, it will become harder for companies to predict change. Thus, we believe that the ability of the companies in the sector to react and change will become increasingly important.

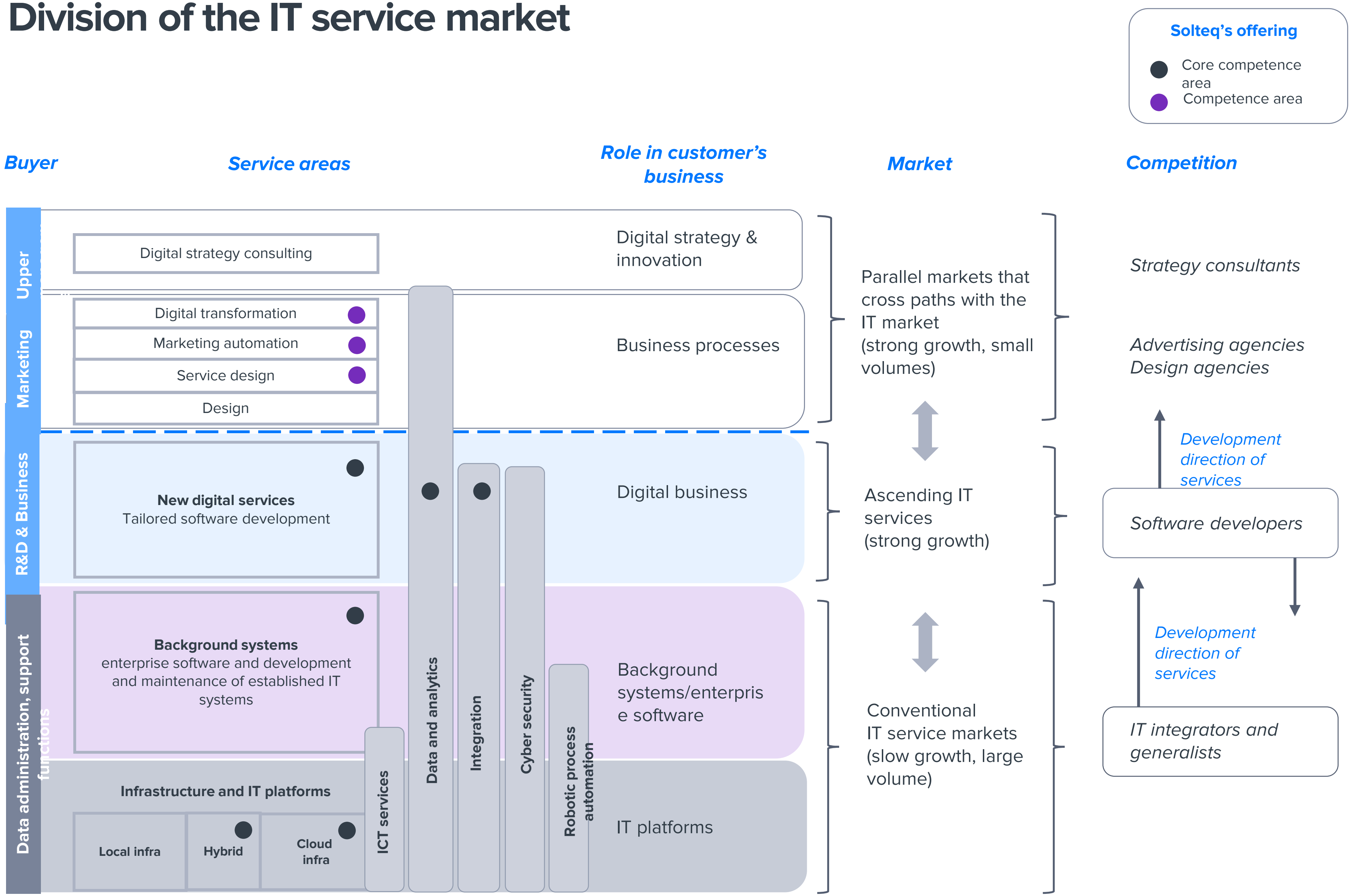
Internal division and development direction of the market

We have divided the IT service markets into three sections (page 14) as follows:

1. **Market for new digital services**, that includes development of new digital services (tailored software development). This has been the strongest growing area (our estimate >15%) on the markets that was practically born only in the past good five years. Well-known players on the markets are, e.g., Reaktor, Futurice, Nitor, Bitfactor, Siili and Vincit, in addition to which large IT generalists have also started investing in this area but have been late to the game. Characteristic for this market is a low threshold to enter the market.
2. **Market for background IT systems and enterprise software**, that includes ERP extensively and related systems covering primarily delivery, tailoring, integration and maintenance of firmware. Known players on this market in Finland include, e.g., Innofactor, Enfo, Solteq, Digia, Sofigate, eCraft, Bilot and IT generalists in particular (such as TietoEVRY and CGI). Market growth has been slow in this area and a high threshold to enter the market is typical for this area.
3. **Market for IT platforms**, that mainly covers infrastructure services (local, hybrid and cloud) and ICT outsourcing. This market has mainly been the strength of IT generalists (like TietoEVRY, Fujitsu) and the threshold for entering the market is high because the market has required benefits of scale and investments. As a result of the cloud revolution, a redistribution of the market is ongoing that has generated new quickly growing players (like Nordcloud) and many medium-sized IT consultants (like Gofore, Siili and Enfo) are also entering the field. This market has rapidly shrinking (local infra) and drastically growing (cloud platforms) areas.

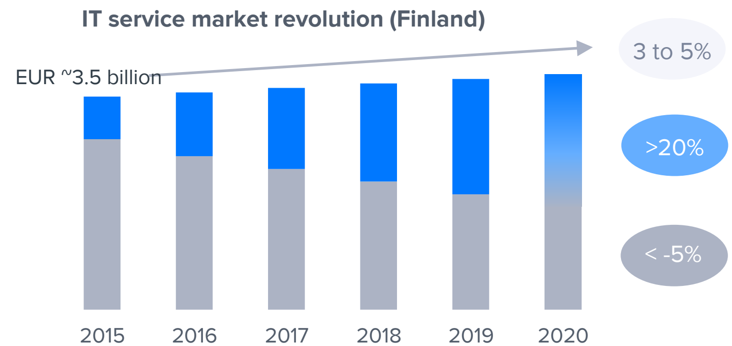
Cross-cutting service areas of these three markets are, for example, data and analytics, integration, cyber security and robotic process automation.

Division of the IT service market



Source: Inderes

Markets and value chain



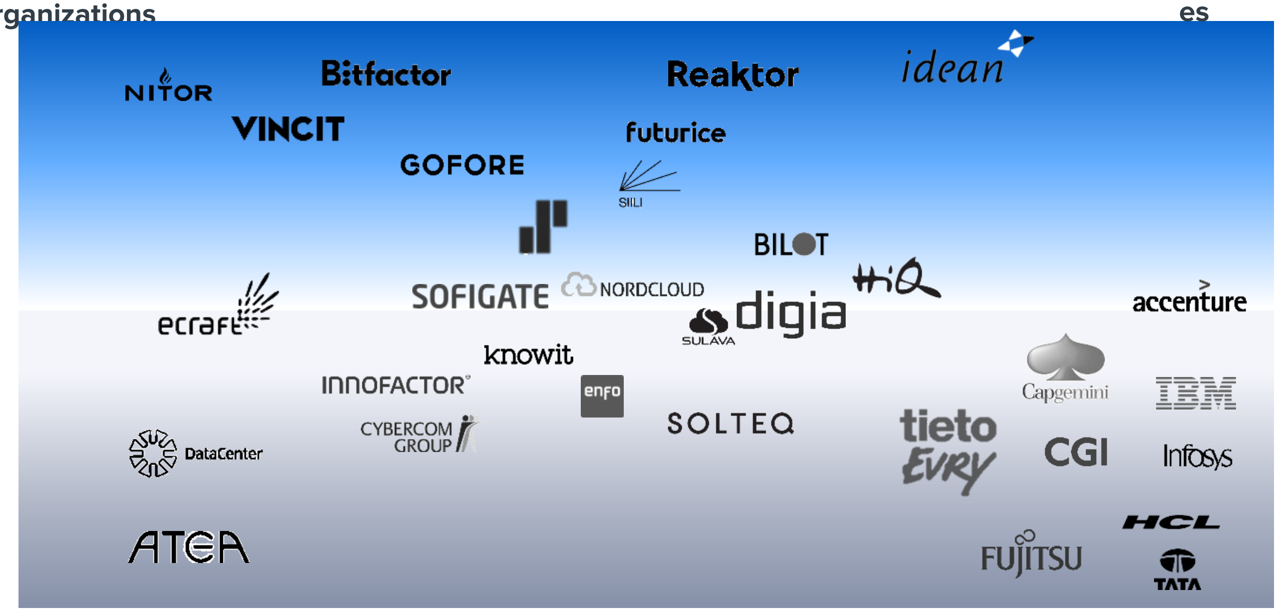
Positioning of IT companies on the Finnish market by main target group and service area

Local competition | *Nordic competition* | *Global competition*

Medium-sized organizations ↔ **Large organizations** ↔ **Global conglomerates**

■ **New digital services**

■ **Maintenance & conventional IT system development**



Strong growth, short order book

Slower growth, strong customer maintenance

Source: Inderes

IT service markets 3/5

In recent years, the most visible trend on the market has been IT players striving to win over customers already when digitalization projects are being planned (digital consulting, service design and design), as selling one hour of design work has translated into selling multiple hours of software development work. Many players seek a stronger position in the value chain by strengthening their consulting service expertise, in which case the IT supplier manages the projects and resources and does not merely deliver them. This trend has been visible as several acquisitions on the market. In addition, many IT consultants try to expand into strategy level consulting, granted with varying degrees of success.

Another clear trend for the players in this sector is the life cycle approach, as many new players now try to build the ability to offer software maintenance as well. Customers' purchases are also strongly shifting from software development projects towards continuous software development. Common for the strategies of all medium-sized and large players is also a strive towards the position of a more business critical partner for the customer. The know-how and offering of small software developers does not in this case reach deep enough into the customer's IT systems and processes. This development may accelerate market consolidation.

We believe the Finnish IT service market is now more strongly developing in a direction where the paths of conventional and new players cross and the boundary between "new" and "conventional" IT becomes blurred.

Background system expertise is making a comeback

The strongest demand on IT markets has for years been in developing digital services and in software development that is still quite experimental by nature. According to our view, the market has, however, moved to a stage where one must be able to integrate new digital services and related data more tightly with the customer's background systems in order to get full benefits from the new solutions. Customers also have increasing needs to modernize their background systems because an old ERP system may act as a break for the development of digitalization solutions. Thus, the nature of the ERP market that has suffered from slow growth for a long time will change, and the and the market is picking up. The importance of integration and data expertise also becomes emphasized.

This development has offered a growth opportunity from Solteq's viewpoint and positioned the company in an interesting position on the markets, as the company's background system and integration know-how especially in the energy sector and retail sector is strong. At the same time, the competitive field is clearly more established in this area, even though many IT players born in the digital era are currently trying to expand their offering and build integration abilities. The threshold for entering the market is, however, high and customer relationships are well-established, and it is hard to build these abilities, which brings competitive advantage for Solteq.

COVID shifts competition from experts to customers

Strong demand and the competition for talent it has generated has, over the past five years, emphasized culture and recruiting know-how as a competitive factor on the IT markets. The winners in this trend have clearly been small and agile players that often stand out through their culture and organization model. Such players include, e.g., Vincit, Reaktor, Futurice, Solita and Gofore. Manufacturing has also become increasingly active in competing for the same talent, which has tightened the competition further. Now, as a result of the pandemic, the market has shifted more towards a situation where the competition is tightest for customers' orders instead of for talent. This changes the market's competitive nature in the short term even though the competition for talent is likely to continue for years in the big picture. This can alleviate the availability of talent and cost inflation but tighten price competition.

Cost inflation and pricing environment

In general, the pricing level for the IT sector is on a healthy base but a weakening economic situation can later lead to price pressure. Based on discussions with various companies, wage inflation has been close to 5% in 2018 to 2019. Based on the companies' comments, accelerated cost inflation has not been fully carried forward to prices because long-term framework agreements often makes it difficult. This has depressed companies' profitabilities in recent years. Despite the weak economic outlook there has been relatively few cooperation negotiations announced in the sector since the start of the pandemic, and these have primarily only resulted in temporary layoffs. Slightly tightening price competition is compensated by cost inflation easing off. TietoEVRY commented in December that wage inflation had been at the lower end of the 3 to 5% range in 2020, and the company expects it to rise slightly in 2021.

IT service markets 4/5

Acquisitions and consolidation

Consolidation of the IT service sector was active throughout the past decade. It has been typical for the sector to patch up shortcomings in strategic expertise areas with acquisitions.

Many players have strong cash positions and acquisitions are part of their strategy. When the pandemic broke out, all acquisitions halted but there have been signs of more activity in the autumn. The pricing of the companies in the sector has increased over the past five years and this high pricing has also spilled over to the unlisted side. Valuations that have risen close to that of listed companies weaken buyers' preconditions to carry out acquisitions that create shareholder value. Thus, the recipe that was highly efficient five years ago, where listed companies bought unlisted companies with lower valuation utilizing their own shares, no longer works as well.

We believe that acquisitions were on ice during the uncertainty caused by the pandemic due to large differences of opinion between buyers and sellers. Now visibility is better thanks to the effects from the first wave and the coronavirus vaccine, which has relaunched acquisition activity in both smaller and larger size classes during autumn.

Foreign players are also looking for acquisition objects in Finland, which increases the consolidation pressure in the sector. From the viewpoint of international investors, Finland is interesting because of an exceptional market of medium-sized digital service developers and the expertise of these players.

As the market for digital service development is becoming more mature and the various areas of the IT market become integrated, a broader consolidation is likely as was seen in the Tieto and EVRY merger. An interesting scenario could be the merger of two medium-sized players into a stronger player to challenge the large generalists. In terms of Solteq's value creation over the next 10 years, being successful in the product business is, however, key.

Future winners on the market in our view

The clearest winners on the IT markets in the past five years have been companies specialized in developing new digital services that have been particularly successful in the competition for talent. The market for digital services has now reached a clearly more mature stage and the next round will be outside pure talent competition. In our view, the sector's success factors change and the winners in the next five years will be:

- The owners of strong customer relationships with a strategic partner role among customers, the ability to manage large IT projects and scale operations through a strong subcontractor network. Small players that hold the role of subcontractor and that have focused more on talent competition that on customers are weak when the macro market weakens.
- Companies with strong integration and background system expertise and the ability to provide maintenance and continuous services. Strong maintenance players are also strong when the market weakens. This is the weakness of many medium-sized digital service developers.
- Companies that are able to build a dynamic organization model that has the agility to react to a rapidly developing market. Many companies in the sector suffer from inefficient and inflexible, hierarchal and silo-like organization structures, which makes renewal difficult when the market changes.
- Companies that maintain a clear strategic focus. Several companies in the sector suffer from growing pains as they are unorganized after the rapid expansion.

Market trends

Trends in organizations' IT purchases

According to our view, the digitalization revolution will drive customers' purchasing behavior towards the following trends, where there are both winners and losers:

Large, multi-year high-risk ERP implementation projects (SAP, Oracle, IBM) are no longer carried out and the nature of this market changes. Established ERP systems will not disappear from customers, but they will remain in maintenance mode by existing IT suppliers and they will be moved to the cloud. Companies invest in modernizing ERP systems so that they do not become a bottleneck for digitalization projects. Generalists dependent on large projects have been the losers. Smaller players that have integration expertise are often the winners.

IT service markets 5/5

Buying IT as large projects will decrease and move towards smaller, iterating processes and continuous development. Slowly reacting project organizations are the losers. Players that have expertise in agile software production, the ability to manage the services of several suppliers, and the ability to generate continuous services are the winners.

As business-oriented purchasing becomes more common, IT companies will seek new value production based, more scalable pricing models in order to break their business model away from poorly scalable sales of expert resources.

IT investments shift from investments that make the customers' business support processes more efficient towards core business processes or investments that improve the end product itself. Players that have conventionally served business support processes and ERP stakeholders are the losers. Developers of new digital service with technological know-how, expertise in background systems and business savvy are the winners.

Ownership of customers' IT budgets becomes blurred and moves from a CIO role more towards the role of business directors and marketing. Players that understand the customer's business and industry are the winners.

The IT market still does least of what is talked about most. The volume of services related to the biggest hype terms (AI, VR, AR, IoT, NLP, etc.) is still small on a sectoral level. These are, however, likely to create considerable service areas over the next five years.

User orientation and the customer experience continue growing. Rising areas include, e.g., digital service design, design and customer experience. Know-how in these areas will become the biggest competitive factor when selecting IT suppliers. Many players have patched up this area through acquisitions. Small, creative, design-centered players have been the winners.

The cloud revolution redistributes the markets. Customers' IT operations are moved to the cloud at an accelerating speed due to the benefits, and because it is often a precondition for new digital business models. Players with strong cloud technology expertise are the winners. The big losers are players in conventional local IT infrastructure.

Conventional reselling of software licenses moves to the cloud and software companies try to take over a larger share of the value chain when moving to SaaS models. License commissions of software resellers have decreased in recent years. Players that are dependent on license reselling are the losers. Customers are the winners.

Customer organizations becoming silo-like will be a challenge for IT company sales. In addition to data administration, the IT buyer is increasingly marketing or product development, but building of a digital business requires cooperation between these areas and the ability to manage the whole. Players that manage large entities and who can address the customer's management and marketing are the winners.

Data and analytics are again becoming one of the hottest trends on the market. Data is becoming a strategic competitive factor in several industries and the precondition for future AI solutions. The challenge for customers is to combine data from silo-like data administration throughout the organization also to marketing and business management. IT companies that have a combination of understanding in analytics, machine learning, and business are the winners.

The importance of cheaper offshore resources as a competitive factor will diminish further as it is hard to generate new digital services reliably, fast enough and cost efficiently with offshore resources located on another continent. Robotic process automation further weakens the competitive advantage of cheap labor. These trends will bring back the competitive advantage based on costs in IT expertise from Asia to Europe. Players whose competitive advantage has been based purely on offshore cost efficiency are the losers. Players who can combine local presence near the customer with sufficient cost efficiency by utilizing nearshore and/or offshore resources proportionately will be the winners. Robotic process automation experts are also among the winners.

Competition 1/2

Competition and peer group

IT generalists and specializers as competitors

Finland's IT service markets of some EUR 4.0 billion is divided between large international generalists (e.g. TietoEVRY, CGI, Fujitsu, Accenture, CapGemini), some 20 medium-sized players like Solteq with net sales of around EUR 20 to 100 million, and numerous small players. We estimate that generalists represent over EUR 2 billion of the market, medium-sized players over EUR 1 billion, and smaller companies with less than 100 employees the remainder of the market. In an international comparison, the Finnish market is characterized by a strong medium-sized players' market.

Solteq's competitors are large, often international IT generalists and smaller software developers. Of the generalists, CGI is faced clearly more often than TietoEVRY. Of smaller software developers the most common competitor the company faces is Digia that also has strong background system and Microsoft know-how. Solteq does not have an extensive group of medium-sized competitors typical for an IT service company due to the company's strong focus on the retail sector. Depending on the product area and the customer's size class, the company competes with small, specialized players or international IT generalists. Among large retail sector customers, Solteq also competes with the customer's own internal IT. When trying to grow into new product areas that are internationally large the company will also face new local players.

Differentiating factors of conventional players

The strength of IT generalists in the competition is extensive resources and a wide selection, which is often supported by offshore production and its cost efficiency. In addition, they often have deeper understanding of customers and the industry than smaller players. These players that are strong in background systems are often well-established among their key customers, and the systems are business critical for the customers, which gives them a competitive advantage. In addition, system deliveries are often challenging and high-risk projects, which raises the threshold of market entry.

Typically, IT generalists have developed their customers' IT systems for over a decade and a big chunk of customers' IT budgets go to the maintenance and development of these existing old systems. This, combined with these players' insightful contract structures, secures the position of large IT companies in the competition. Despite wide-spread criticism, the position of large IT generalists on the market is well-established and they have also shown ability renew themselves alongside the trends on the IT markets.

Differentiating factors of small players

Small players often break into large customers through some other buyer than data administration, which means they may not be competing against the customer's established system supplier. These players typically stand out in competition by their agility, better service or expertise in specialization areas. In addition, their ability to change and react to the changes on the IT markets is often better. Small size can be a benefit when the customer needs creativity, speed and agility in a project.

Competition 2/2

Growth and profitability of the peer group

The figure on page 2 examines the growth and profitability of listed and unlisted Finnish and other Nordic IT service companies.

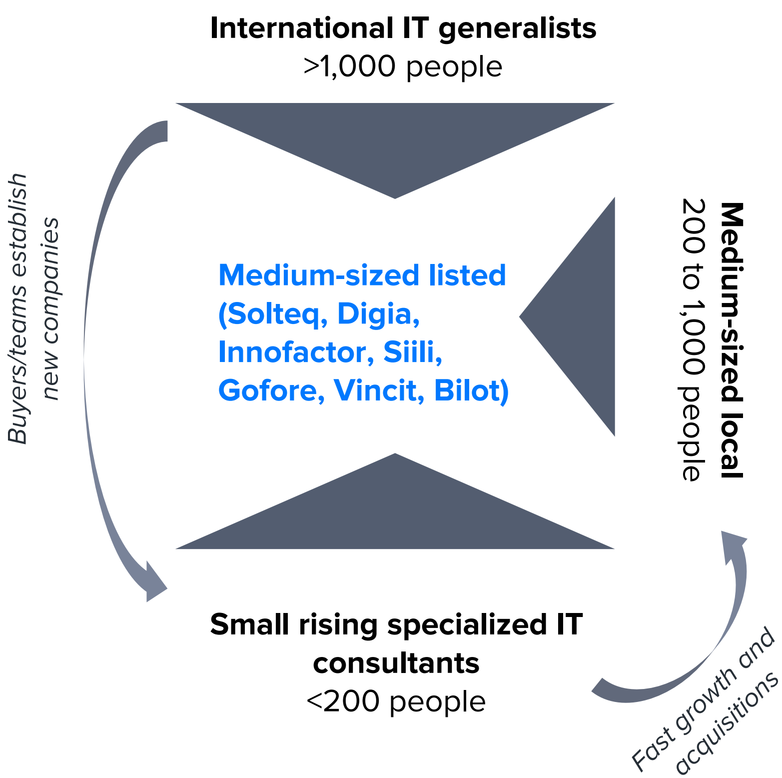
The annual growth of the peer group has been 18% on average in 2015 to 2019, **which is explained by market growth, rapid organic growth of several small players, and acquisitions between several players.** The companies that have grown most strongly have expanded both through acquisitions and organically. Strong organic growers have been Vincit, Siili, Solita, Futurice, Gofore and Reaktor, and in recent years also Digia. Solteq has accelerated its growth with several acquisitions. On the other hand, Solteq has also divested business operations. Growth has been slowest for the largest players that have suffered from the market revolution (like TietoEVRY, CGI, Know-IT).

When examining growth, you can see that small, specialized players have clearly reached the fastest growth on the Finnish IT markets. This reflects the faltering of the demand for conventional system development, and IT demand focusing on new areas to which smaller and more agile players have been able to respond more efficiently. Over the past few years many formerly small and agile players have grown into a relatively larger size class and maintaining the growth rate is becoming more challenging, which was visible as slowing growth in 2019.

In terms of profitability, the average for the peer group is 10% measured by EBITDA % at an annual level in 2015 to 2019 (2014 to 2018 11.5%). Solteq's profitability has been slightly below the levels for the sector. On average, the profitability of the companies is on a healthy level. The IFRS-16 amendment raised the EBITDA % of companies using IFRS accounting by some 1 to 3 percentage points for 2019 (more moderate effect when examining averages). This weakens comparability with the period preceding 2019, and especially with companies using FAS accounting. In the IT service sector, we have considered an EBITDA level of over 10% to be a good profitability level (excluding the IFRS-16 effect). Companies should not be satisfied with single-digit profitability levels. Large generalists Tieto and CGI have generated good profitability despite slow growth, which is based on their strong market position and software business.

By comparing the combination of profitability and growth over the past few years, a few players stand out above the rest. The star players are Eficode, Futurice, Reaktor, Gofore and Vincit. On the Swedish market, the clear winner is HiQ that has been able to revise its business model to respond to market trends. Capital investor Triton acquired HiQ last year.

Solteq's competitive pressure



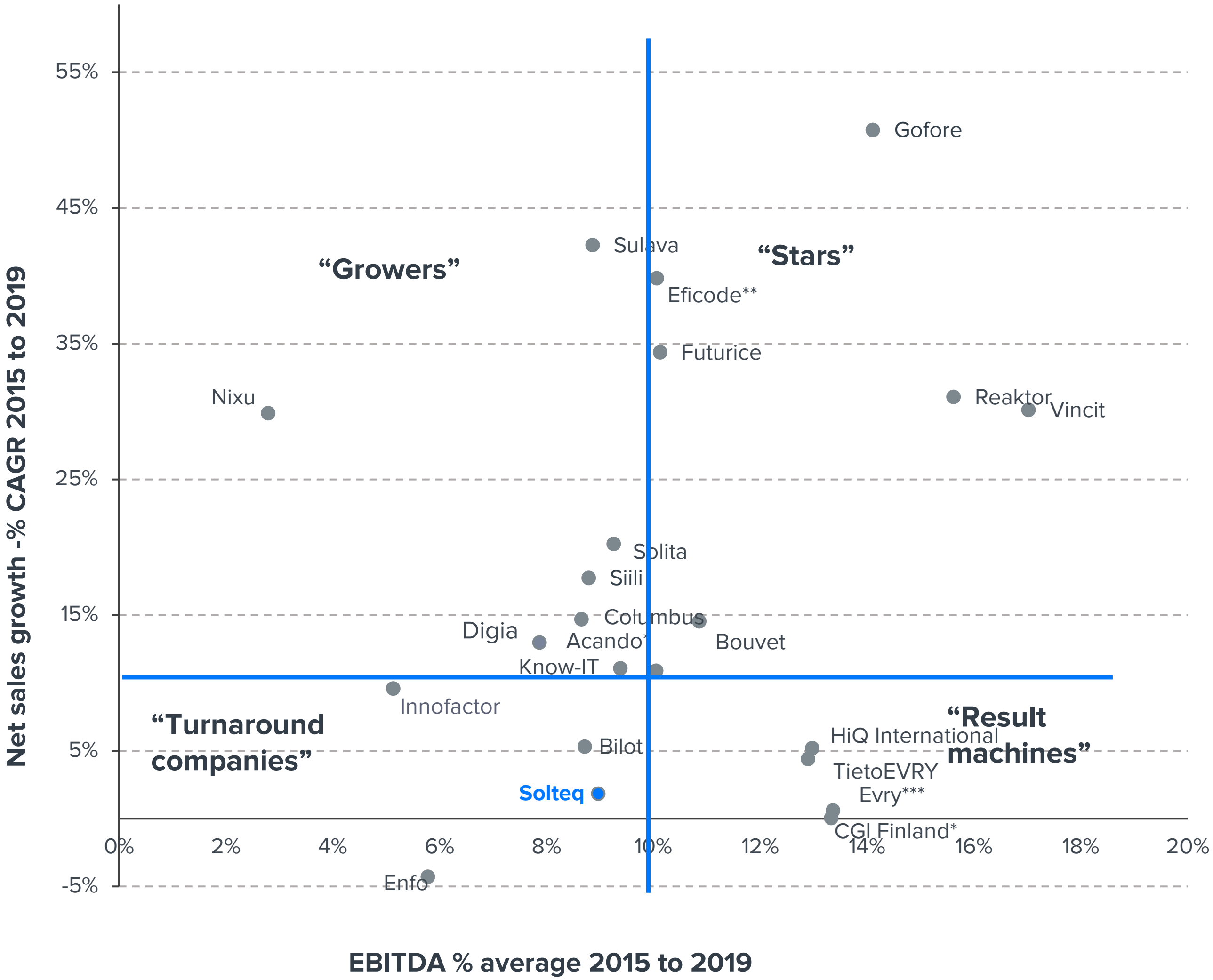
Solteq's strengths

- Strong retail and energy sector focus that supports the service and product business
- Ability to deliver projects that cover the entire IT life cycle vs. small players
- Industry-specific software, in small and medium-sized customers
- Nearshore capacity, compared to other medium-sized and small

Solteq's weaknesses

- Narrower offering vs. generalists with extensive offshore resources, extensive offering and ability to deliver large high-risk projects
- Several small players as challengers, several service areas have a low entrance threshold
- Industry-specific software, in large customers
- Still relatively focused on the retail sector even though headed for better

Development of the competitive field



Stars are the forerunners on the market that have reached strong growth and profitability. These are primarily small and agile players that have positioned themselves and invested in growing areas of the IT markets and operate with a light organization structure. These are often more business-oriented than players serving data administration.

Growers are primarily companies that have reacted to the market revolution but due to their growth investments their profitability has been lower than average. Many have accelerated growth with acquisitions.

Result machines are companies that have a strong hold on existing customers, for example through tailored software solutions, which means that they have reached good profitability despite slow growth.

Turnaround companies are primarily "conventional IT" companies that are in transition or they have not been fully capable to adjust to the IT market revolution.

Source: Inderes, companies and Asiakastieto
*2014 to 2018, **2015 to 2019e and *** EVRY as independent
Figures include the IFRS-16 amendment for 2019

Strategy 1/ 2

Own products and internationalization at the core of the strategy

The aim of Solteq's strategy has for years been internationalization. Over the past 5 years, the company has boosted its internationalization with several small acquisitions. In 2017, when the current CEO started the company began to invest heavily in selected industry-specific software. This transformation has lasted for several years, but the first signs of positive development both in terms of revenue and profitability were seen last year.

In terms of its business structure, Solteq tries to increase the share of cloud services and continuous services in turnover. Cloud services and related work is one of the fastest growing areas on the IT service market. In the service business, and especially in the software business, continuous revenue is valuable and reduces the risk profile.

From a technology viewpoint, Solteq is not specialized on a particular technology. Solteq widely uses third-party technologies, the key ones being Microsoft, AWS, HCL, Informatica and Magento. The company also decided not to focus on SAP technologies and sold this business at the end of 2019.

Solteq focuses on service areas and products where the company can be a major player or develop into one. In Finland's service business this means over 100 people. If the company cannot grow into a major player, the business can be divested as the SAP or MainioIT divestments have shown.

The key themes of Solteq's strategy remain unchanged and the company's focus areas for the next few years are:

- International expansion
- Development of and investment in own products

International expansion

In the past three years, Solteq has expanded internationally to Denmark, Sweden, Norway, and Great Britain with acquisitions. In terms of international growth, the company now has small service business units in the Nordic countries on to which it can start building its business. In addition to the service business, Solteq's strategy is to start selling, in particular, its own industry-specific software internationally.

In terms of Solteq's products, the Utilities business is the most potential international growth driver in the short term. As a result of long sales cycles, stronger international growth can only be expected starting from next year. Retail solutions are adaptive to various customer needs and it is a good basis for internationalization. Replicating the success of Finland requires work and company recognition, which must be built separately on each market.

Geographically, the main focus of Solteq's internationalization lies in Sweden in coming years. The second potential market for a stronger sales focus is Denmark.

Internationalization has been in the focus of Solteq's strategy for several years. International growth has, however, been difficult and looking at the numbers, the acquisitions have not generated the desired development in 2016 to 2018. In 2019, the International operations turned to a stronger growth path, which unfortunately was later slowed down by COVID. We feel the bright spot in the International operations has been the Polish "nearshore" unit that has grown from 20 employees to the current 70 employees.

Own products strategy

Solteq is happy with its current product portfolio and no direct new product openings are on the horizon. The company will focus on further developing current product families and on new products that support existing product families.

Solteq's existing own products that are in a commercial phase stem from the company's long know-how in the retail sector (Retail) and from acquisitions (Utilities). We believe Solteq's growth strategy focuses on increasing the market share in Finland and expanding in Sweden. In terms of the Utilities business, growth is more limited in Finland due to the good market share, but success in Sweden would create a considerable growth opportunity.

Solteq has independently developed its Robotics business from the start and it is also the company's largest investment. In Robotics, Solteq primarily targets retail sector customers and, as the market matures, solutions can also be offered to other industries. The solution is easy to tailor, which increases opportunities when the market is mature. Solteq's strategy in robotics is to deliver the "brains" of the project itself, while a subcontractor delivers the assembly and the actual delivery. Solteq also helps the customer in, e.g., data utilization and improving operational efficiency.

Strategy 2/ 2

Financial objectives

Solteq's objective is to grow profitably in both business segments. Segment-specific objectives:

- Solteq Digital growth ≥ 5 % and EBIT % ≥ 8 %
- Solteq Software growth ≥ 20 % and EBIT ≥ 25 %

The objective of Solteq Software is also to increase the share of continuous earnings from 30% to 50% by 2023.

We believe Solteq Digital's growth and profitability objectives are very realistic. The growth only reflects slightly faster growth than the market in general and the company managed to reach higher growth than the objective in the first nine months of 2020 despite COVID. The profitability objective reflects average sector levels and Solteq's profitability was above the targeted level in Q2 to Q3'20.

We feel Solteq Software's target is ambitious but achievable. The trend in the segment was positive last year and we estimate that revenue has grown by ~10% and operating profit was ~10% in 2020. The target levels are far from these, but we feel the target levels are possible if the company is successful in the internationalization of its products.

In addition to the financial objectives, the company focuses heavily on cash flow. Conventionally, the cash flow of IT service business is strong and capital is tied primarily by acquisitions. For Solteq, the product business and related capitalization depress the cash flow, however.

Solteq has not communicated any dividend distribution objectives to the market. In previous years, the company's weak performance capacity, interest expenses and bond covenants have limited dividend distribution. The good performance capacity, cash flow, stronger balance sheet and slightly lower investments in 2020 should enable dividend distribution.

Acquisition strategy

Solteq's possible acquisitions would probably be directed abroad, at the service business area, where the company could reach new customers. The challenge with acquisitions involving new product businesses can be the valuation level of the company to be acquired and Solteq's financial leeway. Old product businesses are interesting to Solteq if the company can replace them with its own new products.

Culture risk is one of the key risks in acquisitions in the IT service sector. In addition, international acquisitions increase the risk from the viewpoint of culture, management and legislation. In recent years, the sector has been able to lower these risks by tighter culture screening and structuring of acquisitions.

Corporate restructuring

Solteq has modified its business quite heavily in the 2010s through 12 M&A transactions. The company has primarily acquired businesses, but it has also divested three non-strategic operations. Measured in net, Solteq has acquired and estimated EUR 50 million in revenue in the 2010s. Based on figures, Solteq has struggled to integrate the largest acquisitions. After 2017, Solteq has been more successful in integrating two "smaller" but significant acquisitions and these businesses have grown. Solteq's integration challenges have partially been compensated by the low valuation multiples of the acquisitions. Interpreting the reported deal prices and financial statements data, Solteq has paid 0.5x to 0.9x EV/revenue and P/S ratios for the acquisitions. The paid ratios have typically been below Solteq's own ratios.

Solteq's three main acquisitions have been the Aldata Solutions acquisition in 2012, the Descom acquisition in 2015, and the inPulse acquisition in 2017.

With the Aldata acquisition, Solteq strengthened its expertise in the retail sector and its market position in Finland. The acquisition raised the customer base, increased the product offering through the Retail solution and expanded operations to the hotel and restaurant industry. Aldata Solutions' revenue in 2011 was EUR 13 million and Solteq's corresponding revenue was EUR 27 million.

Solteq nearly doubled its size with the Descom acquisition. In 2014, Descom's revenue was EUR 27 million and Solteq's corresponding revenue was EUR 41 million. With the acquisition, Solteq expanded its offering to cover digital retail trade and customer experience. The integration was, however, challenging because the cultural differences were big and, thus, the benefits of the acquisition did not materialize. Now the challenges are over. Solteq's current CEO Väätäinen was the Chairman of the Board of Descom at the time of the acquisition.

With the inPulse acquisition, the company strengthened its own software offering and expanded into the new Utilities business in line with Solteq's strategy. With the acquisition, the customer portfolio expanded into electricity, district heat and water supply companies. The acquisition also strengthened Solteq's existing BI and analytics expertise. The business is a key area for growth in 2020 and the next few years.

Inderes' view on Solteq's strategy

2016 - 2020

Building the basis for international software business

- Internationalization
- Development of product businesses
- Returning performance capacity

2021 - 2023

International growth driven by software business

- Focus strongly on international and software business growth
- Commercialization of products
- Continued product development
- Development of sales channels
- The objective of Solteq Software is to increase the share of continuous earnings from 30% to 50% by 2023.

2024

Growth acceleration

- International businesses drive growth
- Most of the new product businesses support growth
- Expansion into new markets
- Possible acquisitions that accelerate growth

- Solteq Digital's growth ≥ 5 % and EBIT % ≥ 8 %
- Solteq Software's growth ≥ 20 % and EBIT ≥ 25 %

Must Win Battles in the strategy

Implementation

- Expansion to Denmark, Sweden, Norway, and Great Britain with acquisitions in the service business
- Development of the product businesses both internally and through acquisitions
- By building a successful base the performance capacity has improved

Near future, 1 to 2 years

- Strengthening the sales organization in Sweden
- Stronger expansion of Utilities and Retail businesses to Sweden and Denmark
- Commercialization of the Robotics business
- Strengthening international service businesses
- Continued development of existing products

The next 5 years

- Further strengthening of international markets and possible expansion into new markets, e.g., Germany
- Ability to continuously strengthen the product and service businesses in line with market trends and technology shifts organically or through acquisitions

Source: Inderes

Strategy positioning

	Software developers	Medium-sized	IT generalists (like Tieto)
Example	Siili, Solita, Vincit, Futurice, Reaktor, Gofore	Digia, Solteq, Innofactor	TietoEVRY, CGI, Accenture
Genetic heritage	New digital services, digitalization solutions	Background systems Digital services growing	Background systems
Strengths	Talent competition Agility Change rate Low organization model Positioning on growing areas No substantial project risks	Integration know-how Background system expertise Role of business-critical supplier Extensive offering Established customers	Offshore/nearshore talent Global deliverability Most extensive offering Strong customer maintenance
Weaknesses	Remaining in the role of talent resourcer Maintenance abilities Ability to deliver turnkey solutions	Exposure to project risks Need to renew and invest Remaining a loser	Need for constant renewal Change rate Heavy organization
Typical specialization	All customer sizes and industries Selected service areas	Large/medium-sized organizations Often industry focus All service areas	Large/global customers Extensive industry expertise All service areas
Growth and profitability at the moment	Strong growth on current market Strong profitability on current market	Good organic growth Acquisitions as growth drivers Satisfactory/weak profitability	Modest organic growth Growth through acquisitions Good profitability
Consolidation	Small specializers as acquisition targets, aim to expand offering	Small specializers as acquisition targets, aim to strengthen offering, larger mergers possible	Acquisition targets often medium-sized specialized players, also large acquisitions on an international level

Source: Inderes

Past development

Historically even development but weaker than for the sector

In this section, we examine Solteq's history starting from the 2010s because this better depicts development and market changes that are relevant to the company's current business structure. In 2010 to 2019, Solteq grew on average by 9% per year. In the 2010s, the company has acquired an estimated EUR 50 million in revenue and thus growth is based on acquisitions. Strong focus in the retail sector and its revolution has been challenging and we believe it has depressed Solteq's revenue development. In addition, we feel Solteq has not been able to fully benefit from its acquisitions, especially the large Descom integration proved difficult.

In 2010 to 2017, Solteq's depreciations were 2 to 4% of revenue. The depreciations have increased as a result of the IFRS-16 amendment and increased product investments and amounted to 7% of revenue in 2019.

Solteq's operating profit % has been 6% on average during the review period and the range has been between 0 and 10%. Profitability has, thus, been clearly weaker than average for the sector and depicts the market and integration challenges the company has faced.

Solteq has not been much of a dividend distributor in its history but has used its modest cash flow more for acquisitions. In the 2010s, the company has distributed dividends 4 times and then on average 33% of the result.

In 2019, Solteq's revenue grew by 2.5% to EUR 58 million. We estimate that the revenue decreased pushed by project challenges in Finland. The international operations developed strongly, and revenue grew by 26% in 2019.

In terms of the operating result, 2019 was typical for Solteq and operating profit adjusted for the SAP sales gain was EUR 3.5 million or 6% of revenue. The company also recorded a EUR 2.3 million non-recurring sales gain from the SAP business. Due to a large bond, Solteq's financing costs are high and amounted to EUR 2 million in 2019. Thus, the earnings per share was 15 cents and adjusted for the SAP sales gain 5 cents per share.

Outside the income statement, the company also capitalized EUR 3.9 million in R&D costs. Solteq canceled dividend distribution for 2019 due to the COVID situation.

2020 offered first steps in the turnaround and transformation progressing

2020 has been very strong for Solteq considering the circumstances and history. Revenue grew by good 3% in January to September and organically by 9%. We estimate the revenue to grow by 3% to EUR 60 million for the whole year.

Solteq's growth has been good in both segments, Solteq Software's revenue growth that has accelerated throughout the year and improved profitability has been especially positive. In recent years, the company has invested heavily in this segment. During 2020, the Utilities business, in particular, has supported segment growth and during the first nine months of 2020 the company has signed contracts worth some EUR 22 million. Higher billable utilization supported growth and profitability in the Service business.

Depreciations rose slightly in 2020 and we expect them to amount to EUR 4.9 million for the full year (2019: EUR 4.0 million). Depreciation levels were higher due to increased depreciations of capitalized R&D costs.

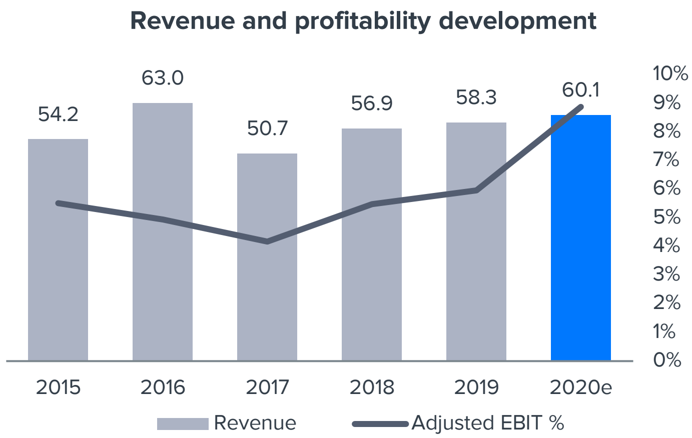
In terms of profitability, we expect the 2020 adjusted operating profit to rise to EUR 5.3 million or to be 8.9% of revenue in 2020 (2019: EUR 3.5 million or 6.0%). The result was supported by efficiency measures carried out in early 2020 and the some EUR 2.0 million cost savings they generated. Last year, financing costs were raised slightly by a non-recurring cost related to bond refinancing, and we estimate it to be EUR 2.6 million in 2020 (2019: EUR 2.0 million). Thus, we estimate the adjusted earnings per share to grow by 8 cents to 13 cents in 2020. Outside the income statement, the company also capitalized R&D costs that we estimate to have amounted to EUR 3 million in 2020.

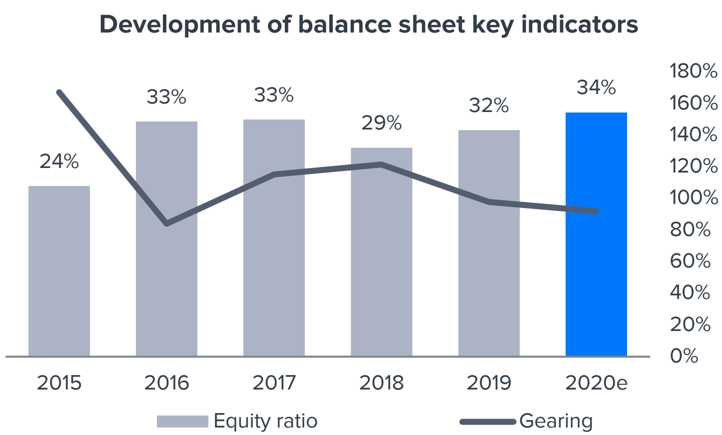
Leveraged but strengthening balance sheet

Solteq's equity ratio at the end of Q3'20 was 35% and gearing had decreased to 108% (Q3'19: 32% and 146%). The company's cash in hand was EUR 5 million and it had EUR 26 million in interest-bearing debt. Excluding the leveraged balance sheet and R&D capitalization, Solteq's balance sheet depicts a typical IT service company that has carried out several acquisitions that have generated goodwill in the balance sheet. There was EUR 39 million in goodwill in the balance sheet at the end of Q3'20. Unlike other companies in the sector, the company has capitalized considerable amounts of R&D costs in the balance sheet and these corresponded with EUR 11 million at the end of Q3'20. There was EUR 10 million in receivables and the balance sheet total was EUR 74 million.

Solteq refinanced its debts last fall when it issued a EUR 23 million senior unsecured fixed rates note due on October 1, 2024. The interest of this loan is also 6%. The original bond was withdrawn in connection with the Descom acquisition in 2015.

Past development





Condensed profit and loss account	2015	2016	2017	2018	2019	2020e
Revenue	54.2	63.0	50.7	56.9	58.3	60.1
EBITDA	3.1	8.4	2.4	4.8	9.7	10.2
Adjusted EBIT	3.0	3.1	2.1	3.1	3.5	5.3
EBIT	1.3	6.4	0.3	2.5	5.7	5.3
Profit before taxes	0.3	4.7	-1.4	0.6	3.7	2.8
Net profit	0.1	4.6	-1.5	0.4	2.8	2.0
Earnings per share	0.1	0.1	0.02	0.05	0.05	0.13
Free cash flow	-27.3	10.1	-5.8	-2.4	4.1	1.4

Key indicators	2015	2016	2017	2018	2019	2020e
Revenue growth %	32.4%	16.3%	-19.6%	12.1%	2.5%	3.2%
Operating margin %	5.7%	13.3%	4.7%	8.4%	16.7%	16.9%
Adjusted EBIT %	5.5%	4.9%	4.2%	5.5%	6.0%	8.9%
EBIT %	2.4%	10.2%	0.6%	4.3%	9.8%	8.9%
ROE %	0.7%	25.9%	-7.3%	1.7%	12.1%	8.0%
ROI %	4.3%	14.4%	0.7%	5.0%	10.8%	10.0%
Equity ratio	24.0%	33.1%	33.3%	29.4%	31.9%	34.3%
Gearing	167.4%	84.1%	115.3%	121.6%	97.9%	92.1%

Share indicators	2015	2016	2017	2018	2019	2020e
EPS (adjusted)	0.11	0.08	0.02	0.05	0.05	0.13
Cash flow/share	-1.61	0.60	-0.31	-0.12	0.21	0.07
Dividend/share	0.00	0.05	0.00	0.00	0.00	0.03
EPS	0.91	1.19	1.11	1.13	1.27	1.38

Source: Inderes

Source: F-Secure

Estimates 1/2

We expect the positive trend to continue in 2021

Year 2020 is done, and we expect the trend has continued as positive in the last quarter. We estimate that Solteq's revenue will grow by 3% to EUR 60 million and adjusted EBITA to be EUR 5.3 million or 8.9% of revenue (2019: EUR 3.5 million or 6.0% of revenue). Our estimate is in line with Solteq's guidance that estimates considerable improvement in adjusted EBITA. The whole year can be seen as very successful considering COVID and the difficulties in the past. In addition, visibility into Solteq's business improved clearly last year when Solteq started reporting business development by segment.

We have raised Solteq Digital's estimates for 2021 to 2022 and our earnings estimate for the entire group rose by good 5%.

In 2021, we estimate that revenue will grow by 8% to EUR 65 million. In our estimates, Solteq Software grows by 16% and is still below long-term objectives. We estimate that Solteq Digital will grow by 5%, which is in line with long-term objectives. 2021 is supported by a strong order book in Solteq Software's Utilities business. In addition to revenue, we follow news especially related to products and international operations.

In terms of the result, we estimate that EBITDA will grow to EUR 11.6 million and be 18% of revenue (2020e EUR 10.2 million and 17% of revenue). Due to large depreciations, we estimate that Solteq's operating profit will be EUR 6.5 million or 10% of revenue in 2021 (2020e EUR 5.3 million). The result and profitability improvement is driven by the strong growth and profitability improvement in the Solteq Software segment (EBIT % 2020e: 10% and 2021e: 14%). To our understanding, there is not much room for improvement in Solteq Digital segment's billable utilization so we expect the segment's profitability to remain at the same level as in the comparison period, around 8%.

We expect the company to continue R&D capitalizations but for these to drop to EUR 2.7 million in 2021. To cover its R&D costs, Solteq has received support from Business Finland, a minimum of EUR 600,000 for 2021.

Visibility into the success of product internationalization and the success and timing of robotics commercialization is still weak. Our 2021 estimate for Solteq Software does not, in our opinion, require any major new orders but orders are needed in order for the 2022 to 2023 estimates for the segment to materialize. During the building stage, the company has capitalized a lot of costs in the balance sheet that now will be written down more aggressively, which will depress operating profit. Thus, ÈBITDA % provides a better picture of Solteq Software's profitability and cash flow.

Income statement	2019	2020e	2021e	2022e	2023e
Revenue	**58.3**	**60.1**	**65.1**	**70.1**	**75.7**
Solteq Digital	41.2	41.6	43.5	45.3	47.1
Solteq Software	17.1	18.6	21.6	24.9	28.6
Operating margin	**9.7**	**10.2**	**11.6**	**12.7**	**13.7**
Depreciation and impairment	-4.0	-4.9	-5.2	-5.4	-5.4
Operating profit excluding non-recurring items	**3.5**	**5.3**	**6.5**	**7.3**	**8.3**
Operating profit	**5.7**	**5.3**	**6.5**	**7.3**	**8.3**
Solteq Digital	4.4	3.5	3.6	3.8	4.0
Solteq Software	1.3	1.8	2.9	3.5	4.3
Net financing costs	-2.0	-2.6	-1.7	-1.4	-1.4
Profit before taxes	**3.7**	**2.8**	**4.8**	**5.9**	**6.8**
Taxes	-0.9	-0.7	-1.0	-1.2	-1.4
Minority interest	0.0	0.0	0.0	0.0	0.0
Net profit	**2.8**	**2.0**	**3.8**	**4.7**	**5.5**
EPS (adjusted)	**0.05**	**0.13**	**0.20**	**0.24**	**0.28**
EPS (reported)	**0.15**	**0.11**	**0.20**	**0.24**	**0.28**

Key indicators	2019	2020e	2021e	2022e	2023e
Revenue growth %	2.5%	3.2%	8.3%	7.6%	7.9%
Growth % of adjusted operating profit	11.3%	53.9%	21.8%	12.7%	13.1%
Operating margin %	16.7%	16.9%	17.9%	18.2%	18.1%
Adjusted operating profit %	6.0%	8.9%	10.0%	10.4%	11.0%
Net profit %	4.8%	3.4%	5.8%	6.7%	7.2%

Source: Inderes

Estimate changes EUR million	2021e Old	2021e New	Change %	2022e Old	2022e New	Change %
Revenue	63.8	65.1	2%	68.3	70.1	3%
Operating margin	11.5	11.6	1%	12.0	12.7	6%
Operating profit excluding non-recurring items	6.2	6.5	5%	7.0	7.3	5%
Operating profit	6.2	6.5	5%	7.0	7.3	5%
Profit before taxes	4.5	4.8	7%	5.5	5.9	7%
Operating profit (excl. non-recurring items)	0.19	0.20	7%	0.23	0.24	7%
Dividend per share	0.05	0.05	0%	0.07	0.07	0%

Source: Inderes

Estimates 2/ 2

Years 2022 to 2023

We expect Solteq's revenue to grow by 8% in 2022 to 2023. Our estimate expects Solteq Software to grow by 15% annually and drive Solteq's growth. In order to succeed in the growth, we believe the company needs new orders in 2021. In terms of Solteq Digital, our estimates are moderate and we expect the segment to grow by 4% in 2022 to 2023.

In terms of profitability, we estimate that EBIT % will rise gradually in 2022 to 2023 to 11% (2020 adjusted EBIT: 9%) driven by the modest improvement in the service business, and primarily by the growth and profitability in the own software and product business.

We expect the company's R&D investments to gradually move from the balance sheet to the income statement. In 2022 to 2023, we estimate R&D capitalizations to decrease to some EUR 2.0 to 2.5 million. In total, the capitalization and R&D costs through the income statement remain at the current level in our estimate. If commercialization of new products and internationalization is successful, growth should scale well to the result and Solteq Software's long-term objectives (growth 20% and EBIT % ≥25 %) could be achievable. This would also change the company's investment profile towards a more interesting direction.

Long term estimates

In the long term, Solteq's estimates are highly dependent on how the company's internationalization and commercialization of software progresses. In 2024 to 2028, we estimate that Solteq will grow by 5 to 7% annually. In our estimates, growth is driven by Solteq Software. We estimate the EBIT % to be 10 to 12% also driven by Solteq Software. If the company is successful in internationalization of the software business and robotics commercialization there is still clear upside in our estimates. At the same time, this would bring visibility and confidence to lean on longer-term estimates, which currently is too early in our opinion.

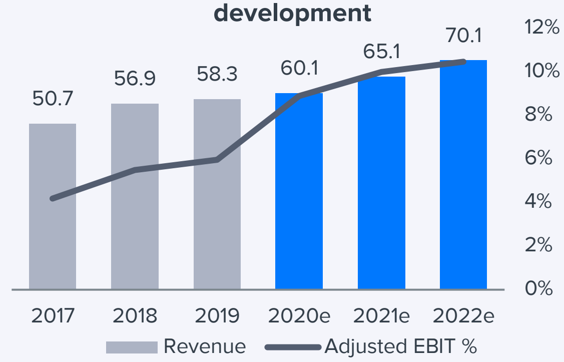
Balance sheet strengthens

With a strong cash flow, the balance sheet strengthens clearly every year. In our estimate, the equity ratio increased from 34% in 2020e to 40% in 2022e and correspondingly net gearing decreases from 92% to 48%. Thus, the company should have good possibilities to refinance the current 6% interest bond with clearly more favorable terms. In addition, Solteq will have more leeway for dividend distribution in future.

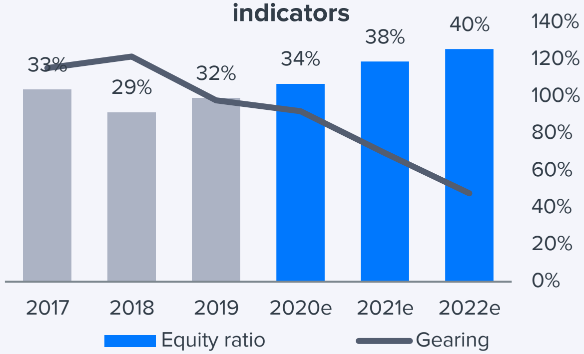
The financial covenants that apply to Solteq's distribution of assets and taking out new loans apart from those separately permitted in the terms of the bond are:

- Net debt/ EBITDA cannot exceed 4x
- Operating profit/interest expenses not below 3x
- Equity ratio at least 27.5%

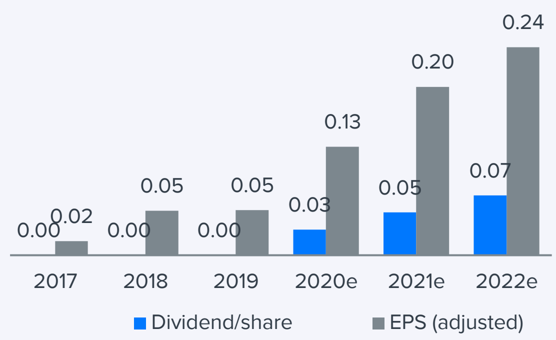
Revenue and profitability development



Development of balance sheet key indicators



EPS and dividend



Investment profile

Turnaround company from a result viewpoint and transformation company from a software viewpoint

Solteq's investor story has after several difficult years progressed towards a more interesting direction in 2020. First signs of both the result turnaround and a transformation in the software and product business have been seen in numbers and the order book. Solteq has strong expertise and a competitive advantage in selected industries and industry-specific solutions. In order to take the next growth leap and prove its international competitiveness, the company has to succeed in exporting its software.

Solteq's financial objectives are ambitious but attainable. The objectives depict Solteq Software's strong role in the strategy. In addition, the company aims for increasing continuous revenue in the software business, which would lower the risk profile and raise the acceptable multiples. In the competitive pressure of the IT service market Solteq's continuous services and a diversified business in terms of the offering become even more valuable.

Solteq's anchor owner the Sentica fund is over 10 years old and from this viewpoint the fund's exit approaches. We believe a possible owner exit would not have much effect on other investors if the result turnaround continued even if part of the backbone is gone because the cash flow is strong, and it gives the necessary leeway through income financing.

First signs of a successful transformation: Over the past five years, Solteq has broadened the offering of the service business, extended its product portfolio, and invested heavily in own software and product solutions. This transformation slowed down growth and maintained profitability under pressure until last year. In 2020, the trend of both of Solteq's segments made a clear turnaround to the positive and provided the first signs of a successful turnaround in the result and the business model.

Products and internationalization as growth drivers: Solteq already has a relatively good market position in its businesses in Finland. The core of the company's strategy is internationalization and development of own products. Solteq already has small service operations in the Nordic countries, which is a good basis to build the service business on and especially for stronger international growth of products. On product level, we follow how the internationalization of the important Utilities and Retail products and the commercialization of robotics progress.

The market has good long term demand fundamentals: The demand fundamentals of the IT service market have been strong for a long time, driven by digitalization. The whole market will grow at an annual rate of 3 to 5% and several of Solteq's expertise areas clearly faster than this. Long-term demand fundamentals have strengthened when the virus has forced many dormant industries to digitize and strengthen their IT core.

The balance sheet is leveraged: Solteq's balance sheet is leveraged and does not offer much leeway at the moment. Solteq's strong cash flow is, however, getting corrected at a good rate and provides new leeway in coming years. In addition, we believe it enables modest dividend distribution.

Upside in valuation as the scalability and continuity of the business model improves. If the growth and profitability objectives (20% and >25%) of Solteq's software business materialize and/or continuity improves there is clear upside in the share.

Risk profile

Solteq's risk profile has improved clearly since the result turnaround began. High gearing and financing costs will still keep the risk level up. In addition, Solteq still needs to prove internationalization for the new software business and the commercialization of the strongly invested robotics business.

New investments in new products naturally maintain the risk level but the company has said it focuses strongly on cash flow, which keeps the risks at a moderate level.

The company's business structure that contains several different service businesses, industry focuses, country organizations and product businesses, increases complexity. As the complexity of the structure is high there are also risks of losing focus.

Acquisitions and especially acquisitions abroad increase the risk. In the past, Solteq has not been very successful in integrating acquired companies.

COVID still creates uncertainty on the markets, but in our view Solteq and the entire IT service sector have successfully navigated through the pandemic and the situation looks better after the autumn.

Investment profile

1. **First signs of a successful transformation**

2. **Products and internationalization as growth drivers**

3. **The market has good long term demand fundamentals.**

4. **The balance sheet is leveraged but strengthening**

5. **Upside in valuation as the scalability and continuity of the business model improves**

Potential

- Strongly growing market
- Own products as growth and profitability drivers
- Internationalization of the product and service business
- Strong cash flow will provide better financial leeway in future and enable a more favorable financial structure
- If the internationalization of the product business is successful there is clear upside in the valuation

Risks

- Transformation is still ongoing
- Unsuccessful commercialization of product businesses
- Unsuccessful internationalization
- Project risks and customers' bargaining power
- Marginalized position between large and small players
- Acquisitions
- COVID keeps uncertainty high on the market

Source: Inderes

Value determination1/2

Peer group

According to our view, Solteq should be positioned among Nordic IT service companies partly as a transition company, whose first signs of a result turnaround and transformation into a product company have already been seen. A good Nordic peer group to which the valuation can be reflected and supported on can be found for Solteq, especially for the service business. Compared to pure IT service companies the company has more continuous and scalable business, which become more valuable in the current situation of tighter talent competition. If the internationalization of the product business is successful, the company has potential for a clearly stronger earnings growth, and we can gradually start accepting higher valuation indicators for the company.

Compared to other IT service companies in the sector, Solteq currently capitalizes clearly more R&D costs in the balance sheet (some 5% of turnover). Last year, the company started to write down capitalized costs from its balance sheet more aggressively. Thus, we feel the result rows starting from the operating profit level are more comparable with the peers. EBITDA depicts the profitability potential and cash flow potential in a situation where the company no longer capitalizes product development.

In the peer group, we have used Inderes' estimates for the companies we cover, which takes into account GWA of the peers and improves comparability between Finnish IT service companies. We accept higher valuation multiples for Solteq than the sector average if the positive trend of the product business continues.

Valuation indicators

In our view, you cannot look at only one indicator when examining Solteq's valuation indicators due to the growth and profitability differences between the segments, the trends and for accounting reasons. Therefore, we view valuation indicators as a whole. With our higher 2021 estimates the company's P/E, EV/EBIT, EV/EBITDA and EV/revenue ratios are 15x, 12x, 7x and 1.2x. The relative indicators are 9% below the Finnish peers. With our target price, the indicators are 2% above the Finnish peers. We accept higher valuation multiples for the company than the sector average if the positive trend of the product business continues. As a whole, we consider the company's valuation indicators to be attractive.

Components of the expected returns for the share

We examine the expected returns for Solteq's shares from the viewpoint earnings growth, dividend yield and the accepted valuation multiple.

According to our estimate, the company has preconditions to reach annual earnings growth of around 15% (from the 2020e level) in coming years. With our dividend estimates the dividend yield is low at 1 to 3%. The leveraged balance sheet and product investments do not, in our opinion, provide much leeway in terms of the dividend. We consider the company's 2021 valuation indicators to be moderate taking into account the result turnaround and the trend of the product business.

Thus, we estimate that the share's return expectation consisting of earnings growth, dividend yield and a slight upside in the indicators will be around 20%. The return expectation is very competitive but the estimates for 2022 to 2023 require modest strengthening in the demand for the product business.

DCF analysis

Our DCF model indicates a fair value of EUR 3.6 per share for Solteq. In our model, we estimate that the company will grow slightly faster than the IT market in 2021 to 2028 at 5 to 8% and the perpetual assumption is 2.5%. We expect the company's EBIT % to be 10 to 12% in 2021 to 2028 and to drop to 10% in the perpetual assumption. In the estimate, the profitability is on the average sector level or slightly higher. If the internationalization of the product business is successful there is, however, clear upside in the estimates.

In our model the cost of capital (WACC) is 9.0% and the cost of equity is 9.7%. The weight of the perpetual assumption is a moderate 48%. Based on the assumptions of our DCF model, Solteq's share is currently priced below the company's fair value. The market's pricing behavior is, in our opinion, explained with the company's still limited proof of a result turnaround and the transformation of the product business.

Solteq has three relatively possible scenarios (service company/partial success in software/success in software). The outcomes of these scenarios are very different. This is also the reason why we do not lean much on the cash flow calculation at this stage.

Value determination 2/2

Sum of parts

The valuation of the share can also be examined through the sum of parts as the company reports the service business and software business separately.

Around 65% of Solteq Software are new and primarily cloud-based product solutions and they drive the growth the business unit. The overall growth rate of own products accelerated from 2% in Q1'20 to 11% in Q3'20. The growth is still far from the targeted level (>20 %), as some 35% of the revenue comes from older solutions that depress the revenue development. The direction is, however, right and the outlook for 2021 is positive thanks to a strong order book.

Currently we accept a 2.5x EV/revenue ratio for the products because the transformation into a product house is still ongoing. If the internationalization is successful and revenue growth accelerates it should also be scaled in the result, in which case we can gradually start accepting multiples comparable to SaaS companies (> 5x EV/S). Clearly higher multiples have been paid for unlisted SaaS growth templates that are only starting out, but this would require proof of the internationalization of products being successful and of strong growth.

We have cautiously accepted a lower 10x EV/EBIT ratio for the service business than the sector average (IT service sector 12x). If revenue growth and profitability remain on sectoral level, we can gradually start accepting the valuation levels of the sector for the service business. The closest peers for the service business are Digia and Bilot. With the sum of parts and using the above-mentioned parameters and estimates we reach a clearly higher DCF value of EUR 90 million for 2021. Correspondingly, the share price is EUR 3.6 and clearly higher than the current share price.

There are no strong synergies between the segments, but the product business still gets some sales support from the geographical presence of the service business. Thus, a possible spin-off of the segments is not in our view topical at this time. Therefore, we do not consider dissolving of the undervaluation likely from a sum of parts viewpoint until there is proof of stronger result growth. The sum of parts, however, depicts the hidden potential in the businesses.

Income statement	2021e
Revenue	**65.1**
Solteq Digital	43.5
Solteq Software	21.6
Operating profit	**6.5**
Solteq Digital	3.6
Solteq Software	2.9

Valuation, Solteq Software	2021e
EV/S 2.5x	**54.0**

Valuation, Solteq Digital	2021e
EV/EBIT 10x	**35.8**
EV	89.8
Net liabilities	20.7
Valuation, total	69.1
per share	**3.6**

Quarterly estimates

Income statement	2019	Q1'20	Q2'20	Q3'20	Q4'20e	2020e	Q1'21e	Q2'21e	Q3'21e	Q4'21e	2021e	2022e	2023e
Revenue	**58,3**	**15,7**	**15,1**	**13,3**	**16,1**	**60,1**	**16,8**	**16,3**	**14,4**	**17,6**	**65,1**	**70,1**	**75,7**
Solteq Digital	41,2	11,3	10,5	9,2	10,6	41,6	11,8	11,0	9,6	11,1	43,5	45,3	47,1
Solteq Software	17,1	4,3	4,6	4,1	5,5	18,6	5,0	5,3	4,8	6,5	21,6	24,9	28,6
EBITDA	**9,7**	**1,9**	**2,7**	**2,7**	**2,9**	**10,2**	**2,6**	**3,0**	**2,8**	**3,3**	**11,6**	**12,7**	**13,7**
Depreciation	-4,0	-1,2	-1,2	-1,3	-1,2	-4,9	-1,2	-1,3	-1,3	-1,3	-5,2	-5,4	-5,4
EBIT (excl. NRI)	**3,5**	**0,7**	**1,5**	**1,4**	**1,8**	**5,3**	**1,4**	**1,7**	**1,4**	**2,0**	**6,5**	**7,3**	**8,3**
EBIT	**5,7**	**0,7**	**1,5**	**1,4**	**1,8**	**5,3**	**1,4**	**1,7**	**1,4**	**2,0**	**6,5**	**7,3**	**8,3**
Solteq Digital	4,4	0,5	1,1	0,8	1,1	3,5	0,7	1,0	0,8	1,1	3,6	3,8	4,0
Solteq Software	1,3	0,2	0,4	0,5	0,7	1,8	0,7	0,7	0,7	0,9	2,9	3,5	4,3
Net financial items	-2,0	-0,6	-0,5	-0,6	-0,9	-2,6	-0,4	-0,4	-0,4	-0,4	-1,7	-1,4	-1,4
PTP	**3,7**	**0,1**	**1,0**	**0,8**	**0,9**	**2,8**	**0,9**	**1,3**	**1,0**	**1,6**	**4,8**	**5,9**	**6,8**
Taxes	-0,9	-0,1	-0,2	-0,3	-0,2	-0,7	-0,2	-0,3	-0,2	-0,3	-1,0	-1,2	-1,4
Minority interest	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
Net earnings	**2,8**	**0,0**	**0,8**	**0,5**	**0,7**	**2,0**	**0,7**	**1,0**	**0,8**	**1,3**	**3,8**	**4,7**	**5,5**
EPS (adj.)	**0,05**	**0,00**	**0,04**	**0,03**	**0,06**	**0,13**	**0,04**	**0,05**	**0,04**	**0,07**	**0,20**	**0,24**	**0,28**
EPS (rep.)	**0,15**	**0,00**	**0,04**	**0,03**	**0,04**	**0,11**	**0,04**	**0,05**	**0,04**	**0,07**	**0,20**	**0,24**	**0,28**

Key figures	2019	Q1'20	Q2'20	Q3'20	Q4'20e	2020e	Q1'21e	Q2'21e	Q3'21e	Q4'21e	2021e	2022e	2023e
Revenue growth-%	2,5 %	5,0 %	2,8 %	2,3 %	2,5 %	3,2 %	7,3 %	8,3 %	8,4 %	9,1 %	8,3 %	7,6 %	7,9 %
Adjusted EBIT growth-%	11,3 %	-53,2 %	159,4 %	384,0 %	63,3 %	53,9 %	90,2 %	13,5 %	5,5 %	13,5 %	21,8 %	12,7 %	13,1 %
EBITDA-%	16,7 %	12,0 %	18,0 %	20,2 %	18,2 %	16,9 %	15,4 %	18,1 %	19,2 %	19,0 %	17,9 %	18,2 %	18,1 %
Adjusted EBIT-%	6,0 %	4,6 %	9,8 %	10,3 %	11,0 %	8,9 %	8,1 %	10,3 %	10,0 %	11,5 %	10,0 %	10,4 %	11,0 %
Net earnings-%	4,8 %	0,3 %	5,2 %	4,1 %	4,3 %	3,4 %	4,4 %	6,1 %	5,6 %	7,2 %	5,8 %	6,7 %	7,2 %

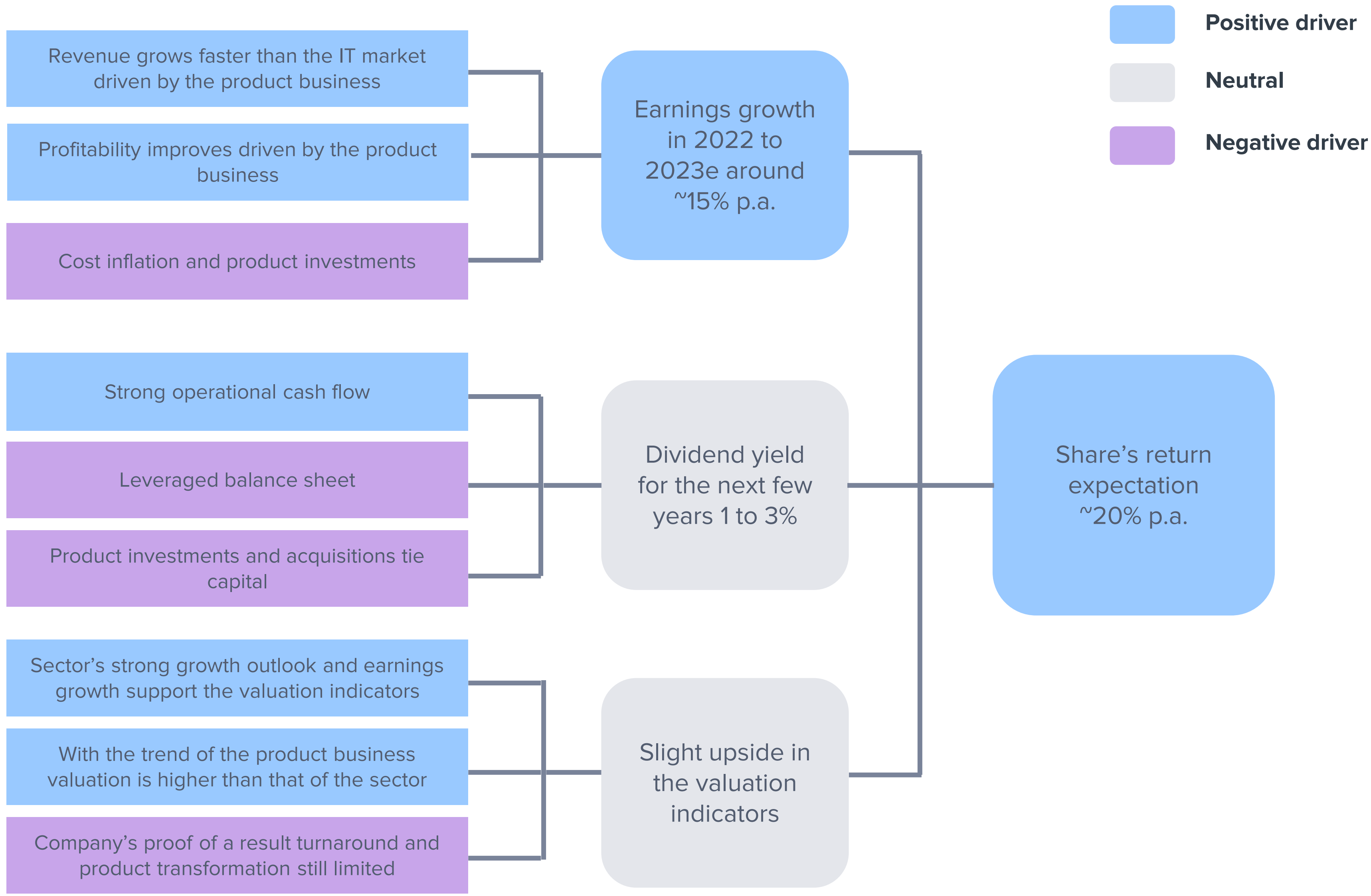
Source: Inderes

Peer group

Peer group valuation Company	Share price	Market value EUR million	EV EUR million	EV/EBIT 2020e	EV/EBIT 2021e	EV/EBITDA 2020e	EV/EBITDA 2021e	EV/Revenue 2020e	EV/Revenue 2021e	P/E 2020e	P/E 2021e	Dividend yield % 2020e	Dividend yield % 2021e
Bilot*	9.92	49	39	48.7	17.7	38.6	16.1	2.2	1.5	54.9	27.0	0.8	1.3
Digia*	7.88	211	227	13.5	11.9	10.8	9.7	1.6	1.4	15.8	14.0	1.8	2.2
Gofore*	18.15	254	240	21.4	17.2	22.5	17.0	3.1	2.5	28.1	22.5	1.5	7.3
Innofactor*	1.37	51	59	12.5	10.2	8.0	6.9	0.9	0.8	13.2	12.0	2.2	2.9
Nixu*	11.05	82	88	75.6	62.0	43.1	28.7	1.6	1.5	667.9	89.7		5.7
Siili*	13.20	92	86	14.2	11.5	10.1	8.9	1.0	1.1	21.1	13.4	2.7	3.6
TietoEVRY*	27.96	3311	4255	12.2	11.0	13.3	9.4	1.5	1.5	12.9	11.8	4.6	4.8
Vincit*	8.00	97	93	12.5	11.2	11.6	10.8	1.8	1.6	17.2	15.9	1.8	1.9
Bouvet	652.00	652	624	20.4	19.9	16.8	16.2	2.7	2.4	27.3	26.8	3.2	3.3
ENEA	241.00	528	555	29.7	24.3	19.8	15.8	6.2	5.5	36.2	28.6	0.5	1.5
KnowIT	290.00	566	546	17.9	15.3	14.0	12.2	1.6	1.5	23.6	21.2	1.7	2.4
Solteq (Inderes)	**2.96**	**57**	**82**	**15.3**	**12.0**	**8.0**	**6.7**	**1.4**	**1.2**	**23.3**	**15.0**	**1.0**	**1.7**
Average				**25.3**	**19.3**	**19.0**	**13.8**	**2.2**	**1.9**	**83.5**	**25.7**	**2.1**	**3.4**
Median Nordics				**17.9**	**15.3**	**14.0**	**12.2**	**1.6**	**1.5**	**23.6**	**21.2**	**1.8**	**2.9**
Difference % cf. median				*-15%*	*-22%*	*-43%*	*-45%*	*-17%*	*-19%*	*-1%*	*-29%*	*-43%*	*-42%*
Median Finnish				**13.8**	**11.7**	**12.4**	**10.3**	**1.6**	**1.5**	**19.1**	**15.0**	**1.8**	**3.3**
Difference % cf. median				*11%*	*3%*	*-36%*	*-35%*	*-17%*	*-18%*	*22%*	*0%*	*-43%*	*-48%*

Source: Thomson Reuters and *adjusted Inderes' estimate/Inderes. NB! The market value used by Inderes does not take into consideration treasury shares.

EPS drivers 2021e to 2023e



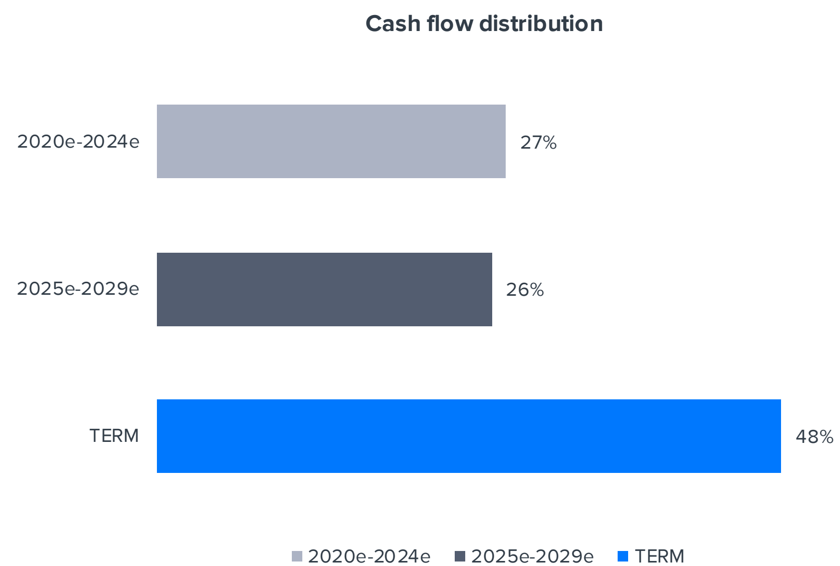
Source: Inderes

DCF calculation

DCF model	2019	2020e	2021e	2022e	2023e	2024e	2025e	2026e	2027e	2028e	2029e	TERM
EBIT (operating profit)	**5.7**	**5.3**	**6.5**	**7.3**	**8.3**	**9.3**	**10.4**	**11.0**	**10.6**	**10.1**	**10.4**	
+ Depreciation	4.0	4.9	5.2	5.4	5.4	5.1	5.1	5.1	5.1	3.7	3.9	
- Paid taxes	-1.1	-0.7	-1.0	-1.2	-1.4	-1.6	-1.9	-2.1	-2.0	-1.9	-1.9	
- Tax, financial expenses	-0.5	-0.7	-0.4	-0.3	-0.3	-0.3	-0.2	-0.2	-0.2	-0.2	-0.2	
+ Tax, financial income	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
- Change in working capital	-4.4	-2.7	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	
Operating cash flow	**3.7**	**6.1**	**10.3**	**11.3**	**12.1**	**12.6**	**13.5**	**14.0**	**13.7**	**11.9**	**12.3**	
+ Change in other long-term liabilities	5.2	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
- Gross CAPEX	-4.8	-4.9	-4.6	-4.5	-4.0	-4.1	-4.1	-4.2	-4.3	-4.3	-6.2	
Free operating cash flow	**4.1**	**1.4**	**5.7**	**6.8**	**8.0**	**8.5**	**9.3**	**9.8**	**9.4**	**7.6**	**6.0**	
+/- Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
FCFF	4.1	1.4	5.7	6.8	8.0	8.5	9.3	9.8	9.4	7.6	6.0	95.7
Discounted FCFF		**1.4**	**5.3**	**5.8**	**6.3**	**6.1**	**6.1**	**5.9**	**5.2**	**3.8**	**2.8**	**44.6**
Sum of FCFF present value		93.3	91.9	86.6	80.8	74.5	68.5	62.3	56.4	51.2	47.4	44.6
Enterprise value DCF		**93.3**										
- Interesting bearing debt		-27.7										
+ Cash and cash equivalents		3.6										
-Minorities		0.0										
-Dividend/capital return		0.0										
Equity value DCF		**69.3**										
Equity value DCF per share		**3.6**										

Wacc	
Tax-% (WACC)	20.0 %
Target debt ratio (D/(D+E)	15.0 %
Cost of debt	6.0 %
Equity Beta	1.20
Market risk premium	4.75%
Liquidity premium	2.00%
Risk free interest rate	2.0 %
Cost of equity	**9.7 %**
Weighted average cost of capital (WACC)	**9.0 %**

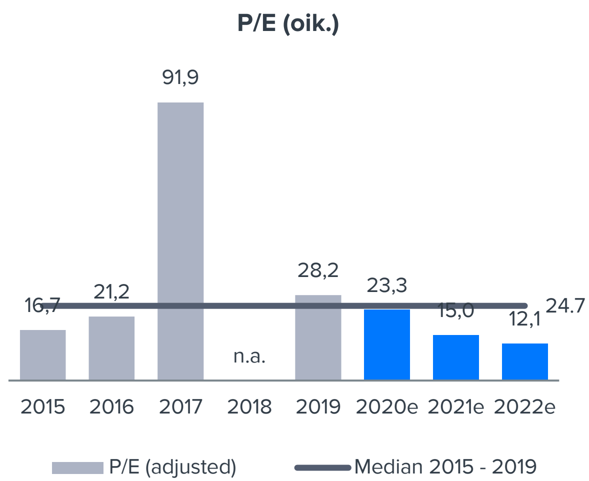
Source: Inderes

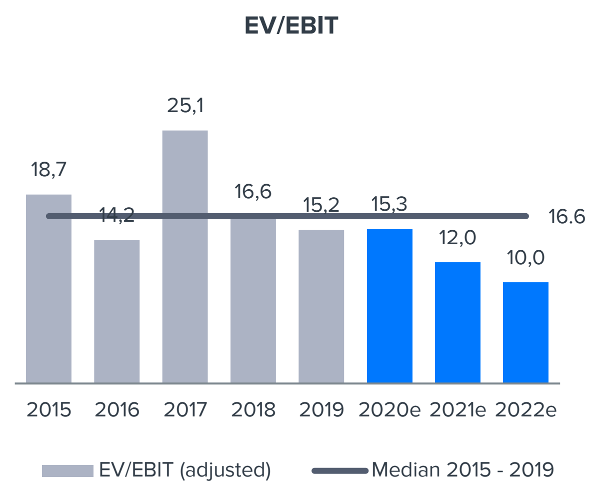


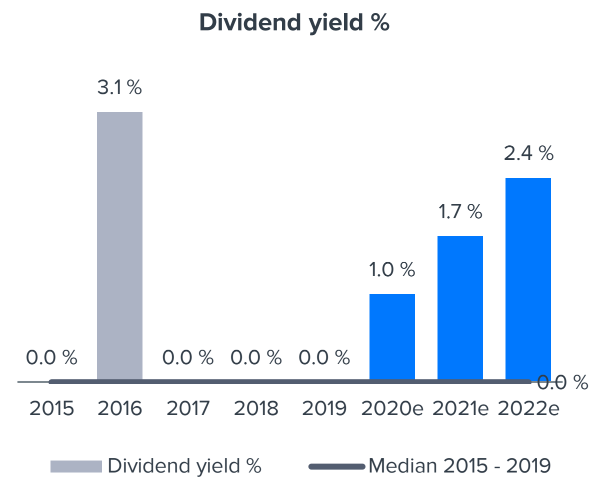
Valuation summary

Valuation level	2015	2016	2017	2018	2019	2020e	2021e	2022e	2023e
Share price	1.78	1.60	1.52	1.30	1.49	**2.96**	**2.96**	**2.96**	**2.96**
Number of shares, million	16.9	17.0	18.5	19.3	19.3	**19.3**	**19.3**	**19.3**	**19.3**
Market value	30	27	28	25	29	**57**	**57**	**57**	**57**
EV	56	44	53	52	53	**82**	**78**	**73**	**68**
P/E (adjusted)	16.7	21.2	91.9	n.a.	28.2	**23.3**	**15.0**	**12.1**	**10.4**
P/E	>100	5.9	neg.	70.5	10.2	**27.9**	**15.0**	**12.1**	**10.4**
P/cash flow	neg.	2.7	neg.	neg.	7.0	**40.2**	**10.1**	**8.4**	**7.1**
P/B	2.0	1.3	1.4	1.2	1.2	**2.2**	**1.9**	**1.7**	**1.5**
P/S	0.6	0.4	0.6	0.4	0.5	**1.0**	**0.9**	**0.8**	**0.8**
EV/Revenue	1.0	0.7	1.0	0.9	0.9	**1.4**	**1.2**	**1.0**	**0.9**
EV/EBITDA (adjusted)	18.2	5.3	22.1	10.8	5.4	**8.0**	**6.7**	**5.7**	**4.9**
EV/EBIT (adjusted)	18.7	14.2	25.1	16.6	15.2	**15.3**	**12.0**	**10.0**	**8.2**
Dividend/earnings (%)	0.0%	18.4%	0.0%	0.0%	0.0%	**28.3%**	**25.4%**	**28.7%**	**31.7%**
Dividend yield %	0.0%	3.1%	0.0%	0.0%	0.0%	**1.0%**	**1.7%**	**2.4%**	**3.0%**

Source: Inderes







Source: Inderes

Summary

Income statement	2017	2018	2019	2020e	2021e
Revenue	50.7	56.9	58.3	**60.1**	**65.1**
Operating margin	2.4	4.8	9.7	**10.2**	**11.6**
Operating profit	0.3	2.5	5.7	**5.3**	**6.5**
Profit before taxes	-1.4	0.6	3.7	**2.8**	**4.8**
Net profit	-1.5	0.4	2.8	**2.0**	**3.8**
Nonrecurring items	-1.8	-0.7	2.2	**0.0**	**0.0**

Per share figures	2017	2018	2019	2020e	2021e
EPS (reported)	-0.08	0.02	0.15	**0.11**	**0.20**
EPS (adjusted)	0.02	0.05	0.05	**0.13**	**0.20**
Operational cash flow/share	0.00	0.60	0.19	**0.32**	**0.54**
Free cash flow/ share	-0.31	-0.12	0.21	**0.07**	**0.29**
EPS	1.11	1.13	1.27	**1.38**	**1.54**
Dividend/share	0.00	0.00	0.00	**0.03**	**0.05**

Balance sheet	2017	2018	2019	2020e	2021e
Balance sheet total	61.5	74.2	77.0	**77.4**	**78.0**
Shareholders' equity	20.5	21.8	24.5	**26.6**	**29.8**
Goodwill	36.9	40.4	38.8	**38.8**	**38.8**
Net liabilities	23.6	26.5	24.0	**24.5**	**20.7**

Growth and profitability	2017	2018	2019	2020e	2021e
Revenue growth %	-20%	12%	3%	**3%**	**8%**
EBITDA growth %	-71%	99%	104%	**5%**	**14%**
Adjusted net sales growth %	-32%	47%	11%	**54%**	**22%**
Adjusted EPS growth %	-78%	215%	1%	**140%**	**55%**
Operating margin %	4.7%	8.4%	16.7%	**16.9%**	**17.9%**
Adjusted EBIT %	4.2%	5.5%	6.0%	**8.9%**	**10.0%**
EBIT %	0.6%	4.3%	9.8%	**8.9%**	**10.0%**
ROE %	-7.3%	1.7%	12.1%	**8.0%**	**13.5%**
ROI %	0.7%	5.0%	10.8%	**10.0%**	**12.0%**
Equity ratio	33.3%	29.4%	31.9%	**34.3%**	**38.2%**
Gearing	115.3%	121.6%	97.9%	**92.1%**	**69.5%**

Cash flow	2017	2018	2019	2020e	2021e
Operating margin	2.4	4.8	9.7	**10.2**	**11.6**
Change in net working capital	-2.6	7.6	-4.4	**-2.7**	**0.0**
Operational cash flow	0.0	11.6	3.7	**6.1**	**10.3**
Investments	-6.4	-13.9	-4.8	**-4.9**	**-4.6**
Free cash flow	-5.8	-2.4	4.1	**1.4**	**5.7**

Biggest shareholders	% of shares
Sentica Buyout III Ky	23.9%
Profiz Business Solution Oy	10.7%
Mutual Pension Insurance Company Elo	10.4%
Saadetdin Ali	7.3%
Mutual Pension Insurance Company Varma	6.5%
Aalto Seppo	3.8%

Multiples	2017	2018	2019	2020e	2021e
EV/Revenue	1.0	0.9	0.9	**1.4**	**1.2**
EV/EBITDA (adjusted)	22.1	10.8	5.4	**8.0**	**6.7**
EV/EBIT (adjusted)	25.1	16.6	15.2	**15.3**	**12.0**
P/E (adjusted)	91.9	24.9	28.2	**23.3**	**15.0**
P/B	1.4	1.2	1.2	**2.2**	**1.9**
Dividend yield %	0.0%	0.0%	0.0%	**1.0%**	**1.7%**

Source: Inderes

Acquisitions in the IT service sector

Acquisitions in the IT service sector in Nordic countries

Date	Buyer	Target	Revenue EUR million	EBITDA EUR million	EBITDA %	Personnel	EV EUR million	EV/Sales	EV/EBITDA
12/20	IBM	Nordcloud	80			490			
12/20	Digia	Climber (SE, FI, DK, NED)	14	0.7	5%	77	8 to 14	0.6X to 1.0x	12X to 20x
12/20	Siili	Supercharge (Hungary)	9	2.1	23%	115	17	~1.8x	~8x
08/20	Triton	Hiq	~180	~25	14%	1500	~340	1.9x	13.6x
08/20	Bilot	CastorIT	7.3	0.9	12%	60	8.8	1.2x	10x
08/20	Gofore	Qentinel	12.0	1.7	14%	100	8.9 to 10.9	~0.9x	~6.4x
08/20	Pinja (Protacon)	PiiMega							
11/19	Solita	Ferrologic	13.1			100			
11/19	Fellowmind	eCraft and Orango							
06/19	Tieto	Evry	1290	180	14%	9400		1.4x	9x
06/19	Digia	Accountor Enterprise Solutions	12.7	0.8		114	9.0	0.7x	6x
05/19	Eficode	Praqma (SE, NO, DK)	5.5			46			
03/19	Nixu	Ezenta (DK)	8.8					0.7X to 0.9x	
03/19	Nixu	Vesper Group (SE)	2					1.0	
03/19	CGI (bid)	Acando (SE and 2018 actual figures)	280	28	10%	2100	410	1.5x	14.6x
02/19	Digia	Starcut	~1.5		~5 %	19			
02/19	Gofore	Silver Planet	7.2	1.8	0.3	40	10.8	1.5x	6.0x
01/19	eCraft	Evry (Fi - Dynamics operations)				40			
01/19	Vincit	LeanCraft	3.0	>1	>30%		5.5	1.8x	5.5x
10/18	Elisa	Fenix Solutions	2.7	0.6	>20%		4.5 to 5.4	1.7X to 2.0x	7.5X to 9.0x
08/18	Infosys	Fluido	18.0				65.0	3.6	
08/18	Digia	Mavisystems Oy	3.2			34			
08/18	Gofore	Solinor	4.0	0.5	0.1	50	4.0	1.0x	7.7x
08/18	Siili	Vala Group (Siili's holding 60%)	5.8	1.4	0.2	80	6.0	1.7	7.0
04/18	Apax Digital Fund	Solita	76.1			650			
03/18	Viria	BitFactor	14.0			150			
03/18	Digia	Avarea	3.6			41			
04/18	Sofigate	Csolutor (FI)	6.9			50			
01/18	Sofigate	Headstart (FI)	5.0						
01/18	Solteq	TM United A/S (DK)	4.8	0.5	0.1	35	3.5	0.7x	7.3x

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Reduce The 12-month risk-adjusted expected shareholder return of the share is weak

Sell The 12-month risk-adjusted expected shareholder return of the share is very weak

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Recommendation history (>12 mo)

Date	Recommendation	Target price	Share price
2/20/2017	Reduce	€ 1.60	€ 1.69
4/24/2017	Reduce	€ 1.70	€ 1.71
7/12/2017	Accumulate	€ 1.80	€ 1.62
7/18/2017	Reduce	€ 1.75	€ 1.68
9/06/2017	Reduce	€ 1.75	€ 1.73
10/27/2017	Reduce	€ 1.60	€ 1.60
2/20/2018	Reduce	€ 1.50	€ 1.50
4/27/2018	Reduce	€ 1.65	€ 1.63
8/13/2018	Reduce	€ 1.55	€ 1.53
10/26/2018	Reduce	€ 1.55	€ 1.46
3/01/2019	Reduce	€ 1.45	€ 1.50
5/02/2019	Reduce	€ 1.50	€ 1.48
5/17/2019	Reduce	€ 1.50	€ 1.44
8/13/2019	Reduce	€ 1.50	€ 1.48
10/30/2019	Reduce	€ 1.45	€ 1.41
2/25/2020	Reduce	€ 1.45	€ 1.45
2/28/2020	Reduce	€ 1.30	€ 1.33
4/05/2020	Reduce	€ 1.00	€ 1.00
5/04/2020	Reduce	€ 1.10	€ 1.08
8/14/2020	Accumulate	€ 1.60	€ 1.47
10/30/2020	Buy	€ 2.00	€ 1.59
12/08/2020	Reduce	€ 3.00	€ 3.00
2/03/2021	Accumulate	€ 3.40	€ 2.96

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Itämerentori 2

FI-00180 Helsinki, Finland

+358 10 219 4690

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