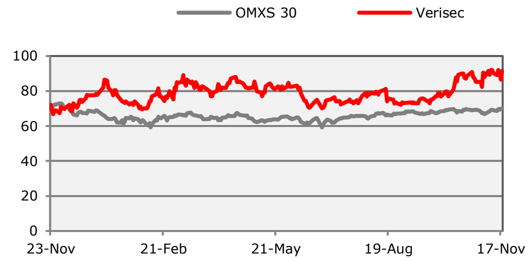
Summary

Verisec (VERI.ST)

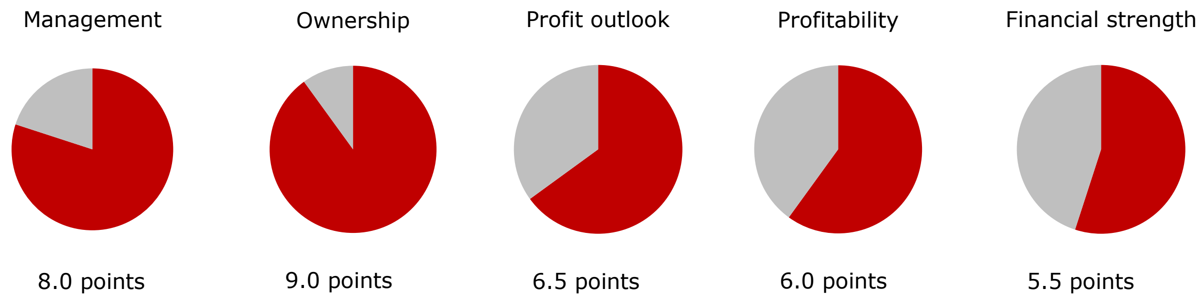
Better future profitability

- Verisec reported revenue of SEK 16.6 million, which was in line with our estimate of SEK 13 million. EBIT was better than expected, at SEK -2.8 million, while our expectation was SEK -4.5 million.
- A high level of business activity and a continued focus on sharpening the product and service offering will likely mark the beginning of a bright future. A directed share issue of SEK 34 million has improved the company's circumstances in a competitive landscape.
- We have lowered our EBIT expectations in the short term due to the high cost of growth. However, higher investment will pay off in 2019 and beyond. Our new value range is between SEK 50-140 with a base case of SEK 75 (earlier SEK 65).

List:	First North
Market Cap:	406 MSEK
Industry:	Information Technology
CEO:	Johan Henrikson
Chairman:	Dragoljub Nesic



Redeye Rating (0 – 10 points)



Key Financials

	2014	2015	2016E	2017E	2018E
Revenue, MSEK	55	66	62	85	110
Growth	*-3%*	*20%*	*-7%*	*38%*	*29%*
EBITDA	3	-7	-15	-7	6
EBITDA margin	*5%*	*-11%*	*-24%*	*-8%*	*6%*
EBIT	2	-10	-18	-15	5
EBIT margin	*3%*	*-14%*	*-30%*	*-18%*	*5%*
Pre-tax earnings	2	-10	-17	-14	5
Net earnings	1	-8	-17	-12	4
Net margin	*2%*	*-12%*	*-28%*	*-14%*	*4%*
Dividend/Share	0.00	0.00	0.00	0.00	0.00
EPS adj.	0.33	-2.03	-3.88	-2.68	0.96
P/E adj.	119.5	-36.9	-23.6	-34.1	95.5
EV/S	2.1	4.1	6.4	4.7	3.6
EV/EBITDA	45.7	-38.3	-26.6	-56.1	63.9

Share information	
Share price (SEK)	91.5
Number of shares (m)	4.4
Market Cap (MSEK)	406
Net debt (MSEK)	-13
Free float (%)	33 %
Daily turnover ('000)	100

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Redeye Rating: Background and definitions

The aim of a Redeye Rating is to help investors identify high-quality companies with attractive valuation.

Company Qualities

The aim of Company Qualities is to provide a well-structured and clear profile of a company's qualities (or operating risk) – its chances of surviving and its potential for achieving long-term stable profit growth.

We categorize a company's qualities on a ten-point scale based on five valuation keys; 1 – Management, 2 – Ownership, 3 – Profit Outlook, 4 – Profitability and 5 – Financial Strength.

Each valuation key is assessed based a number of quantitative and qualitative key factors that are weighted differently according to how important they are deemed to be. Each key factor is allocated a number of points based on its rating. The assessment of each valuation key is based on the total number of points for these individual factors. The rating scale ranges from 0 to +10 points.

The overall rating for each valuation key is indicated by the size of the bar shown in the chart. The relative size of the bars therefore reflects the rating distribution between the different valuation keys.

Management

Our Management rating represents an assessment of the ability of the board of directors and management to manage the company in the best interests of the shareholders. A good board and management can make a mediocre business concept profitable, while a poor board and management can even lead a strong company into crisis. The factors used to assess a company's management are: 1 – Execution, 2 – Capital allocation, 3 – Communication, 4 – Experience, 5 – Leadership and 6 – Integrity.

Ownership

Our Ownership rating represents an assessment of the ownership exercised for longer-term value creation. Owner commitment and expertise are key to a company's stability and the board's ability to take action. Companies with a dispersed ownership structure without a clear controlling shareholder have historically performed worse than the market index over time. The factors used to assess Ownership are: 1 – Ownership structure, 2 – Owner commitment, 3 – Institutional ownership, 4 – Abuse of power, 5 – Reputation, and 6 – Financial sustainability.

Profit Outlook

Our Profit Outlook rating represents an assessment of a company's potential to achieve long-term stable profit growth. Over the long-term, the share price roughly mirrors the company's earnings trend. A company that does not grow may be a good short-term investment, but is usually unwise in the long term. The factors used to assess Profit Outlook are: 1 – Business model, 2 – Sale potential, 3 – Market growth, 4 – Market position, and 5 – Competitiveness.

Profitability

Our Profitability rating represents an assessment of how effective a company has historically utilised its capital to generate profit. Companies cannot survive if they are not profitable. The assessment of how profitable a company has been is based on a number of key ratios and criteria over a period of up to the past five years: 1 – Return on total assets (ROA), 2 – Return on equity (ROE), 3 – Net profit margin, 4 – Free cash flow, and 5 – Operating profit margin or EBIT.

Financial Strength

Our Financial Strength rating represents an assessment of a company's ability to pay in the short and long term. The core of a company's financial strength is its balance sheet and cash flow. Even the greatest potential is of no benefit unless the balance sheet can cope with funding growth. The assessment of a company's financial strength is based on a number of key ratios and criteria: 1 – Times-interest-coverage ratio, 2 – Debt-to-equity ratio, 3 – Quick ratio, 4 – Current ratio, 5 – Sales turnover, 6 – Capital needs, 7 – Cyclicality, and 8 – Forthcoming binary events.

Continued EBIT pressure

Verisec reported revenue of SEK 16.6 million, which was in line with our estimate of SEK 17 million. EBIT was better than expected, at SEK -2.8 million, while we expected SEK -4.5 million.

Estimates

SEKm	Q2'16	Q3'16E	Actual	Diff.
Revenues	**14.6**	**17.0**	**16.6**	**-2%**
COGS	**-5.0**	**-6.0**	**-5.5**	**8%**
Gross Margin	66%	65%	67%	
External costs	-6.6	-7.5	-5.9	22%
Personnel costs	-7.9	-7.0	-7.1	-2%
Depreciation	-0.8	-1.0	-0.9	10%
EBIT	**-5.7**	**-4.5**	**-2.8**	
Sales Growth (QOQ	4%	-5%	-8%	
EBIT margin %	*-39.0%*	*-26.5%*	*-16.7%*	

Source: Redeye Research

Continued EBIT pressure is expected in the following quarters.

Increased costs for personnel and sales initiatives continued to put pressure on EBIT, and this is expected continue in the coming quarters. However, external costs and COGS were better than our estimates, which allowed higher than expected EBIT in Q3. Efforts to provide a product that is better adapted to the market will likely continue to squeeze EBIT as costs increase in the short term, such as for investment in the company's business model transformation to Authentication as a Service (AaaS).

High level of business activity during Q2 2016

Business activity during the quarter was high, and this continued after the end of the period. In August, Verisec signed an agreement with the Scottish local authority of North Lanarkshire for a complete infrastructure solution using Verisec's Freja ID and Freja Mobile digital identities.

Verisec also renewed its agreement with Government Cloud (GCloud) in the UK. This agreement allows public sector clients and prospects to order cloud-based products and services directly from Verisec, thus avoiding public procurement.

Verisec also expanded its collaboration with Banco Provincial in Venezuela when the bank made an additional order to address problems of card fraud among its customers.

Cajamar: Important new customer in Spain

Grupo Cooperativo Cajamar has signed an agreement to implement Verisec's Freja Mobile and Freja ID digital identity products for its mobile application for end customers. Cajamar is a major Spanish banking group with over 1,200 branches and 4 million customers.

Cajamar intends that all its customers with a smartphone should eventually be able to use Verisec's digital identity solution. However it is uncertain when Verisec's solutions will be fully deployed throughout Cajamar's infrastructure. Factors such as Cajamar's overall digital efforts, including app development, and customer demand will be critical in how long the deployment takes.

SBAB: Service expansion

In May, Verisec signed a contract with a major Swedish financial group for products and services relating to secure signing and login. The solution was initially intended to help retail customers to log in by phone (telephone banking). The name of the customer was unknown, but on October 7 the collaboration was extended with digital identities for new services, at which time Verisec communicated that the financial group was SBAB. Verisec's Freja ID will now include enhanced login to external services for lending (SBAB's SPAR segment). SBAB customers have 259,000 registered savings accounts.

Directed share issue enables new business model

Verisec announced a directed share issue of SEK 34.255 million, with 403,000 new shares priced at SEK 85. The buyer is the successful mutual fund Swedbank Robur Ny Teknik. The money will primarily be used to enable a shift from Verisec's digital identities product offering towards a subscription-based model. This kind of transition is normally costly in the short run, but should increase Verisec's recurring revenue and profitability in the long run.

Following the directed share issue, Swedbank Robur Ny Teknik is Verisec's second-largest shareholder and its largest institutional investor, with 9 percent of shares and votes. The placement leads to dilution of approximately 10 percent for existing shareholders, but the share price of SEK 85 represents a premium of 3 percent compared with the closing price on the previous day. Over the past 30 days the share has been traded between SEK 79 and SEK 91, which is an all-time high for Verisec.

Subscriptions enables higher recurring revenues and better profitability

The background to this capital injection is that Verisec is in discussions with a number of potential new customers seeking a subscription-based model instead of a product offering. This demand has existed for a long time, but Verisec now believes the time is right to offer the new business model. One positive aspect of the transition is that, by delivering a service instead of a product, Verisec will obtain a closer relationship with its customers. Offering subscriptions also often means more stable cash flows, better recurring revenues and better profitability. Exactly what the new offering will look like is still not finalised, but this shift towards subscription-based models is a strong trend in all kinds of software companies so we are not surprised that Verisec is making the switch. Another positive effect is that the service offering will become more standardised, in contrast to the more customised product solution the company has today. An initial version of the new service offering is expected to be on the market from Q3 2017.

Market Analysis

Strong authentication market

According to Verizon, 80 percent of cyber-attacks are possible due to simple passwords. Along with this comes a convenience issue, namely the increasing number of passwords used. A study by the Ponemon Institute of approximately 2,000 participants indicated a general mistrust towards passwords. In essence, almost half of consumers do not trust systems or websites that rely on passwords, making this a significant issue for companies to solve in going forward if they are to avoid losing consumers.

This means that it is natural for corporations to consider strong authentication. Since 2013, the Breach Level Index has reported 3 billion security breaches and it is likely that the majority of records were not encrypted. According to Ponemon, 43 percent of the sample companies experienced a data breach in 2014, which is a 30 percent increase from the previous year. The increasing number of breaches and the greater use of online banking ought to lead to an increased need for software ID solutions. Considering the large increase in the frequency of cyber-attacks, it is evident that companies will choose to seek out support services and solutions from specialized security firms like Verisec.

According to Gartner, the market for two-factor authentication is worth USD 2 billion, and represents around 3 percent of the total security market. Given the intensity of the competition, even a 0.1 percent stake (approx. SEK 150 million) of this market is strong performance.

In general, product demand is at its greatest where high security is most critical, such as in banking and finance, e-government, defense and enterprise security. Furthermore, around 88 percent of IT technology decision-makers regard existing threats and vulnerabilities as being of high or critical priority.

Two major emerging trends

Software tokens that use smartphones are one major component in achieving both cost efficiency for banks, as well as maximum utility for customers. This segment is expected to grow with a CAGR of 50 percent until 2016, according to TechNavio.

We expect that Authentication as a Service (AaaS), and its associated cloud services, will grow significantly in both the banking and the non-banking verticals, and Verisec is fully aligned for this development by its Freja Service solution.

Competitive landscape and verticals

We start by depicting Verisec's competitive landscape by segment, and then describe the current leaders and prospective leaders.

Classification	Digital identity		Information Security
Leaders	US EMC Corp, Vasco Data Security, Symantec, Nok Nok Labs	EU Gemalto	US Safenet
Challengers	US Ping identity, Okta, Centrify, Google, SaasPaas	EU Pointsharp AB, Encap Security, Finansiell ID Teknik BID AB	US Cryptomathic, Porticor LTD.

The figure above indicates that the leaders specializing in security are mainly from the US. These companies typically have a high level of exposure to the banking sector and aim to diversify their portfolios. For example, Vasco's management recently intensified its focus on cloud solutions and the non-banking verticals. Pursuing hot trends however, may not be the best option for Verisec in the long term since competition will be significant. These companies regularly make acquisitions to keep up with the latest technology, which could pose a risk for a smaller player like Verisec, which may not have the expertise or the financial strength to acquire disruptive technology.

The landscape is poised to change significantly in the coming years since innovators such as Google may become leaders in this sector with their solutions. We can expect cloud solutions to be heavily disrupted by Google Authenticator, especially in the public/enterprise sector, where this is a serious consideration for any head of IT. Google can be seen as mimicking what the other leaders are doing, but for free, and its solution has already gained widespread utilization across industries. Nevertheless, Verisec's edge lies in its dedicated support, adaptability and full-service solution, along with strong market momentum, which it will probably be able to continue to rely on.

The information security segment is dominated by a small number of players, with Thales accounting for almost 80 percent of worldwide payment transactions. Verisec acts as a reseller for Thales. Safenet (acquired by Gemalto) is the company's strongest competitor in this segment.

Potential in the banking vertical

We regard the banking sector as Verisec's most important vertical in going forward, since we believe it generates the majority of revenues. The cost of breaches can be significant to banks due to their responsibility and accountability for fraudulent transactions. There is a clear growth trend in online banking usage, with Gemalto forecasting 48 percent growth in the US and Europe over the next four years.

Online banking represents approximately 30 percent of the market worldwide according to comScore. Asia is poised for higher growth; it represents a low market share, but is expected to grow over time in correlation with internet user numbers.

This means there is still a large potential for ground to be gained in the online banking industry, but this will be much harder to achieve in reality. The potential for Verisec may lie in binding one or two mega-banks, but this is less likely as it faces severe competition from solutions offered by larger security providers such as Vasco, RSA and Gemalto. AaaS and biometrics could trigger further competition for Verisec within this segment.

Opportunities in the non-banking vertical

The non-banking vertical includes enterprise security and other segments that may grow in the future.

The company has already established strong market shares in some niches, with around 20-30 percent of all UK local council users utilizing Verisec solutions. The confidence of UK local councils will likely help it to expand its market share to approximately 50 percent by 2018 – along with significant opportunities in other EMEA local councils.

The planned implementation of a new European data protection law by 2016 will impose significant fines on corporations if they do not comply with the regulations.

Additionally, we believe that similar opportunities could exist within or outside governmental organizations in other markets. The problem within enterprises is often cost, which may hinder organizations from adapting to these solutions. Gambling verification is also an opportunity, this could be a profitable business given that many individual Nordic sites exceed 500,000 registrations. Hospitals and universities are other sectors that could become interesting for Verisec.

Estimates

Based on the company's success, especially in the banking vertical, and the strong need for full-service security providers, we expect Verisec to have significant traction in its growth for the foreseeable future. Redeye believes the company will meet, or come close to, its sales target growth of SEK 200 million by 2020.

Its current cash balances have increased from around SEK 22 million to SEK 56 million after the quarter, thanks to the directed shares issue. The cash will secure the company's investment needs to enhance the momentum of its growth during the transition phase.

In the most recent year, the company did not obtain sufficient orders in relation to its cost of sales to gain momentum in margins, as personnel and external costs increased. This is expected to gradually revert into margin expansion when the salesforce comes up to speed. We expect Verisec's margins to expand as the company reaches scale of revenues and maturity in its markets for software sales. This process is likely to take time, and we therefore do not expect any significant margin expansion in the near term.

Business shift leads us to change our estimates

There have been some changes to our estimates. The gross margin has been changed on the downside by a few percent for the next two years. Verisec will meet customer demand and transition its business model by delivering a service instead of a product, known as Authentication as a Service (AaaS), to prospects that ask for this offering. A subscription-based model often means more stable cash flows, better recurring revenues and better profitability in the long run. But in the short term, the subscription-based model will mean decreased revenues due to lower initial take from customers implementing Verisec's solution. This means higher margin pressure in 2017 and 2018 than previously expected. However, our scenario suggests higher long-term margins and more stable cash flows.

Estimates - 2016/2017

SEKm	Q1'15	Q2'15	Q3'15	Q4'15	Q1'16	Q2'16	Q3'16E	Q4'16E	2016E	2017E	2018E
Revenues*	**13.7**	**15.9**	**18.0**	**18.4**	**12.3**	**14.6**	**17.0**	**18.0**	**62**	**85**	**110**
Sales Growth Rate										*37%*	*29%*
COGS	*3.5*	*7.0*	*7.6*	*5.7*	*3.1*	*5.0*	*6.0*	*6.3*	*20*	*28*	*34*
Gross margin	*74%*	*56%*	*58%*	*69%*	*75%*	*66%*	*65%*	*65%*	*64%*	*67%*	*69%*
Personnel + external costs	10.0	12.5	12.1	12.7	14.0	14.5	14.5	14.5	58	66	69
Depreciation	0.5	0.8	0.5	0.7	1.0	1.0	1.0	1.0	4	5	6
EBIT	**-0.4**	**-4.4**	**-2.2**	**-0.6**	**-5.8**	**-5.9**	**-4.5**	**-3.8**	**-20**	**-14**	**1**
EBIT Margin	*-3%*	*-28%*	*-12%*	*-4%*	*-47%*	*-40%*	*-26%*	*-21%*	***-32%***	***-16%***	***1%***

Source: Redeye Research

*After R&D Recognized Revenues

Valuation

In this section we perform DCF and peer analysis to determine the value of the company.

DCF

In our DCF scenario, we assume that the company is able to enjoy momentum in its key markets, it will however have to cope with more intense competition and constantly adapt to a changing security software landscape. The company has an efficient sales organization and is established in niches across the banking and non-banking verticals, which will produce higher EBIT margins and sales growth in the foreseeable future. Verisec's digital identity segment accounts for the majority of the company's success, but if competition intensifies and makes the product portfolio obsolete, it is possible that Verisec will have to adapt and accept lower margins by acting as a service provider for other proprietary solutions.

In general, sales momentum is being fueled by regulation, increased security concerns and a transition from hardware to software tokens. All of these are powerful forces that will set the company to grow at an even higher rate than the market.

Its current cash balances of around SEK 56 million will secure Verisec's investment needs to enhance the momentum of its growth during the transition phase. This will also give the company room for some upgrades in existing technologies and possible endeavors in other technologies such as biometrics. We anticipate that only a small requirement for working capital will be necessary during the strong sales momentum since additional products do not require more inventory.

The EBIT margin is expected to be around 7 percent with an average sales growth of 25 percent during the period 2017-2022. Based on our rating and on our discount rate of 10.3 percent, we estimate the company's DCF value in our base case to be **SEK 75.**

Investment Case

Verisec is a software security company providing digital identity solutions, including mobile ID, and information security solutions such as encryption and decryption. Since it was founded, Verisec's skilled management team has been quick to adapt to the market environment, enabling the company to outgrow the security market as a whole. Verisec's management originates from the successful Protect Data business, and they retain significant ownership in Verisec of approximately 60 percent. Verisec's compound annual growth rate has been substantial, at around 30 percent, and its EBIT margins have remained relatively stable at around 15 percent over the past 12 years. The company's target is to achieve revenues of SEK 200 million in year 2020 with an EBIT margin of 15-20 percent.

Redeye's investment case rests on strong annual revenue growth of 20-30 percent over the coming years, along with subsequent margin expansion at the maturity phase. The maturity phase is the likely future scenario where its investment decreases, enjoying decent sales momentum on its existing solution portfolio. Verisec has the potential to expand its margin significantly once it achieves maturity, with its EBIT margin eventually reaching around 15-20 percent. We expect that Authentication as a Service (AaaS), and its associated cloud services, will grow significantly in both the banking and the non-banking verticals.

Reviewing the revenue distribution among Verisec's customers, its ten largest account for approximately 50 percent of revenues. In the longer term we expect Verisec's customer concentration to decrease as its customer numbers increase. Approximately 20 percent of the company's total revenues are recurring, with the average length of recurring revenue streams at approximately three years and with a proper time-spread of contracts. With its segments, including Freja Mobile, requiring increasing support, we estimate that the company will grow its share of recurring revenues over the longer term. This will become evident in the maturity stage, when non-recurring revenue will decline, thus inducing a margin expansion.

Verisec holds a significant position in the information security segment, as a preferred supplier to Thales within the EMEA region, providing data encryption. This business is likely to continue to grow in absolute terms but will probably remain static as a proportion of total revenues in the longer term. Verisec's reseller network for Thales also plays an important role in gaining, widening and intensifying its sales of proprietary solutions for Freja ID.

Representing 80 percent of sales for the digital identity segment, online banking is a core focus for Verisec and is likely to remain so in the future. Online banking customer penetration is relatively low in Europe, at approximately 38 percent, and the growth rate of online banking users is expected to be 48 percent in the US and Europe over the next four years.

Online banking penetration is one important factor for Verisec's continued growth but, more importantly, capturing the next frontier solution requires rapid adaptation to user convenience.

With smartphones expected to be available to 2.5 billion people in 2017, a non-standalone device that covers the majority of people will be required in the future. Mobile IDs or software tokens are expected to experience CAGR of 50 percent by 2016, and TechNavio estimates that in 2019 the software token market will represent approximately 20 percent of the total security token market. The hardware token market (proprietary physical log-in devices) is expected to grow only by around 8 percent. This is explained by the changing climate in the industry: Hardware tokens are not cost-efficient per user over software solutions.

Furthermore, revenue growth will be enhanced by Verisec establishing itself in the public and enterprise sectors. The company has already established strong market shares in some niches, with around 20-30 percent of all UK local council users utilising Verisec solutions. This confidence of UK local councils will likely help its market share to expand to approximately 50 percent by 2019.

A probable risk is an increase in alliances or bank consortiums, making all or parts of Verisec's solutions portfolio a standard across a sector. This could be a consequence of meeting regulatory security requirements or for organisations to control their own security solutions. Another alternative to buying Verisec's solutions would be to create a consortium of participants to share development costs, rather like the Swedish consortium for mobile bank ID solutions supplying the major banks. Organisations reproducing this strategy and type of technology within EMEA should not be disregarded.

Scenario Analysis

This analysis presents the scenario range from the most pessimistic to the most optimistic.

Bear Case

In our bear case, we assume that disruptive technologies limit Verisec's competitive advantage and that margins consequently fall in order to sustain sales. Despite this, sales efforts and dedicated support by the company induce continued growth in small niches for local councils and banks. We assume in this scenario due to the highly competitive landscape, that the proportion of recurring revenues expands more rapidly than in our other scenarios as new sales shrink, nevertheless, it may be prudent to question the recurring revenue extensions. This leads to an assumption that the company will trade at a level depicting the future risk warranted in this scenario at that point of time in the future. Average EBIT margins will be around 1 percent during the period 2017-2022, with a growth rate of 9 percent. This leads to a value of **SEK 50** with a probability of 25 percent.

Base Case

In our base case, we assume that the company can maintain sales momentum in the EMEA region, led by focused sales efforts and early-mover advantage in niche markets in the banking and non-banking verticals.

Furthermore, we assume that the company retains its competitive standing by gradually transitioning itself to the security software segment. This is achieved in practice by continuously improving the following parts of its product portfolio: a) cost, b) user convenience and relevance, and c) security.

Margin contraction can be expected, although it will provide enough to expand the margin significantly from the current level. The company must seek to retain a high degree of new product sales, around 60-80 percent, which could be significantly difficult considering the competitive landscape, making it a price taker.

The EBIT margin is expected to be around 7 percent with an average sales growth of 25 percent during the period 2017-2022. Based on our rating and on our discount rate of 10.3 percent, we estimate the company's DCF value in our base case to be **SEK 75.**

Bull Case

In our bull case, we assume that the company is able to retain and improve its competitive standing through higher-than-expected expenses in biometrics and innovations in the software token market. Consequently, the sales efforts in its niches makes it easier to negotiate favorable prices and Verisec gains product momentum led by its increased efforts on product development in its niche market segments. In this scenario, we assume that the company will at a future point of time, in 3-5 years be seen as a company with prospects for further margin expansion and growth.

Its margins are set to be around 17 percent with an average sales growth of approximately 26 percent during the period 2018-2022. This leads to a DCF value of **SEK 140** per share with a probability of 25 percent.

Margins around 10 percent in maturity phase

This is a key question in valuing Verisec today. If the company becomes service-dominated, we will see EBIT-margins in the range of 5-10 percent in the longer term. This is not unlikely as competition becomes more intense and its product may be increasingly confronted with intense pricing pressure. If the company is able to gain momentum in niche markets through its software solutions however, Verisec could gain EBIT margins of 10-20 percent. This is in line with its historical margins. The economies of scale are evident, with its mobile solution providing substantial margins when binding larger or many smaller customers. The lower margin reflects harsher conditions and could quite possibly be even lower if Verisec needs to compete on price to allow sales to grow at a decent rate.

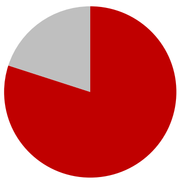
We estimate that the company will be able to maintain a margin at around 10 percent on maturity at an entity level, and grow faster than the market. Otherwise, we believe that Verisec could achieve higher margins but would grow at a slower rate as this strategy would be the likely consequence of a more margin-focused approach than currently being witnessed.

Summary Redeye Rating

The rating consists of five valuation keys, each constituting an overall assessment of several factors that are rated on a scale of 0 to 2 points. The maximum score for a valuation key is 10 points.

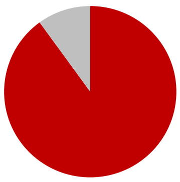
No rating changes in the report

Management 8.0p



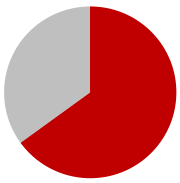
The current leadership has delivered in terms of both growth and profitability over an extended time horizon. The allocation of capital by management can be considered value-accretive by observing its track record. Albeit, the management track record performance was largely during the pre-IPO era making the decisions of management hard to follow and interpret. Transparency could be increased to some extent in terms of more detailed segment revenues for example.
Although, management has historically allowed Verisec to grow with profitability at a pace it can handle.

Ownership 9.0p



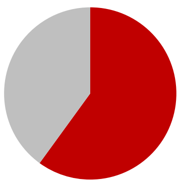
The founders of Protect Data own a significant share of the company. This ownership has enabled the company to grow profitably and to constantly evolve its products and services. An entrance of institutions into the company would increase this rating.

Profit outlook 6.5p



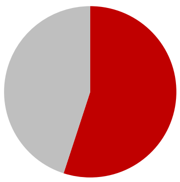
The company has since its inception been able to transform its product offering in line with user convenience trends. However, the competition is intense and there are a number of initiatives that pose a danger to the company in the longer term, possibly including Google Authenticator and the FIDO Alliance.

Profitability 6.0p



Verisec has historically had an impressive profitability record during periods of high growth. It was not until recently that the level of profitability dropped due to its expansion into EMEA. It has a defensive approach to expansion - expanding through long-term profitability rather than through growth.

Financial strength 5.5p



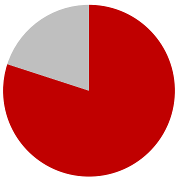
Verisec has a strong cash position from its cash flow and a major equity issue. These funds will likely be enough to cover the future trajectory of its expansion plans and product development. Enhancing its proportion of recurring revenue and diversifying the allocation of revenue among its customers would increase Verisec's rating.

Summary Redeye Rating

The rating consists of five valuation keys, each constituting an overall assessment of several factors that are rated on a scale of 0 to 2 points. The maximum score for a valuation key is 10 points.

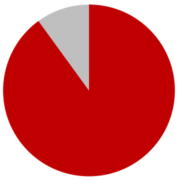
No rating changes in the report

Management 8.0p



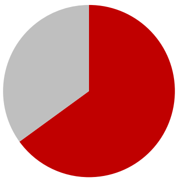
The current leadership has delivered in terms of both growth and profitability over an extended time horizon. The allocation of capital by management can be considered value-accretive by observing its track record. Albeit, the management track record performance was largely during the pre-IPO era making the decisions of management hard to follow and interpret. Transparency could be increased to some extent in terms of more detailed segment revenues for example.
Although, management has historically allowed Verisec to grow with profitability at a pace it can handle.

Ownership 9.0p



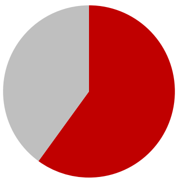
The founders of Protect Data own a significant share of the company. This ownership has enabled the company to grow profitably and to constantly evolve its products and services. An entrance of institutions into the company would increase this rating.

Profit outlook 6.5p



The company has since its inception been able to transform its product offering in line with user convenience trends. However, the competition is intense and there are a number of initiatives that pose a danger to the company in the longer term, possibly including Google Authenticator and the FIDO Alliance.

Profitability 6.0p



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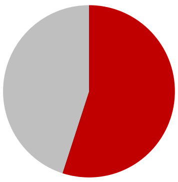
Financial strength 5.5p



Verisec has a strong cash position from its cash flow and a major equity issue. These funds will likely be enough to cover the future trajectory of its expansion plans and product development. Enhancing its proportion of recurring revenue and diversifying the allocation of revenue among its customers would increase Verisec's rating.

Income statement	2014	2015	2016E	2017E	2018E
Net sales	55	66	62	85	110
Total operating costs	-53	-73	-76	-92	-104
EBITDA	**3**	**-7**	**-15**	**-7**	**6**
Depreciation	-1	0	-1	0	0
Amortization	0	-3	-3	-8	-1
Impairment charges	0	0	0	0	0
EBIT	**2**	**-10**	**-18**	**-15**	**5**
Share in profits	0	0	0	0	0
Net financial items	0	0	1	1	0
Exchange rate dif.	0	0	0	0	0
Pre-tax profit	**2**	**-10**	**-17**	**-14**	**5**
Tax	-1	0	0	2	-1
Net earnings	**1**	**-8**	**-17**	**-12**	**4**

Balance	2014	2015	2016E	2017E	2018E
Assets					
Current assets					
Cash in banks	42	30	31	37	81
Receivables	20	24	21	29	38
Inventories	1	1	1	1	2
Other current assets	0	0	0	0	0
Current assets	**63**	**55**	**54**	**67**	**121**
Fixed assets					
Tangible assets	2	2	2	3	4
Associated comp.	0	0	0	0	0
Investments	0	0	0	0	0
Goodwill	0	0	0	0	0
Cap. exp. for dev.	0	0	0	0	0
O intangible rights	4	6	9	6	10
O non-current assets	0	0	0	0	0
Total fixed assets	**6**	**9**	**11**	**9**	**14**
Deferred tax assets	1	0	0	0	0
Total (assets)	**70**	**64**	**65**	**76**	**135**
Liabilities					
Current liabilities					
Short-term debt	0	0	18	29	70
Accounts payable	30	33	33	45	58
O current liabilities	3	3	3	3	3
Current liabilities	**33**	**36**	**54**	**77**	**132**
Long-term debt	0	0	0	0	0
O long-term liabilities	0	0	0	0	0
Convertibles	0	0	0	0	0
Total Liabilities	**33**	**36**	**54**	**77**	**132**
Deferred tax liab	1	0	0	0	0
Provisions	0	0	0	0	0
Shareholders' equity	35	28	11	-1	3
Minority interest (BS)	0	0	0	0	0
Minority & equity	**35**	**28**	**11**	**-1**	**3**
Total liab & SE	**70**	**64**	**65**	**76**	**135**

Free cash flow	2014	2015	2016E	2017E	2018E
Net sales	55	66	62	85	110
Total operating costs	-53	-73	-76	-92	-104
Depreciations total	-1	-3	-3	-8	-1
EBIT	**2**	**-10**	**-18**	**-15**	**5**
Taxes on EBIT	0	0	0	2	-1
NOPLAT	**1**	**-10**	**-18**	**-13**	**4**
Depreciation	1	3	3	8	1
Gross cash flow	**2**	**-7**	**-15**	**-5**	**5**
Change in WC	5	-2	3	4	4
Gross CAPEX	-4	-5	-6	-6	-6
Free cash flow	**4**	**-14**	**-18**	**-7**	**4**

Capital structure	2014	2015	2016E	2017E	2018E
Equity ratio	50%	43%	16%	-2%	2%
Debt/equity ratio	0%	0%	171%	-2,294%	2,362%
Net debt	-42	-30	-13	-7	-11
Capital employed	-7	-2	-3	-9	-8
Capital turnover rate	0.8	1.0	1.0	1.1	0.8

Growth	2014	2015	2016E	2017E	2018E
Sales growth	-3%	20%	-7%	38%	29%
EPS growth (adj)	-18%	-707%	91%	-31%	-136%

DCF valuation		Cash flow, MSEK	
WACC (%)	10.3 %	NPV FCF (2016-2018)	13
		NPV FCF (2019-2025)	85
		NPV FCF (2026-)	208
		Non-operating assets	30
		Interest-bearing debt	0
		Fair value estimate MSEK	337
Assumptions 2016-2022 (%)			
Average sales growth	24.8 %	**Fair value e. per share, SEK**	**75.9**
EBIT margin	1.4 %	Share price, SEK	91.5

Profitability	2014	2015	2016E	2017E	2018E
ROE	6%	-26%	-89%	0%	0%
ROCE	7%	-27%	-60%	-49%	10%
ROIC	-24%	135%	802%	490%	-50%
EBITDA margin	5%	-11%	-24%	-8%	6%
EBIT margin	3%	-14%	-30%	-18%	5%
Net margin	2%	-12%	-28%	-14%	4%

Data per share	2014	2015	2016E	2017E	2018E
EPS	0.33	-2.03	-3.88	-2.68	0.96
EPS adj	0.33	-2.03	-3.88	-2.68	0.96
Dividend	0.00	0.00	0.00	0.00	0.00
Net debt	-10.58	-7.52	-2.98	-1.65	-2.48
Total shares	4.00	4.00	4.44	4.44	4.44

Valuation	2014	2015	2016E	2017E	2018E
EV	117.7	269.9	392.7	398.6	394.9
P/E	119.5	-36.9	-23.6	-34.1	95.5
P/E diluted	119.5	-36.9	-23.6	-34.1	95.5
P/Sales	2.9	4.5	6.6	4.8	3.7
EV/Sales	2.1	4.1	6.4	4.7	3.6
EV/EBITDA	45.7	-38.3	-26.6	-56.1	63.9
EV/EBIT	77.1	-28.2	-21.6	-26.6	79.0
P/BV	4.5	10.8	38.2	-318.4	136.4

Share performance		Growth/year	14/16e
1 month	3.1 %	Net sales	5.5 %
3 month	21.6 %	Operating profit adj	�
12 month	24.5 %	EPS, just	�
Since start of the year	17.7 %	Equity	-45.1 %

Shareholder structure %	Capital	Votes
Marquay Invest AB	67.0 %	67.0 %
Svolder	5.6 %	5.6 %
Merlinum AB	4.1 %	4.1 %
AMF F□rs□kring & Fonder	3.8 %	3.8 %
Kristofer von Beetzen	3.0 %	3.0 %
Arpeggio AB	1.8 %	1.8 %
G□ran Collert	1.0 %	1.0 %
Denny Sj□gren	0.9 %	0.9 %
Christian Rajter	0.7 %	0.7 %
Hans Robert Sandin	0.6 %	0.6 %

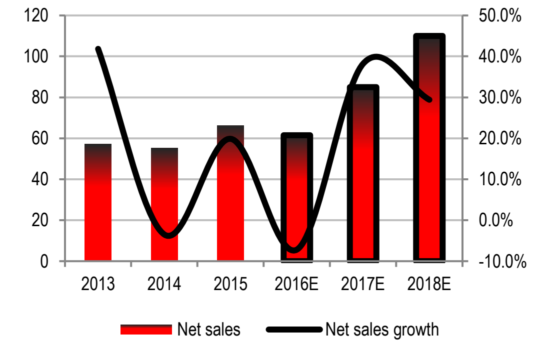
Share information	
Reuters code	
List	First North
Share price	91.5
Total shares, million	4.4
Market Cap, MSEK	405.9

Management & board	
CEO	Johan Henrikson
CFO	Jakub Missuna
IR	Kristofer von Beetzen
Chairman	Dragoljub Nesic

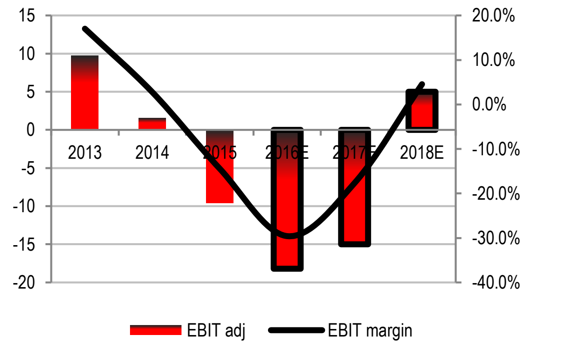
Financial information

Analysts	Redeye AB
Tomas Otterbeck	Mäster Samuelsgatan 42, 10tr
tomas.otterbeck@redeye.se	111 57 Stockholm

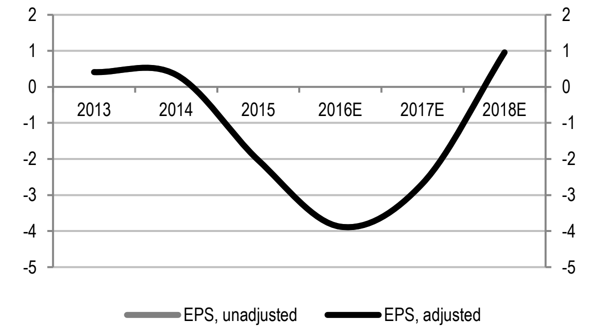
Revenue & Growth (%)



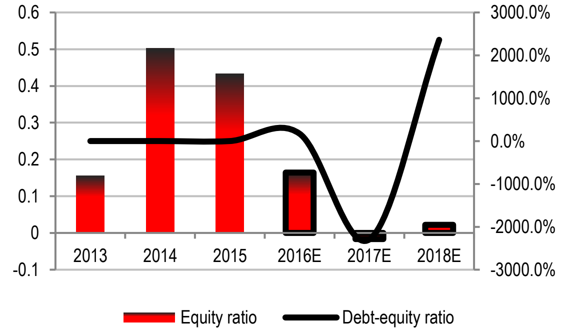
EBIT (adjusted) & Margin (%)



Earnings per share



Equity & debt-equity ratio (%)



Conflict of interests

Tomas Otterbeck owns shares in the company : No

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

Company description

Verisec has a track record of growth in security and hardware services from when it was founded in 2002. It has gradually transitioned itself into a software player in the digital identity and information security sectors. Verisec conducted an IPO in December 2014 on the First North exchange in order to access the capital markets and to meet funding for its expansion in EMEA (raised approximately 40 MSEK). They are planning to expand in Germany, Spain, Dubai and UK. The company has a goal of 200 MSEK in sales within five years accompanied with EBIT-margins between 15-20 percent.

DISCLAIMER

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Redeye Rating (2016-11-28)

Rating	Management	Ownership	Profit outlook	Profitability	Financial Strength
7,5p - 10,0p	40	42	20	8	19
3,5p - 7,0p	71	61	92	34	44
0,0p - 3,0p	9	17	8	78	57
Company N	120	120	120	120	120

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