

IAR SYSTEMS

Multiples compression post-results

The Q3 results marked the second consecutive 'clean beat and raise', where multiples has compressed as we have increase our 2023–2024e adj. EBIT by 29–13%, while the stock gained 18% today. Although small-caps generally remain out of favour, we believe IAR is in the best shape operationally in the six years we have covered it. Having trimmed the cost base, we expect 42% growth in EBIT YOY in 2024 via self-help measures, while buybacks should counter its decade-low multiples. We have raised our fair value to SEK140–210 (130–210).

Inspiring Q3, with adj. EBIT 65% above our forecast. Q3 organic sales growth was 6% YOY (we expected -4% YOY, split: deferred revenues up 11% YOY (-5% QOQ); flat upfront licences YOY; and recurring revenues up 24% YOY) on 17% organic growth YOY in the US (having repackaged its offering, targeting customers' opex budgets instead of capex). The organic growth outperformance together with solid cost control and efficiencies (net sales/employee up 15% YOY) as well as improved drop through of 95%, led to adj. EBIT 65% above our forecast (28.2% margin, up 7.4%-points YOY). FCF conversion was 121% (from 100%+ in H1 2023) as FCF grew 19% YOY, resulting in net cash of SEK128m at end-Q3. IAR has utilised <1% of its buyback mandate and touted ambitions to make complementary bolt-on M&A (likely technology-related).

We have raised our 2023–2024e net sales raised by 4–2% and adj. EBIT by 29–13%, factoring in: 1) the second consecutive significant earnings beat; 2) deal-slippage into Q4; 3) increased confidence on cost-savings; and 4) negative FX (-3% on 2024e EBIT).

We have raised our fair value to SEK140–210, corresponding to a 2024e EV/EBIT of 14–22x. We like IAR's progress to becoming a platform business, as well as: its profitable growth and solid net cash position (11% of its market cap, or 17% excluding IFRS16 leases), the latter offering prospects of generous capital allocations; the defensive qualities of c45% of revenues being recurring; the optionality in embedded security, RISC-V; and the ambition to expand its embedded systems market.

Year-end Dec	2019	2020	2021	2022	2023e	2024e	2025e
Revenue (SEKm)	406	372	358	423	451	487	520
EBITDA adj (SEKm)	146	133	238	128	149	190	215
EBIT adj (SEKm)	108	84	66	75	84	120	141
PTP (SEKm)	107	77	-69	74	69	111	131
EPS rep (SEK)	5.96	4.36	-4.94	4.23	2.98	6.17	7.33
EPS adj (SEK)	5.96	4.36	4.90	4.17	3.94	6.67	7.82
DPS (SEK)	3.00	0.00	0.00	1.50	1.38	2.33	2.74
Revenue growth (%)	5.3	-8.3	-3.8	18.1	6.6	8.2	6.7
EBITDA growth adj (%)	1.7	-9.0	79.4	-46.2	16.1	27.9	12.9
EPS growth adj (%)	-10.6	-26.8	12.5	-14.9	-5.5	69.2	17.3
EBITDA margin adj (%)	35.9	35.7	66.5	30.3	33.0	39.0	41.3
EV/Sales adj (x)	6.30	5.12	4.32	4.67	2.34	2.02	1.77
EV/EBITDA adj (x)	17.5	14.3	6.5	15.4	7.1	5.2	4.3
EV/EBIT adj (x)	23.6	22.7	23.6	26.4	12.5	8.2	6.5
P/E adj (x)	31.2	32.1	24.0	36.1	22.2	13.1	11.2
P/Book (x)	4.28	3.11	2.74	3.08	1.70	1.55	1.43
ROE (%)	14.2	9.9	nm	9.2	5.9	11.4	12.4
ROCE (%)	17.7	12.4	9.9	10.9	11.3	15.2	16.6
Dividend yield (%)	1.6	0.0	0.0	1.0	1.6	2.7	3.1
FCF yield (%)	0.9	1.9	3.6	3.3	7.3	7.3	8.0

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

IARB versus OMXS30 (12m)



Source: FactSet

SUMMARY

Share price (SEK)	87.5
Tickers	IARB SS

CAPITAL STRUCTURE

No. of shares (m)	13.7
No. of shares fully dil. (m)	13.8
Market cap. (SEKm)	1,195
NIBD adj end-2023e (SEKm)	-142
Enterprise value adj (SEKm)	1,053
Net debt/EBITDA adj (x)	-0.95
Free float (%)	100

Source: Company, DNB Markets (estimates)

NEXT EVENT

Q4 2023	08/02/2024
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ESTIMATE CHANGES (SEKm), (SEK)

Year-end Dec	2023e	2024e	2025e
Sales (old)	432.3	475.5	512.4
Sales (new)	450.7	487.4	520.3
Change (%)	4.2	2.5	1.5
EPS adj (old)	3.41	5.88	7.18
EPS adj (new)	3.94	6.67	7.82
Change (%)	15.5	13.4	8.9

Source: DNB Markets.

This report has been commissioned and paid for by IAR Systems, and is deemed to constitute an acceptable minor non-monetary benefit as defined in MiFID II

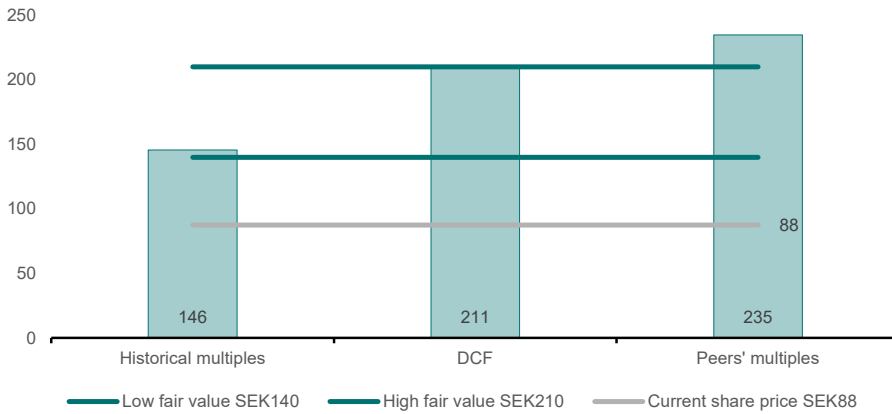
ANALYST

Joachim Gunell

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Overview

Valuation (SEK)



Source: FactSet, DNB Markets

Downside risks to our fair value

- Weakening of the embedded systems developer community (C/C++ language difficulty, cultural shifts in the workforce, low-level code abstraction, etc.).
- Competitive advantages disrupted by open-source alternatives or stronger commercial technologies.
- New product developments are too costly and might not translate into sales, which could make investors lose trust in the company's ability to resurrect its organic growth profile.
- IAR Systems is highly sensitive to a strengthening of the SEK (particularly against the USD, EUR, and JPY).

Source: DNB Markets

DNB Markets estimates

- We view IAR Systems as a market leader in a niche industry (ensuring high code quality in embedded software and programming secure devices for the Internet of tomorrow) with the potential to accelerate organic growth to above its targeted 10–15% from new product launches (for which SEK500m+ of R&D investment has already been taken).
- Our assessed medium-term value-creation potential remains high, but so is the burden of execution at this stage after the negative EPS revision trend since 2019, where we believe IAR is 1.5 years into its turnaround.

Source: DNB Markets

Valuation methodology

- We continue to base our fair value on a DCF, IAR Systems' historical valuation multiples, and a peers' multiple regression analysis (methodology unchanged).
- On our estimates, IAR Systems is trading at a 2024e P/E of 13x, EV/EBIT of 8x, and EV/sales of 2x.

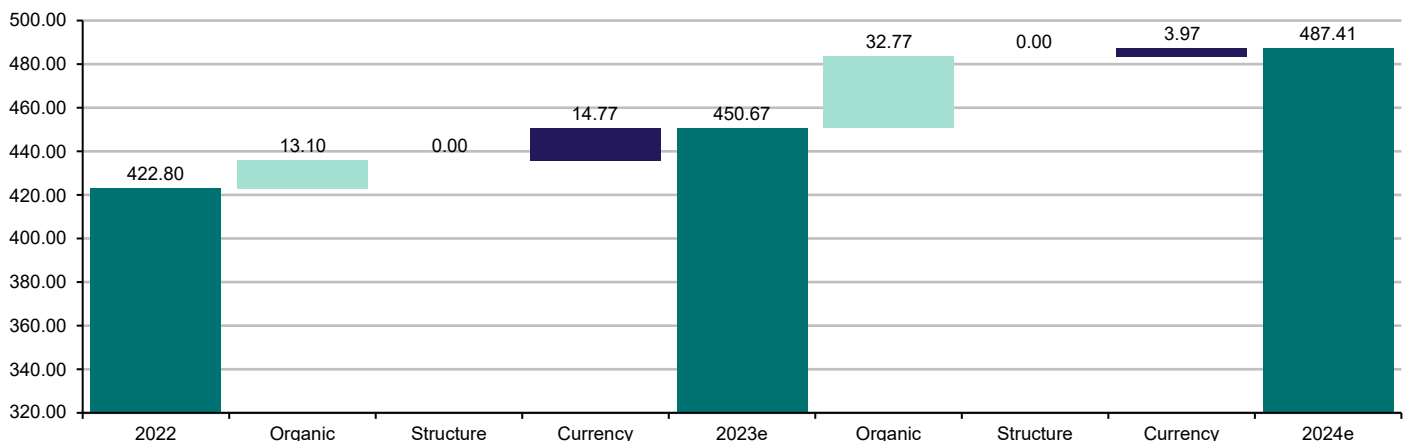
Source: DNB Markets

Upside risks to our fair value

- The company over-achieving on its financial targets (particularly 10–15% organic growth).
- Successful traction of its new offerings (IoT security, RISC-V, 64-bit, etc.) could offer potential shareholder value creation beyond our fair value.
- IoT security legislation that requires identity to be built into microcontrollers.
- SaaS transition would support the revenue mix, lessen the cyclicality, and enhance the investment profile.
- Participation in industry consolidation owing to the strategic importance of development tools.

Source: DNB Markets

Sales bridge 2022–2024e (SEKm)



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

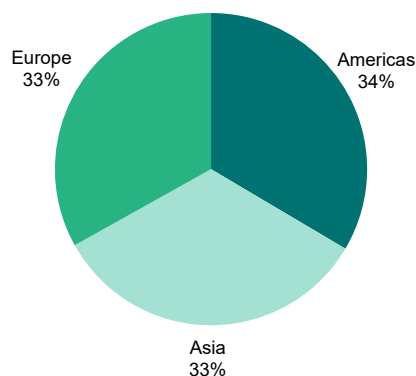
Company overview and SWOT analysis

Company description

- IAR Systems is a world-leading provider of commercial software tools and services for programming processors in embedded systems (computer hardware and software designed for a specific function) that enable the development and ensure the code quality of digital products. Its solutions support 15,000+ processors from 200+ chip vendors globally.
- Its professional customers are mainly developers (22,000 active users) at OEMs building these systems for products going into fields such as industrial automation, medical technology, telecommunication, consumer electronics, and the automotive industry.

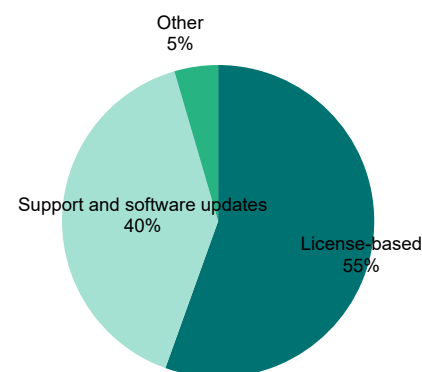
Source: DNB Markets

Sales by geography (2022)



Source: Company

Sales by mix (2022)



Source: Company

Financial targets

Through-the-cycle:

- 10–15% annual sales growth in local currencies (organic).
- EBIT margin of 25%+.

Source: Company

Key management

- CEO – Richard Lind (since 2021).
- CFO – Ann Zetterberg (since 2021).

Source: Company

Largest shareholders

- Andra AP-fonden – 9.3%.
- Avanza Pension 9.3%.
- Alcur – 6.8%.
- Aktia - 6.2%.

Source: Company

SWOT analysis

Strengths

- Niche-market leader with ~40% market share for commercial tools via its integrated development environment (IDE).
- Key competitive advantages are: 1) complete toolchain for developers regardless of processor/architecture and independent market position; and 2) superior industrial-quality, as its commercial customers cannot compromise on tools' code performance, reliability (industry standards compliance etc.), user-friendliness, access to support, or time-to-market.

Opportunities

- Early leader in two of the embedded industry's most prominent themes (embedded IoT security and RISC-V).
- Perpetual licences still make up 50%+ of IAR's sales. We prefer subscription-based revenue models versus traditional perpetual licence delivery models, since the SaaS model generates more predictable near-term revenue and cash flow, with, we believe, the potential to become more profitable longer-term (limited further customer acquisition costs).

Source: DNB Markets

Weaknesses

- IAR has yet to undergo a SaaS transition which could optically dent revenue growth and profitability.
- History of bad capital allocation in search of growth opportunities outside its core Embedded Workbench (~SEK200m Secure Thingz acquisition in 2018)

Threats

- Competitive shift as open-source-based alternatives could gain popularity, as younger generations of developers could be unwilling to pay for licences or be restricted to a single technology from one vendor.
- OEMs and processor manufacturers might prefer high-level tools that can abstract out the lower-level hardware and software in product development.

ESG overview

Sustainability assessment

	Positive	Negative
Conclusions	<p>IAR Systems’ software-development tools are market-leading in terms of code quality, analysis, functional safety, and security. Its software ensures that the code is in line with industry standards, thereby guaranteeing its reliability when applied.</p> <ul style="list-style-type: none"> ■ Increased IoT security legislation drives demand for its products, as its OEM customers must comply with new security design requirements. 	<ul style="list-style-type: none"> ■ Data loss or security bugs in the software code could trigger regulatory scrutiny as well as legal costs and reputational damage, hampering its growth prospects. ■ IAR Systems’ competitiveness relies greatly on its ability to continuously innovate. For this, its highly skilled workforce is a key resource. Failure to attract and retain such professionals could lead to delays in innovation and a loss of market share.
Actions being taken by company	<ul style="list-style-type: none"> ■ Embedded programmers need to protect their code from IP theft and illegal copying, as IoT security issues are becoming increasingly prevalent. Following the acquisition of Secure Thingz, IAR Systems’ tools are increasingly linked to sustainability, as they help developers take control of security from inception in the IP throughout the lifecycle of a digital product. 	<ul style="list-style-type: none"> ■ IAR Systems’ development tools are the most used in the embedded industry, owing to its leading optimisation technology, comprehensive debugger quality, and renowned technical support. This is confirmed by its loyal customer base (~5% annual customer churn). It has 46,000+ OEM customers and 150,000+ technology users, 95% of which recurring customers, we believe.

Key ESG drivers

Short-term

- IAR Systems’ security offering (Secure Desktop Provisioner, Embedded Trust, and C-Trust) ensures that its customers’ intellectual property is protected against IP theft, overproduction, and piracy, and that software updates can be managed in a secure fashion. In other words, it creates a secure infrastructure and protects its customers’ digital products from sabotage programmes and data intrusion.
- Examples of customer use cases have included: a leading vending-machine provider, whose IP was stolen (stolen credit card and transaction details); a global white-goods company, whose stolen IP led to twice as many products being manufactured; and a leading door-sensor provider, whose IP was stolen internally, which led to direct revenue loss.
- To stay ahead of the competition, IAR Systems relies heavily on its employees in the development and innovation of new technologies.
- Following the integration of Secure Thingz, IAR Systems’ addressable market has expanded from application development into manufacturing and update management (the entire lifecycle of embedded systems). To keep pace with competition in a larger market, it needs to retain highly skilled software engineers, which could come at a higher cost than its traditional business.
- An increasingly larger part of IAR Systems could revolve around Cambridge-based Secure Thingz. This could create some corporate cultural challenges versus the Uppsala-based legacy business.

Long-term

- Regulators are likely to play an active role in the long-term uptake of secure development tools. This should have an impact on programmers’ designs, as applications need to remain secure across the entire lifecycle to comply with new legislation. We note legislative initiatives in Europe (UK government, ETSI, ENISA) and the US (California and Oregon IoT Security law, IoT Cybersecurity Improvement Act), and government initiatives across Singapore, Japan, South Korea, China, etc.
- Considering its offering of software development tools to over 150,000+ technology users as well as the sensitive nature of the data it handles, IAR Systems is exposed to possible hacking attempts and misappropriation of technological data.

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Q3 results

Figure 1: Q3 results versus expectations

Key highlights (SEKm, except per share data)	Q3 2023		Deviation	Deviation	Q3 2022	DNBe
	Actual	DNB	(%)	Absolute	Actual	2023e
Net sales	116.3	105.2	11%	11	106.1	448.0
Gross profit	113.2	102.0	11%	11	103.0	438.4
Gross margin	97.3%	97.0%	0.4pp		97.1%	97.9%
One-offs	-3.9	-5.7		2	0.0	-13.5
EBITDA adj.	47.3	35.0	35%	12	34.2	135.3
EBITDA adj. margin	40.7%	33.2%	7.4pp		32.2%	30.2%
EBIT	28.9	19.9	45%	9	22.1	84.3
EBIT margin	24.8%	18.9%	5.9pp		20.8%	18.8%
EBIT adj.	32.8	19.9	65%	13	22.1	84.3
EBIT adj. margin	28.2%	18.9%	9.3pp		20.8%	18.8%
EPS	1.02	0.68	49%	0.34	1.04	2.98
Adj. FCF (CFO - capex)	39.6	15.8	150%	24	33.2	88.1
Cash conversion	121%	79%	41.3pp		150%	104%
Rule of 40 (EBIT)	37.8%	18.0%	19.8pp		38.7%	25.3%
Revenue growth YOY	9.6%	-0.9%	10.5pp		20.2%	7.3%
Organic	5.9%	-3.7%	9.7pp		10.9%	3.1%
Structural	0.0%	0.0%	0pp		0.0%	0.0%
FX	3.7%	2.8%	0.8pp		9.3%	4.2%
Segment (SEKm)	Q3 2023		Deviation	Deviation	Q3 2022	DNBe
	Actual	DNB	(%)	Absolute	Actual	2023e
Net sales						
Development tools	116.2	104.4	11%	12	105.6	445.2
Security solutions	0.1	0.7	-86%	-1	0.5	2.8
Other	0.0	0.0	n.a.	0	0.0	0.0
Total	116.3	105.2	11%	11	106.1	448.0
Net sales growth						
Development tools	10.0%	-1.1%	11.1pp		20.3%	6.4%
Security solutions	-80.0%	42.8%	-122.8pp		400.0%	87.0%
Other						
Total	9.6%	-0.9%	10.5pp		20.2%	7.3%
Net sales						
License-based	55.8	49.8	12%	6	56.2	218.4
Support and softw are updates	55.2	51.2	8%	4	44.4	209.0
Other	5.3	4.2	26%	1	5.5	20.5
Total	116.3	105.2	11%	11	106.1	448.0

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

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Estimate revisions

Figure 2: Estimate changes

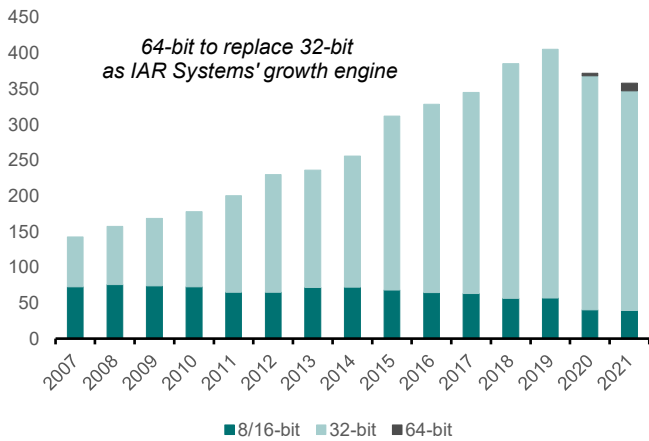
(SEKm, except per share data)	Old			New			Change		
	2023e	2024e	2025e	2023e	2024e	2025e	2023e	2024e	2025e
Net sales	432	476	512	451	487	520	4%	2%	2%
Growth YOY, of which	3.0%	10.0%	7.8%	7.3%	8.2%	6.7%	436bp	-184bp	-101bp
Organic	-1.3%	8.3%	7.8%	3.1%	7.3%	6.7%	439bp	-101bp	-101bp
Structural	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0bp	0bp	0bp
FX	4.3%	1.7%	0.0%	4.2%	0.9%	0.0%	-3bp	-82bp	0bp
Gross profit	420	463	499	438	474	507	4%	3%	2%
<i>Gross margin</i>	97.1%	97.3%	97.5%	97.3%	97.3%	97.5%	19bp	7bp	4bp
EBITDA	121	171	198	135	184	208	12%	8%	5%
IAC	-15	-7	-7	-14	-7	-7	-12%	0%	0%
Adj. EBITDA	136	177	205	149	190	215	9%	7%	5%
Depreciation and amortisation	-63	-64	-68	-63	-63	-67	-1%	-1%	-2%
EBIT	50	99	123	71	113	134	41%	14%	9%
Adj. EBIT	66	106	130	84	120	141	29%	13%	9%
<i>Adj. EBIT margin</i>	15.2%	22.3%	25.3%	18.7%	24.6%	27.1%	355bp	231bp	179bp
Capitalised development costs (CDC)	45	55	61	38	54	59	-15%	-1%	-2%
EBIT excl. CDC	4.8%	10.8%	13.5%	10.3%	13.6%	15.7%	548bp	273bp	224bp
Adj. Net profit	47	80	98	54	91	107	16%	13%	9%
Adj. EPS (diluted)	3.41	5.88	7.18	3.94	6.67	7.82	15%	13%	9%
DPS	1.19	2.06	2.51	1.38	2.33	2.74	15%	13%	9%
Net sales by segment									
Development tools	427	460	481	445	473	489	4%	3%	2%
Security solutions	3	15	31	3	15	31	-18%	-4%	-2%
Other	0	0	0	0	0	0			
Total	432	476	512	451	487	520	4%	2%	2%
Net sales by product type									
License-based	208	237	261	218	242	262	5%	2%	0%
Support and software updates	203	219	231	209	225	237	3%	3%	3%
Other	19	20	21	21	21	22	6%	5%	5%
Total	432	476	512	451	487	520	4%	2%	2%
Balance sheet and cash flow									
Adj. FCF	63	78	86	88	87	96	41%	12%	11%
Cash	178	232	282	198	259	315	11%	11%	11%
Net cash (-) / net debt (+)	-123	-185	-243	-142	-210	-274	15%	14%	13%

Source: DNB Markets

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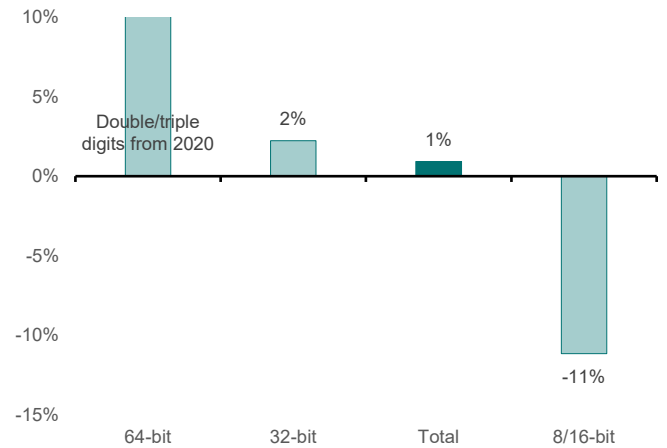
Key charts

Figure 3: Net sales mix by processor type (2007–2021)



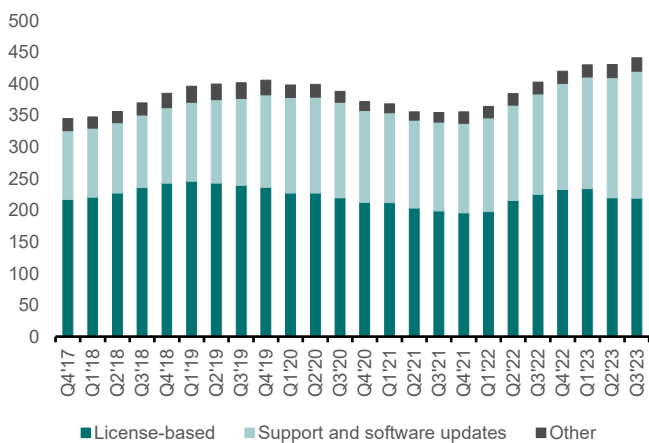
Source: Company (historical data), DNB Markets (further calculations)

Figure 4: Net sales CAGR by processor type (2017–2021)



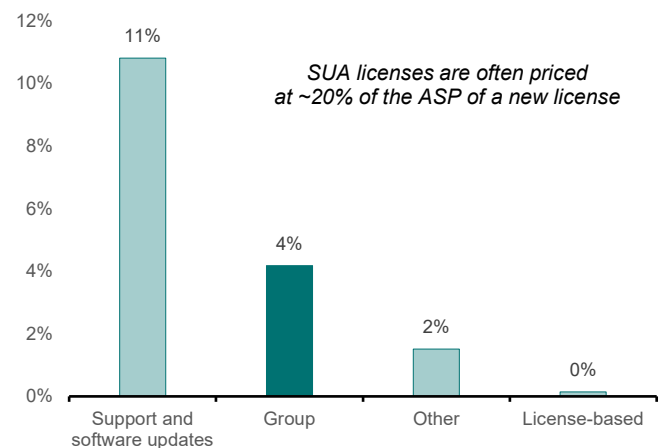
Source: Company (historical data), DNB Markets (further calculations)

Figure 5: Net sales mix by product type (LTM, 2017–2023e)



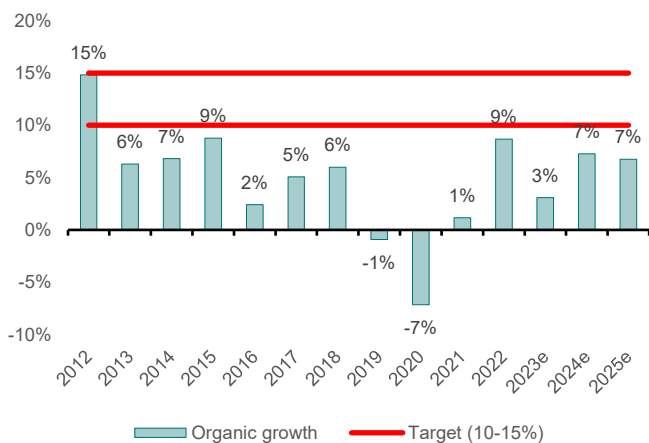
Source: Company (historical data), DNB Markets (further calculations)

Figure 6: Net sales CAGR by processor type (2017–2023e)



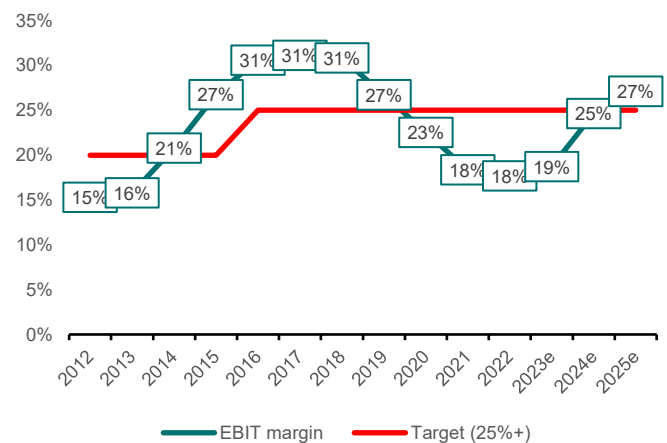
Source: Company (historical data), DNB Markets (further calculations)

Figure 7: Financial goal 1 – organic sales growth of 10–15%



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

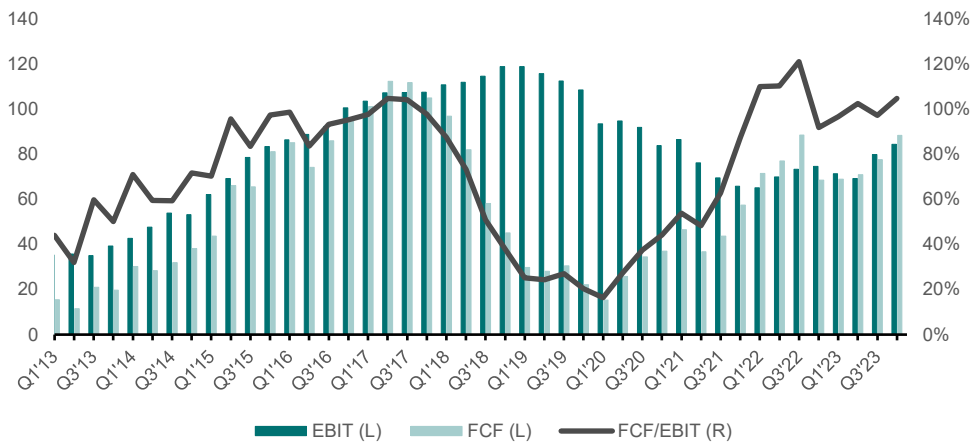
Figure 8: Financial goal 2 – EBIT margin >25%



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

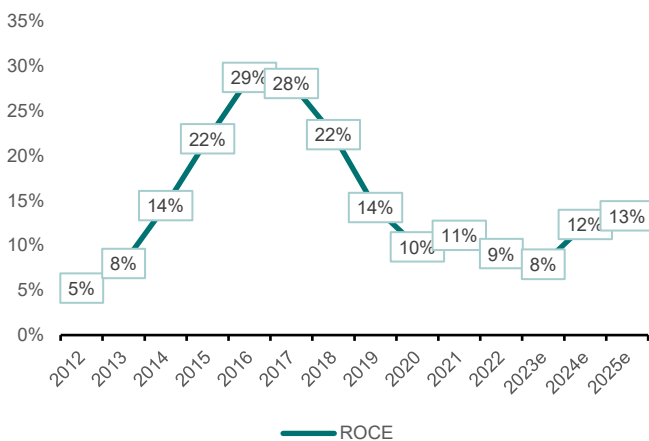
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Figure 9: LTM FCF versus LTM EBIT (2013–2023e) – coming out of an intense investment period to accelerate organic growth since 2018



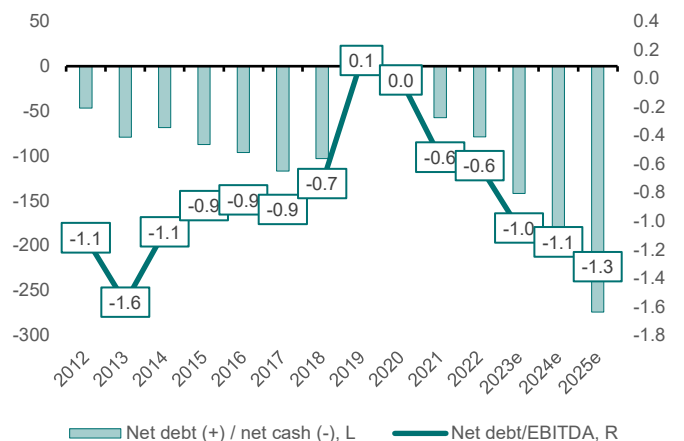
Source: DNB Markets (forecasts), company (historical data)

Figure 10: Return on capital employed (2012–2025e)



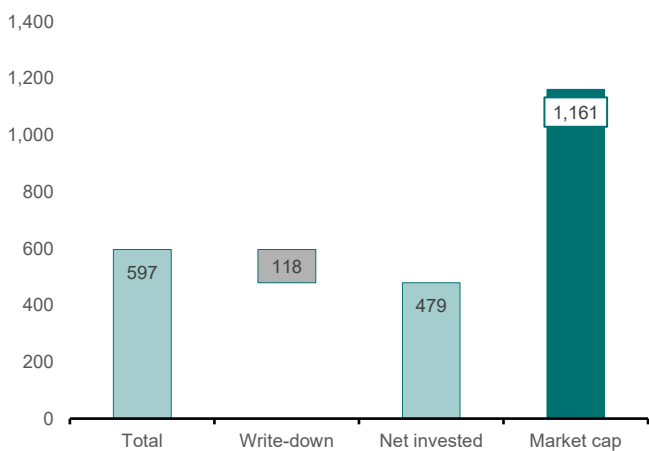
Source: DNB Markets (forecasts), company (historical data)

Figure 11: Net debt to EBITDA (x, SEKm)



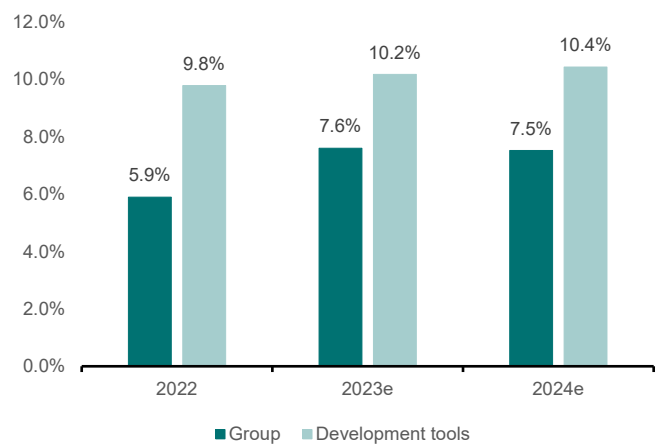
Source: DNB Markets (forecasts), company (historical data)

Figure 12: Investments (SEKm, 2016–2023e)



Source: Company (historical data), DNB Markets (forecasts and further calculations)

Figure 13: FCF yield (2022–2024e)



Source: Company (historical data), DNB Markets (forecasts and further calculations)

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Forecasts

Figure 14: Annual income statement and key items (SEKm, 2018–2025e)

(SEKm)	2018	2019	2020	2021	2022	2023e	2024e	2025e	22-25e CAGR
Net sales	385.2	405.6	372.0	355.8	419.9	448.0	487.4	520.3	7%
Growth YOY, of which	10%	5%	-8%	-4%	18%	7%	8%	7%	
Organic	6%	-1%	-7%	1%	9%	3%	7%	7%	
Structural	0%	0%	0%	0%	0%	0%	0%	0%	
FX	4%	6%	-1%	-6%	9%	4%	1%	0%	
COGS	-9.0	-10.8	-14.1	-12.0	-12.8	-12.3	-13.0	-13.0	
Gross profit	376.2	394.8	357.9	346.0	410.0	438.4	474.4	507.3	
Capitalised work	0.0	0.0	0.0	64.4	50.2	38.0	54.0	59.2	
Other external expenses	-68.2	-63.7	-37.7	-48.3	-58.2	-48.1	-53.9	-56.2	
Personnel costs	-167.9	-185.3	-187.5	-258.2	-273.0	-293.0	-291.0	-302.4	
EBITDA	140.1	145.8	132.7	103.9	129.0	135.3	183.5	208.0	
IAC	-3.2	0.0	0.0	-134.2	0.9	-13.5	-6.8	-6.8	
Adj. EBITDA	143.3	145.8	132.7	238.1	128.1	148.8	190.3	214.8	
Depreciation and amortisation	-24.5	-37.4	-48.9	-172.4	-53.3	-62.8	-63.4	-66.9	
EBIT	115.6	108.4	83.8	-68.5	75.7	70.8	113.3	134.3	
Adj. EBIT	118.8	108.4	83.8	65.7	74.8	84.3	120.1	141.1	24%
Financial items	-1.8	-1.4	-7.0	-0.1	-2.2	-1.4	-2.6	-3.2	
Profit before tax	117.0	107.0	76.8	-68.6	73.5	69.4	110.7	131.1	
Taxes paid	-26.2	-25.8	-17.4	1.2	-15.7	-28.7	-26.4	-31.0	
Adj. Net profit	94.0	81.2	59.4	66.8	56.9	54.2	91.1	106.9	23%
EPS	6.67	5.96	4.36	-4.94	4.23	2.98	6.17	7.33	
Adj. EPS (diluted)	6.67	5.96	4.36	4.90	4.17	3.94	6.67	7.82	
DPS	5.00	3.00	0.00	0.00	1.50	1.38	2.33	2.74	
Margins									
Gross	97.7%	97.3%	96.2%	96.6%	97.0%	97.3%	97.3%	97.5%	
EBITDA	36.4%	35.9%	35.7%	29.0%	30.5%	30.0%	37.6%	40.0%	
Adj. EBITDA	37.2%	35.9%	35.7%	66.5%	30.3%	33.0%	39.0%	41.3%	
EBIT	30.0%	26.7%	22.5%	-19.1%	17.9%	15.7%	23.3%	25.8%	
Adj. EBIT	30.8%	26.7%	22.5%	18.4%	17.7%	18.7%	24.6%	27.1%	
FCF margin	11.9%	5.4%	9.9%	16.1%	16.2%	19.6%	17.9%	18.4%	
Rule of 40 (EBIT)	42.5%	32.0%	14.2%	14.6%	35.8%	25.3%	32.8%	33.9%	
ROCE	28.1%	17.7%	12.4%	9.9%	10.9%	11.3%	15.2%	16.6%	
Cash flow									
Cash flow from operating activities	92.6	105.7	118.4	131.6	128.0	133.7	148.9	163.5	
Capex	-46.8	-83.6	-81.4	-74.1	-59.6	-45.6	-61.6	-67.6	
Adj. FCF	45.8	22.1	37.0	57.5	68.4	88.1	87.3	95.9	12%
Cash conversion (FCF/EBIT)	39%	20%	44%	88%	91%	104%	73%	68%	
Balance sheet									
Cash	106.1	60.7	67.8	113.4	148.2	198.1	258.6	314.5	
Net cash (-) / net debt (+)	-103.3	18.4	-1.5	-57.4	-78.9	-141.9	-210.4	-274.3	
Net debt/EBITDA	-0.7x	0.1x	0.0x	-0.6x	-0.6x	-1.0x	-1.1x	-1.3x	

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

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Figure 15: Annual segment overview (SEKm, 2018–2025e)

(SEKm)	2018	2019	2020	2021	2022	2023e	2024e	2025e	22-25e CAGR
Net sales by segment									
Development tools	380.2	403.9	367.0	355.1	418.4	445.2	472.6	489.5	5%
Security solutions	5.0	1.7	5.0	0.7	1.5	2.8	14.8	30.8	174%
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Total	385.2	405.6	372.0	355.8	419.9	450.7	487.4	520.3	7%
Net sales growth by segment									
Development tools	10%	6%	-9%	-3%	18%	6%	6%	4%	
Security solutions		-66%	194%	-86%	114%	87%	429%	108%	
Other									
Total	10%	5%	-8%	-4%	18%	7%	8%	7%	
Net sales by product									
License-based	242.9	236.3	212.4	196.1	233.0	218.4	241.9	261.9	4%
Support and softw are updates	119.4	146.3	145.2	141.6	167.9	209.0	224.9	236.9	12%
Other	22.9	23.0	14.4	18.1	19.0	20.5	20.7	21.6	4%
Total	385.2	405.6	372.0	355.8	419.9	450.7	487.4	520.3	7%
Net sales growth by product									
License-based	12%	-3%	-10%	-8%	19%	-6%	11%	8%	
Support and softw are updates	10%	23%	-1%	-2%	19%	25%	8%	5%	
Other	20%	0%	-37%	26%	5%	8%	1%	4%	
Total	10%	5%	-8%	-4%	18%	7%	8%	7%	

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

Figure 16: Quarterly segment overview (SEKm, 2022–2023e)

(SEKm)	Q3'22	Q4'22	Q1'23	Q2'23	Q3'23	Q4'23e	Q1'24e	Q2'24e	Q3'24e	Q4'24e
Net sales by segment										
Development tools	105.6	108.6	107.3	107.1	116.2	114.6	115.0	116.3	120.4	120.9
Security solutions	0.5	0.2	0.4	1.1	0.1	1.2	2.4	3.6	3.6	5.2
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total	106.1	110.7	108.6	108.9	117.4	115.8	117.4	120.0	124.0	126.1
Net sales growth by segment										
Development tools	20%	19%	11%	0%	10%	5%	7%	9%	4%	6%
Security solutions	400%	100%	0%	175%	-80%	502%	502%	229%	3500%	332%
Other										
Total	20%	19%	10%	1%	10%	6%	9%	11%	7%	9%
Net sales by product										
License-based	56.2	57.0	53.3	53.0	55.8	56.3	58.4	59.8	60.3	63.4
Support and softw are updates	44.4	45.4	49.7	50.7	55.2	53.4	54.7	55.4	58.2	56.5
Other	5.5	6.4	4.7	4.5	5.3	6.0	4.2	4.8	5.5	6.2
Total	106.1	110.7	108.6	108.9	117.4	115.8	117.4	120.0	124.0	126.1
Net sales growth by product										
License-based	22%	15%	2%	-22%	-1%	-1%	10%	13%	8%	13%
Support and softw are updates	20%	26%	21%	37%	24%	18%	10%	9%	5%	6%
Other	15%	5%	12%	55%	-4%	-6%	-11%	6%	4%	3%
Total	20%	19%	10%	1%	10%	6%	9%	11%	7%	9%

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

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Figure 17: Quarterly income statement and key items (SEKm, 2021–2023e)

(SEKm)	Q3'22	Q4'22	Q1'23	Q2'23	Q3'23	Q4'23e	Q1'24e	Q2'24e	Q3'24e	Q4'24e
Net sales	106.1	110.7	108.6	108.9	117.4	115.8	117.4	120.0	124.0	126.1
Grow th YOY, of w hich	20%	19%	10%	1%	10%	6%	9%	11%	7%	9%
Organic	11%	7%	5%	-4%	6%	4%	7%	9%	7%	9%
Structural	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
FX	9%	12%	6%	5%	4%	2%	2%	1%	0%	0%
COGS	-3.1	-3.8	-3.2	-2.8	-3.1	-3.2	-3.3	-3.1	-3.2	-3.4
Gross profit	103.0	106.9	105.4	106.1	114.3	112.6	114.1	116.9	120.8	122.7
Capitalised work	11.3	16.2	9.4	10.4	7.2	11.0	12.0	14.0	14.0	14.0
Other external expenses	-18.8	-16.1	-12.7	-10.0	-11.9	-13.5	-13.0	-10.8	-15.1	-15.0
Personnel costs	-61.3	-74.6	-76.8	-76.0	-66.2	-74.0	-73.0	-73.6	-66.0	-78.4
EBITDA	34.2	32.4	25.3	30.5	43.4	36.1	40.1	46.4	53.7	43.4
IAC	0.0	0.0	-1.7	-6.2	-3.9	-1.7	-1.7	-1.7	-1.7	-1.7
Adj. EBITDA	34.2	32.4	27.0	36.7	47.3	37.8	41.8	48.1	55.4	45.1
Depreciation and amortisation	-12.1	-15.9	-13.9	-19.3	-14.5	-15.1	-15.6	-16.0	-15.9	-16.0
EBIT	22.1	16.5	11.4	11.2	28.9	19.3	22.8	28.8	36.1	25.7
Adj. EBIT	22.1	16.5	13.1	17.4	32.8	21.0	24.5	30.5	37.8	27.4
Financial items	1.1	-1.9	0.3	2.8	-4.0	-0.5	-0.7	-0.7	-0.7	-0.7
Profit before tax	23.2	14.6	11.7	14.0	24.9	18.8	22.2	28.1	35.5	25.0
Taxes paid	-6.4	0.0	-5.3	-7.9	-10.9	-4.6	-5.4	-6.7	-8.4	-6.0
Adj. Net profit	16.8	14.6	8.1	12.3	17.9	15.9	18.5	23.1	28.8	20.7
EPS	1.04	1.07	0.47	0.45	1.02	1.04	1.23	1.57	1.98	1.39
Adj. EPS (diluted)	1.23	1.07	0.59	0.89	1.29	1.16	1.35	1.69	2.11	1.52
DPS	0.00	0.00	0.00	1.50	0.00	0.00	0.00	1.38	0.00	0.00
Margins										
Gross	97.1%	96.6%	97.1%	97.4%	97.4%	97.2%	97.2%	97.4%	97.4%	97.3%
EBITDA	32.2%	29.3%	23.3%	28.0%	37.0%	31.2%	34.1%	38.7%	43.3%	34.4%
Adj. EBITDA	32.2%	29.3%	24.9%	33.7%	40.3%	32.6%	35.6%	40.1%	44.7%	35.7%
EBIT	20.8%	14.9%	10.5%	10.3%	24.6%	16.7%	19.4%	24.0%	29.1%	20.3%
Adj. EBIT	20.8%	14.9%	12.1%	16.0%	27.9%	18.1%	20.9%	25.4%	30.5%	21.7%
FCF margin	31.3%	3.0%	14.6%	16.9%	34.0%	12.2%	16.6%	21.7%	20.2%	13.3%
Rule of 40 (EBIT)	38.7%	35.8%	22.5%	17.2%	38.6%	22.7%	29.0%	35.5%	36.1%	30.6%
ROCE	11.1%	10.9%	10.1%	9.5%	10.7%	11.3%	12.6%	14.2%	14.6%	15.2%
Cash flow										
Cash flow from operating activities	47.4	25.8	26.1	29.1	51.9	26.6	33.1	42.1	41.0	32.7
Capex	-14.2	-22.5	-10.4	-10.7	-12.0	-12.5	-13.7	-16.1	-16.0	-15.9
Adj. FCF	33.2	3.3	15.7	18.4	39.9	14.1	19.5	26.0	25.0	16.8
Cash conversion (FCF/EBIT)	150%	20%	120%	106%	122%	67%	80%	85%	66%	61%
Balance sheet										
Cash	158.8	148.2	158.1	153.8	186.0	198.1	215.6	220.8	243.8	258.6
Net cash (-) / net debt (+)	-131.1	-78.9	-92.6	-94.7	-127.8	-141.9	-161.4	-168.6	-193.6	-210.4
Net debt/EBITDA	-1.2x	-0.6x	-0.7x	-0.8x	-1.0x	-1.0x	-1.1x	-1.0x	-1.1x	-1.1x

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

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Valuation

Figure 18: Valuation approaches (SEKm, %)

	Peers regression	DCF	Historical average
Net sales (2024e)			487
Adj. EBIT (2024e)			120
Adj. EPS (2024e)			6.67
Sales CAGR (2022–2024e)	12.6		7.4
Adj. EBIT margin (2023e)	21.9		18.7
RO40 (2023e)	46.7		26.1
Target multiple	<i>RO40, P/B, EV/S</i>	<i>10% WACC</i>	<i>15x EV/EBIT</i>
Enterprise value	3,036	2,703	1,802
Net debt (+)/cash (-)	-210	-210	-210
Equity value	3,246	2,914	2,012
Shares outstanding	13.8	13.8	13.8
Implied fair value/share	235	211	146
Implied potential	168%	141%	66%

2024e valuation multiples

Implied EV/sales	6.2	5.5	3.7
Implied EV/EBIT	25.3	22.5	15.0
Implied P/E	35.6	32.0	22.1

Source: DNB Markets

Figure 19: Implied valuation multiples based on current share price

(SEKm)	2016	2017	2018	2019	2020	2021	2022	2023e	2024e	2025e
Net sales	328	345	385	406	372	356	420	448	487	520
Growth YOY	5.4%	5.1%	10.2%	5.2%	-8.3%	-4.4%	18.1%	7.3%	8.2%	6.7%
Gross profit	316	337	376	395	358	346	410	438	474	507
Gross margin	96.3%	97.5%	97.7%	97.3%	96.2%	96.6%	97.0%	97.3%	97.3%	97.5%
Adj. EBITDA	117	127	140	146	133	104	129	135	184	208
EBITDA margin	36.9%	36.9%	37.2%	35.9%	35.7%	66.5%	30.3%	33.0%	39.0%	41.3%
Adj. EBIT	101	107	119	108	84	66	75	84	120	141
EBIT margin	30.6%	31.1%	30.8%	26.7%	22.5%	18.4%	17.7%	18.7%	24.6%	27.1%
Adj. Net profit	82	80	94	81	59	67	57	54	91	107
Adj. FCF	95	105	46	22	37	58	68	88	87	96
FCF margin	29.0%	30.4%	11.9%	5.4%	9.9%	16.2%	16.3%	19.7%	17.9%	18.4%
Cash conversion	95%	98%	39%	20%	44%	88%	91%	104%	73%	68%
Rule of 40 (EBIT)	36.0%	36.2%	41.0%	31.9%	14.2%	14.0%	35.8%	26.0%	32.8%	33.9%
ROCE	35.0%	37.4%	28.1%	17.7%	12.4%	9.9%	10.9%	11.3%	15.2%	16.6%
ROIC	27.4%	28.5%	21.9%	13.8%	10.1%	10.4%	8.7%	7.4%	11.9%	13.0%
Market cap	2,602	2,387	3,310	2,535	1,905	1,606	1,194	1,195	1,195	1,195
Net debt	-97	-117	-103	18	-1	-57	-79	-142	-210	-274
Enterprise value	2,505	2,270	3,206	2,554	1,904	1,548	1,115	1,053	985	921
EV/Sales	7.6x	6.6x	8.3x	6.3x	5.1x	4.4x	2.7x	2.4x	2.0x	1.8x
EV/EBIT	24.9x	21.1x	27.0x	23.6x	22.7x	23.6x	14.9x	12.5x	8.2x	6.5x
P/E	31.7x	29.8x	35.2x	31.2x	32.1x	24.0x	21.0x	22.1x	13.1x	11.2x
FCF yield	3.7%	4.4%	1.4%	0.9%	1.9%	3.6%	5.7%	7.4%	7.3%	8.0%

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

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Figure 20: EV/sales 12-month forward IAR Systems (2018–2023)



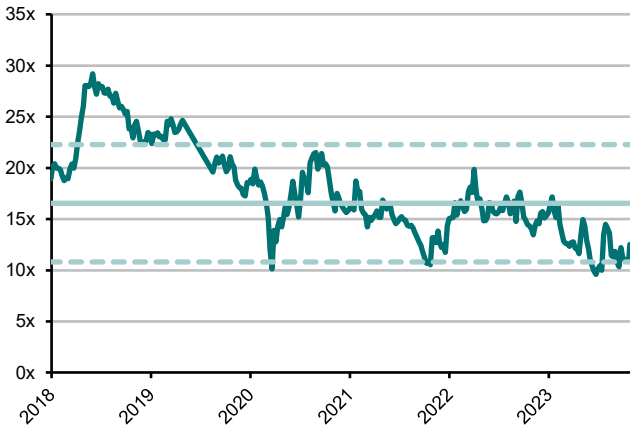
Source: Bloomberg

Figure 21: EV/EBITDA 12-month forward IAR Systems (2018–2023)



Source: Bloomberg

Figure 22: EV/EBIT 12-month forward IAR Systems (2018–2023)



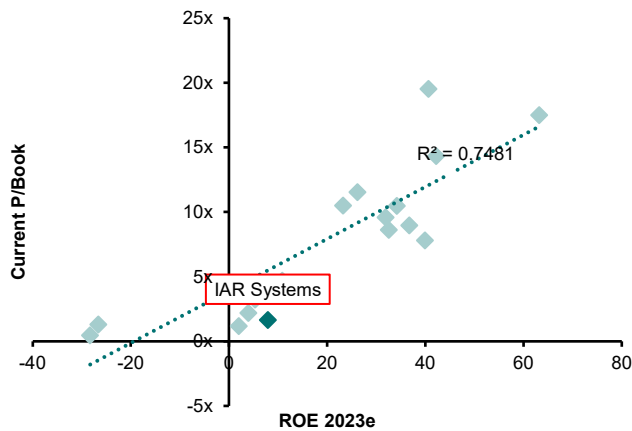
Source: Bloomberg

Figure 23: P/E 12-month forward IAR Systems (2018–2023)



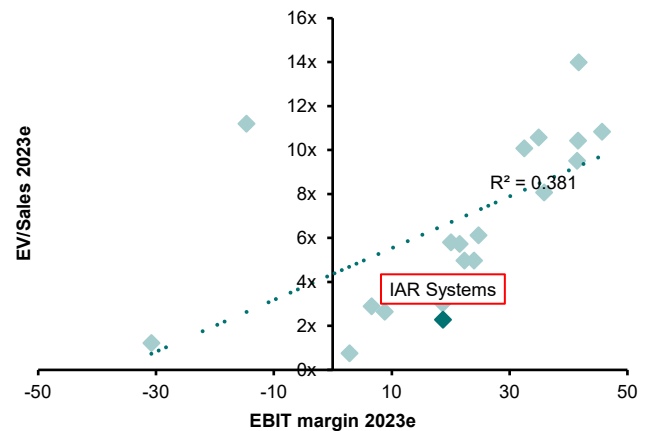
Source: Bloomberg

Figure 24: Current P/book versus ROE 2023e



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

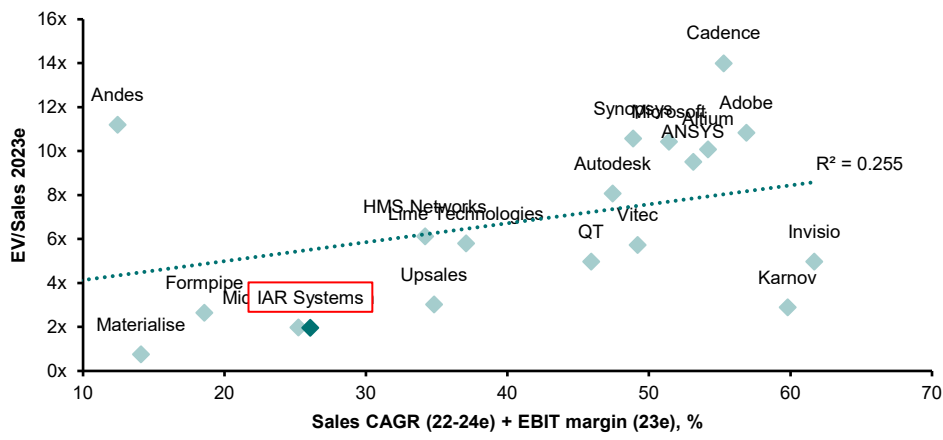
Figure 25: EV/sales versus EBIT margin (2023e)



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

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Figure 26: EV/sales 2023e versus sales CAGR + EBIT margin



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

Figure 27: IAR Systems' valuation versus listed peers

	Mkt. cap.	P/E (x)			EV/EBIT (x)			EV/EBITDA (x)			EV/Sales (x)			2023 yield (%)		ROE (%)		EBIT margin		CAGR 2022-2024e (%)				
	(SEKbn)	2023e	2024e	2025e	2023e	2024e	2025e	2023e	2024e	2025e	2023e	2024e	2025e	DPS	FCF	2023e	2024e	2023e	2024e	Sales	EBIT	EPS		
IAR Systems (DNBe)	1.2	29	14	12	12	8	7	8	5	4	2	2	2	1.6	7.4	8	12	18.7	24.6	7	27	21		
Premium/discount		-17%	-54%	-49%	-56%	-70%	-66%	-84%	-78%	-71%	-68%	-68%	-68%											
IAR Systems (Cons.)	1.2	26	15	12	18			8			3	2	2	1.4	5.2			13.5	21.6	6	8	13		
Premium/discount		-27%	-52%	-48%	-35%	n.a.	n.a.	-83%	n.a.	n.a.	-65%	-63%	-61%											
Nordic software																								
Enea	0.8	7	8	7		21	16	6	4	3	1	1	1		12.3	-28	4	-30.8	5.1	-3	-33	-6		
Formpipe	1.5	54	30	19							3	3	2	1.1	1.6	5	10	8.9	13.2	10	135	120		
HMS Networks	17.4	29	35	30	23	27	23	20	23	19	6	6	6	1.2	3.0	33	23	24.7	21.9	9	2	4		
Invisio	7.4	37	28	23	26	20	16	22	17	14	6	5	4	0.9	2.6	34	34	22.3	24.2	39	175	202		
Karnov	5.3	19	15	12	44	29	17	13	11	9	3	3	3	0.5	4.7	4	8	6.6	9.3	53	8	27		
Lime Technologies	3.7	39	32	28	32	26	21	21	18	15	7	6	5	1.1	3.4	36	36	20.1	21.3	17	25	19		
Micro Systemation	1.0	21	17	14	16	12	10	14	10	8	2	2	2	3.8	6.2	40	43	14.2	16.6	11	26	22		
QT	13.7	33	23	17	26	17	12	21	15	11	6	5	4	0.0	3.5	32	34	24.0	27.6	22	34	24		
Upsales	0.6	25	23	20	18	17	14	13	12	11	3	3	2	3.7	2.9	63	69	18.7	16.7	16	4	6		
Vitec	16.4	43	28	25	31	25	22	17	15	13	7	6	5	0.7		11	13	21.5	22.6	28	43	47		
WithSecure	1.6										123	12	1	1	1	0.0		-27	-9	-23.2	-6.0	7	-51	-47
Engineering software																								
Adobe	2,662.5	33	29	26	27	23	21	26	23	20	12	11	10	0.0	3.2	42	37	45.7	45.3	11	11	15		
Altium	37.8	52	41	34	38	30	24	34	28	22	12	10	8	1.8	1.0	23	26	32.5	33.2	22	30	30		
Andes	7.2		89	31		100	26	552	46	20	16	11	8	0.9	0.3	-1	5	-14.6	10.8	27	101	-38		
ANSYS	262.7	32	28	25	25	22	19	24	20	17	10	10	9	0.0	2.8	13	13	41.4	41.9	12	12	12		
Autodesk	483.4	31	27	24	24	23	20	23	22	20	9	8	7	0.0	4.5	161	113	35.9	35.7	12	19	22		
Cadence	716.3	46	40	35	38	32	27	35	30	25	16	14	13	0.0	2.0	41	38	41.7	43.1	14	17	18		
Materialise	3.3	57	32	16	27	15	8	6	5	4	1	1	1	0.0		2	3	2.9	4.5	11		124		
Microsoft	27,950.2	35	30	27	28	24	21	24	21	18	12	10	9	0.8	2.4	37	33	41.6	42.2	10	10	8		
Synopsys	784.0	42	36	31	34	29	25	32	28	26	12	11	9		2.1	26	26	35.0	35.9	14	19	20		
Average	1,648.9	35	31	23	29	27	19	50	25	15	7	6	5	0.9	3.4	27	28	18.4	23.3	17	31	31		
Median	10.6	34	29	25	27	24	20	21	20	15	6	6	5	0.8	2.9	29	26	21.9	22.2	13	19	19		

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

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Summary of positives

Attractive position in a structural growth niche

Sweden-based IAR Systems is a world-leading provider of commercial software tools and services for programming processors in embedded systems (computer hardware and software designed for a specific function) that enable the development and ensure the code quality of digital products. Its professional customers are mainly developers (22,000+ active technology users) at OEMs building these systems for products going into fields such as industrial automation, medical technology, telecommunication, consumer electronics, and the automotive industry. Although the niche for IAR Systems' addressable market is largely undefined, it has said it captures a ~40% market share for commercial tools. We note several prospects for the market to show a mid-to-high single-digit CAGR over the medium term: 1) a continued increase in the number (and complexity) of embedded systems driven by the growth of IoT; 2) demand for reliable and advanced software tools that offer faster time-to-market and a complete development platform; and 3) a lack of software developers, which increases demand for more powerful software-development tools.

Market dynamics benefiting the market leader

In our view, IAR Systems' key competitive advantages stem from: 1) its complete toolchain for product developers across 8-, 16-, 32-, and 64-bit processors; 2) its independence, which enables it to support a wide range of design architecture – customers can choose the programming environment and tools according to their own needs, regardless of processor or project, which avoids locking customers into one technical platform (a factor amplified by the global semiconductor shortage); and 3) superior industrial-quality, as its commercial customers cannot compromise on tools' code performance, reliability, user-friendliness, or time-to-market by using inferior technologies, such as open-source alternatives. IAR Systems' solutions create codes that are compact, fast, and stable.

96%+ gross margins ensure high level of scalability

Although IAR Systems' organic growth has averaged 1% in the past five years, we believe the company has a diversified set of growth opportunities that could support its 10–15%+ organic sales growth target in the medium term and an acceleration of its most promising new product launches: 1) migrating its existing 32-bit customers (~80% of 2021 sales) to 64-bit; 2) broader RISC-V adoption; and 3) IoT security taking off. With ~95% customer retention, we believe it could scale up with its existing customer base, which, in combination with 96%+ gross margins, could provide a highly scalable cost structure over the coming years that could add a tailwind to significant margin expansion with high cash conversion.

Early leader in two of the embedded industry's most prominent themes

In 2018, IAR Systems acquired Cambridge-based start-up Secure Thingz, which offers advanced security solutions focusing on IoT. Although we share the company's view about the potential to emerge as an early leader in the embedded systems security market, it has taken IAR Systems several years to find a way to commercially package its award-winning security technology (which led to a SEK116m write-down of intangible assets in 2021). We expect broader adoption in the coming years from secure IP being seen as a business imperative and increasingly stringent security legislation. We are cautiously optimistic about recent customer agreements to provide secure coding in the manufacturing of IoT devices for Secure Thingz. Moreover, the RISC-V ecosystem is maturing (RISC-V foundation members have expanded fivefold since IAR Systems joined in 2018), setting the scene for a potential breakout. Semico and Tractica forecast a ~100% CAGR of RISC-V cores, reaching an estimated 62bn units in 2025 and a ~USD70m–80m RISC-V tools market for a 40%+ CAGR to 2025, of which IAR should gain a sizeable share.

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Summary of negatives

Possible shift in the competitive landscape

IAR Systems holds leading positions across most processor types, but it still faces a highly competitive environment, particularly from the independent supplier Green Hills Software and Arm's development tool, Kiel, we believe. In addition, the increasingly strategic nature of development tools for many industries could attract competition from disruptive innovators or free, open-source-based alternatives, which are gaining popularity, as younger generations of developers could be unwilling to pay for licences or be restricted to a single technology from one vendor.

Potential weakening of the Embedded Workbench community

According to Slashdata, there were 7.5m active software developers writing in the C/C++ language of the ~27m active developers globally in 2021. However, C++ is relatively hard to master. As developers often understand all aspects of a programming language, the difficulty of the language may affect the future number of C++ developers. We view this as a challenge, especially if we see a wider push from processor manufacturers and OEMs to provide developers with high-level tools that can abstract out the lower-level hardware and software in product development.

Product development could prove too costly and not materialise in sales growth

We believe IAR Systems was underinvested from 2015, which drove a considerable EBIT margin and ROCE expansion up to 30%+ given the inherent scalability of the business model. However, as organic growth abated, IAR Systems underwent the most comprehensive investment phase in its nearly 40-year history, investing SEK500m+ over the past five years in its security offering, 64-bit support, and RISC-V tools. We believe these investments have been the appropriate approach to provide building blocks to take the company to the next level. The pandemic has delayed project designs and, thus, customers committing to new investment decisions, but we have still seen few proof-points indicating that IAR Systems stands to reap the fruit of these investments. Its new management team made a SEK116m impairment of intangible development assets in Q4 2021.

One of the most FX-sensitive stocks on the OMX Stockholm exchange

Although >98% of sales are from markets outside Sweden, we estimate ~40% of the fixed-cost base is denominated in SEK; thus, the company is sensitive to fluctuations in this currency. If the SEK were to strengthen by ~10% against its most important currencies (USD, EUR and JPY) as well as the GBP and KRW, we estimate a ~10% FX headwind to sales and a ~40% headwind to 2023e EBIT.

SaaS transition still ahead for IAR Systems

We prefer subscription-based revenue models to traditional on-premises perpetual licence delivery models, as the SaaS models generates more predictable near-term revenue and cash flow, with, we believe, the potential to become more profitable longer-term. We believe it would make sense for IAR Systems to undergo such a transition in revenue mix to add visibility while potentially opening up for new customers that would not typically pay for its high-end licence products. However, such a transition would probably come at the expense of a short-term moderation in revenue growth and profitability (cloud revenue recognised over time versus perpetual upfront, in combination with increased investments to support cloud infrastructure).

Continued market consolidation among processor vendors

The ongoing consolidation trend among processor vendors could last longer than IAR Systems expects, which could continue to create market uncertainty and disrupt IAR Systems' partner network. We believe that a certain level of market fragmentation has been central to IAR Systems' competitiveness, as it has the broadest support in the market for different processor vendors and design architectures.

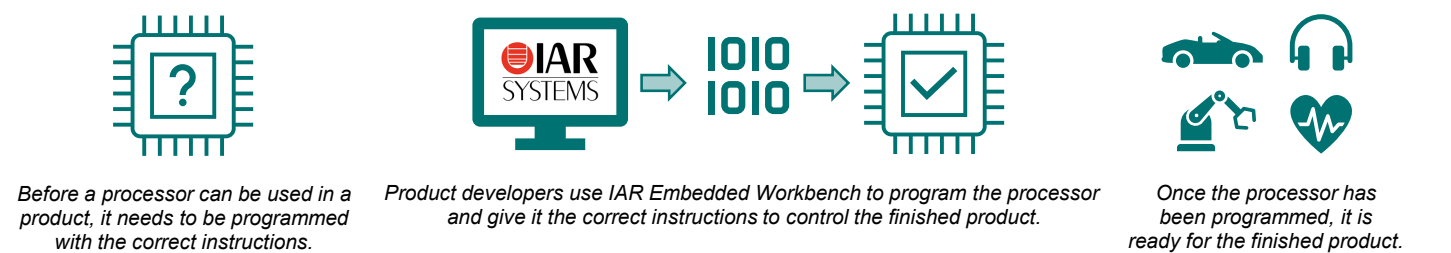
Business overview

Founded in 1983 by engineer Anders Rundgren, IAR Systems provides world-leading software for programming processors in embedded systems (computer systems designed to perform a dedicated function in a mechanical or electrical system). Its leading software tool chain – the IAR Embedded Workbench – facilitates, quality-assures, and improves the time-to-market of programming instructions in 8-, 16-, 32-, and 64-bit processors.

According to the company, individuals interact 30+ times a day with a product that is programmed by one of its loyal 46,000+ OEM customers (~95% recurring customers), or 150,000+ technology users found mainly in the automotive, industrial automation, medical technology, and consumer electronics industries such as Denso, Bosch, ABB, Continental, or Miele.

World-leading provider of software for programming processors in embedded systems, which enable the development of digital products

Figure 28: IAR Embedded Workbench in the customer’s product development



Source: Company (underlying data), DNB Markets (graph structuring)

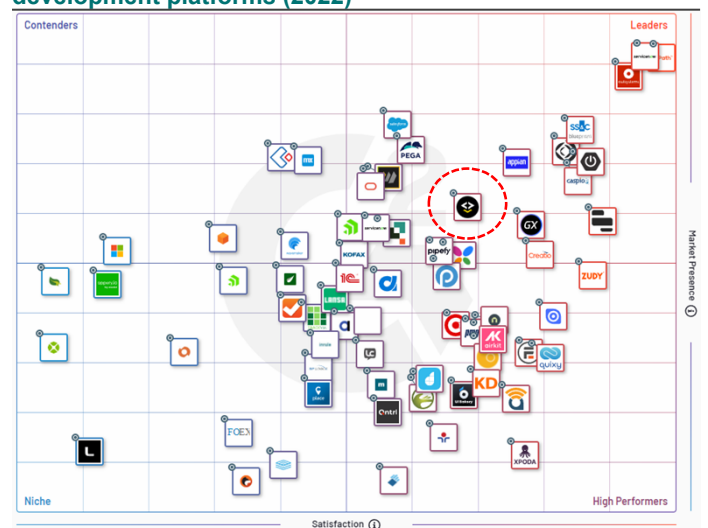
Headquartered in Uppsala, Sweden, IAR Systems has 200+ employees in 15 offices on three continents with technical support teams in its customers’ local time zones in 10+ languages. Its independent software supports more than 14,000 processors from more than 70 vendors, more than any other supplier, meaning customers can choose the programming environment and tools according to their own needs regardless of processor or project. This avoids locking customers into one technical platform. Moreover, it can re-use 70–80% of previously developed code instead of rewriting it (saving time and resources).

Figure 29: Example of customers



Source: Company

Figure 30: Users view IAR Systems as a leader for low-code development platforms (2022)



Source: G2 Grid
 Note: G2 scores products and sellers based on reviews gathered from its user community, as well as data aggregated from online sources and social networks; score is based on market presence and user satisfaction

With almost 40 years’ experience in the embedded industry, IAR Systems has built long-standing relationships and an extensive partner network, including: 1) suppliers of processors and architectures (Arm, RISC-V, Renesas, STMicroelectronics, etc.); 2) industry organisations for coding standards, certification, security compliance (TÜV SÜD, CERT C, MISRA, IoT Security Foundation, etc.); 3) services vendors (cloud services vendors, programming

Long-standing embedded industry partnerships

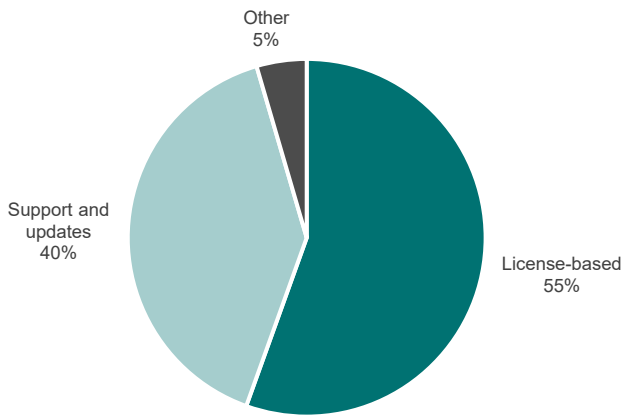
companies, etc.); and 4) suppliers of integrated programmes (real-time operating systems, graphics development, etc.).

IAR Systems' business model is primarily licence- and transaction-based, where customers (users, developers) pay upfront for a right-to-use licences (perpetual software keys) to access the software, while the customer can add support and updates for an annual cost of ~20% of the licence price. This means IAR Systems depends on selling new licences to facilitate growing net sales, we believe.

Perpetual licence-based business model with ~40% recurring revenues

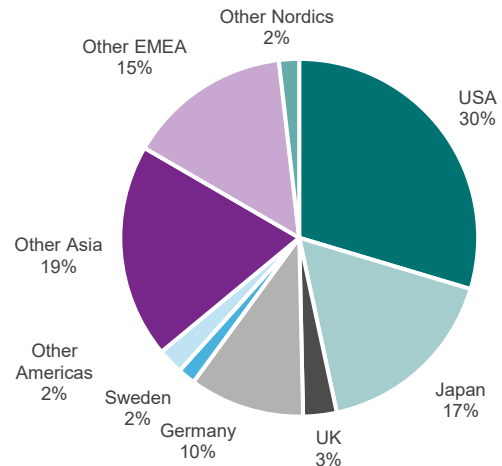
- **Development tools (~99% of 2022 net sales)** consist of IAR Embedded Workbench (8- to 64-bit) with world-leading code-optimisation technology, compiler, debugger probes and analysis tools (ensuring code quality and coding standards), functional safety certifications (pre-certified build tools), RISV-V architecture, and a Linux offering for continuous integration.
- **Security solutions (~1% of 2022 net sales)** consist of: 1) Embedded Trust, which enables the security specialist in an organisation to set security guidelines in accordance with company policy; 2) C-Trust, which makes it possible for developers to prepare encrypted code that automatically follows the prevailing security guidelines; and 3) Secure Desktop Provisioner, which helps OEM customers to securely programme products by giving each device a unique identity. The medium-term embedded security market opportunity with an 'out of the box' solution for mainstream MCUs appears likely to be beneficial for IAR, especially in device production as opposed to product development (royalty-based instead of licences). However, it will probably take time for security regulations and standards to significantly affect the marketplace.

Figure 31: Net sales by revenue stream (2022)



Source: Company

Figure 32: Geographical net sales split (2022)



Source: Company

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Forecast changes – P&L

(SEKm)	New			Old			Change		
	2023e	2024e	2025e	2023e	2024e	2025e	2023e	2024e	2025e
Revenues	451	487	520	432	476	512	18	12	8
Cost of sales	-12	-13	-13	-13	-13	-13	0	0	0
Gross profit	438	474	507	420	463	499	19	12	8
Operating expenses	-341	-345	-359	-344	-347	-362	2	2	4
EBITDA	135	184	208	121	171	198	14	13	10
EBITDA adj	149	190	215	136	177	205	12	13	10
EBITDA margin (%)	30.0	37.6	40.0	28.0	35.9	38.6	2.0	1.8	1.3
Depreciation	-27	-29	-31	-27	-30	-32	0	1	1
Amortisation	-36	-34	-36	-36	-34	-36	0	0	0
EBIT	71	113	134	50	99	123	21	14	11
EBIT adj	84	120	141	66	106	130	19	14	11
Net financial items	-1	-3	-3	2	-3	-3	-4	0	0
PBT	69	111	131	52	97	120	17	14	11
Taxes	-29	-26	-31	-21	-23	-28	-8	-3	-3
Net profit	41	84	100	31	74	91	9	11	9
Adjustments to net profit	14	7	7	15	7	7	-2	0	0
Net profit adj	54	91	107	47	80	98	7	11	9
<i>Per share data (SEK)</i>									
EPS	2.98	6.17	7.33	2.31	5.38	6.69	0.67	0.79	0.64
EPS adj	3.94	6.67	7.82	3.41	5.88	7.18	0.53	0.79	0.64
DPS ordinary	1.38	2.33	2.74	1.19	2.06	2.51	0.18	0.28	0.22
DPS	1.38	2.33	2.74	1.19	2.06	2.51	0.18	0.28	0.22
<i>Other key metrics (%)</i>									
Revenue growth	6.6	8.2	6.7	2.3	10.0	7.8	4.3	-1.8	-1.0
EBIT adj growth	12.7	42.5	17.5	-17.4	62.1	22.2	30.1	-19.6	-4.7
EPS adj growth	-5.5	69.2	17.3	-24.1	72.3	22.2	18.7	-3.1	-4.8
Avg. number of shares (m)	14	14	14	14	14	14	0	0	0
Capex	-46	-62	-68	-49	-65	-69	3	3	1
OpFCF	103	129	147	87	112	136	16	16	11
Working capital	-55	-56	-53	-54	-59	-55	-1	3	2
NIBD adj	-142	-210	-274	-123	-185	-243	-19	-25	-31

Source: DNB Markets

Forecast changes – By segment and assumptions

(SEKm)	New			Old			Change		
	2023e	2024e	2025e	2023e	2024e	2025e	2023e	2024e	2025e
Revenue									
Assumptions									
Revenue org. % YOY	3.10	7.27	6.75	-1.29	8.29	7.76	4.39	-1.01	-1.01
Currency impact % YOY	4.23	0.88	0.00	4.25	1.70	0.00	-0.03	-0.82	0.00

Source: DNB Markets

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Quarterly numbers

(SEKm)	Q2 2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023	Q3 2023	Q4 2023e	Q1 2024e	Q2 2024e	Q3 2024e	Q4 2024e
Revenues	108	106	111	109	109	117	116	117	120	124	126
Cost of sales	-3	-3	-4	-3	-3	-3	-3	-3	-3	-3	-3
Gross profit	105	103	107	105	106	114	113	114	117	121	123
Operating expenses	-83	-80	-91	-90	-86	-78	-88	-86	-84	-81	-93
EBITDA	32	34	32	25	31	43	36	40	46	54	43
Depreciation	-6	-5	-9	-7	-7	-7	-7	-7	-7	-7	-7
Amortisation	-7	-7	-7	-7	-13	-8	-8	-9	-9	-9	-9
EBIT	20	22	17	11	11	29	19	23	29	36	26
Net financial items	-1	1	-2	0	3	-4	-1	-1	-1	-1	-1
PBT	19	23	15	12	14	25	19	22	28	35	25
Taxes	-5	-6	0	-5	-8	-11	-5	-5	-7	-8	-6
Net profit	14	17	15	6	6	14	14	17	21	27	19
Adjustments to net profit	0	0	0	2	6	4	2	2	2	2	2
Net profit adj	14	17	15	8	12	18	16	18	23	29	21
Dividend paid	0	0	0	0	-21	0	0	0	-19	0	0
Avg. number of shares (m)	14	14	14	14	14	14	14	14	14	14	14
<i>Per share data (SEK)</i>											
EPS	1.05	1.04	1.07	0.47	0.45	1.02	1.04	1.23	1.57	1.98	1.39
EPS adj	1.05	1.23	1.07	0.59	0.89	1.29	1.16	1.35	1.69	2.11	1.52
DPS ordinary	0.00	0.00	0.00	0.00	1.50	0.00	0.00	0.00	1.38	0.00	0.00
DPS	0.00	0.00	0.00	0.00	1.50	0.00	0.00	0.00	1.38	0.00	0.00
<i>Growth and margins (%)</i>											
Revenues, QOQ growth	9.5	-1.4	4.3	-1.9	0.3	7.8	-1.4	1.4	2.2	3.4	1.7
Revenues, YOY growth	23.1	17.9	20.9	10.5	1.2	10.7	4.6	8.1	10.1	5.6	8.9
EPS adj, YOY growth	26.6	21.8	-49.3	-26.9	-14.7	5.2	8.8	129.9	89.2	62.9	30.2
Gross margin	97.1	97.1	96.6	97.1	97.4	97.4	97.2	97.2	97.4	97.4	97.3
EBITDA adj margin	29.6	32.2	29.3	24.9	33.7	40.3	32.6	35.6	40.1	44.7	35.7
Depreciation/revenues	-5.3	-5.1	-7.9	-6.1	-6.0	-5.8	-6.1	-6.0	-6.2	-5.9	-5.9
EBIT adj margin	18.2	20.8	14.9	12.1	16.0	27.9	18.1	20.9	25.4	30.5	21.7
Net profit margin	13.3	15.8	13.2	5.9	5.6	11.9	12.3	14.3	17.8	21.9	15.1

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

Adjustments to quarterly numbers

(SEKm)	Q2 2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023	Q3 2023	Q4 2023e	Q1 2024e	Q2 2024e	Q3 2024e	Q4 2024e
EBITDA	32	34	32	25	31	43	36	40	46	54	43
EBITDA adj	32	34	32	27	37	47	38	42	48	55	45
EBIT	20	22	17	11	11	29	19	23	29	36	26
Other EBIT adjustments	0	0	0	-2	-6	-4	-2	-2	-2	-2	-2
EBIT adj	20	22	17	13	17	33	21	25	30	38	27
Net profit	14	17	15	6	6	14	14	17	21	27	19
Other EBIT adjustments	0	0	0	-2	-6	-4	-2	-2	-2	-2	-2
Net profit adj	14	17	15	8	12	18	16	18	23	29	21

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

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Quarterly numbers by segment and assumptions

(SEKm)	Q2 2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023	Q3 2023	Q4 2023e	Q1 2024e	Q2 2024e	Q3 2024e	Q4 2024e
Assumptions											
Revenue org. % YOY	13.84	10.89	6.88	4.53	-4.46	5.94	4.02	6.82	9.37	6.56	8.81
Structure impact % YOY	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Currency impact % YOY	9.27	9.33	11.90	5.95	5.02	3.68	2.27	2.08	1.43	-0.02	0.13

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

Annual P&L

(SEKm)	2016	2017	2018	2019	2020	2021	2022	2023e	2024e	2025e
Revenues	328	345	385	406	372	358	423	451	487	520
Cost of sales	-12	-9	-9	-11	-14	-12	-13	-12	-13	-13
Gross profit	316	337	376	395	358	346	410	438	474	507
Operating expenses	-203	-209	-236	-249	-225	-307	-331	-341	-345	-359
EBITDA	113	127	140	146	133	104	129	135	184	208
Depreciation	-3	-2	-3	-13	-20	-20	-26	-27	-29	-31
Amortisation	-14	-17	-22	-25	-29	-152	-28	-36	-34	-36
EBIT	97	107	116	108	84	-69	76	71	113	134
Net financial items	0	-2	-2	-1	-7	0	-2	-1	-3	-3
PBT	100	106	117	107	77	-69	74	69	111	131
Taxes	-22	-26	-26	-26	-17	1	-16	-29	-26	-31
Effective tax rate (%)	22	24	22	24	23	2	21	41	24	24
Net profit	78	80	91	81	59	-67	58	41	84	100
Adjustments to net profit	4	0	3	0	0	134	-1	14	7	7
Net profit adj	82	80	94	81	59	67	57	54	91	107
Dividend paid	-88	-63	-68	-68	0	0	0	-21	-19	-32
Avg. number of shares	13	13	14	14	14	14	14	14	14	14
<i>Per share data (SEK)</i>										
EPS	6.18	6.33	6.67	5.96	4.36	-4.94	4.23	2.98	6.17	7.33
EPS adj	6.18	6.33	6.67	5.96	4.36	4.90	4.17	3.94	6.67	7.82
DPS ordinary	7.00	5.00	5.00	3.00	0.00	0.00	1.50	1.38	2.33	2.74
DPS	7.00	5.00	5.00	3.00	0.00	0.00	1.50	1.38	2.33	2.74
<i>Growth and margins (%)</i>										
Revenue growth	5.4	5.1	11.7	5.3	-8.3	-3.8	18.1	6.6	8.2	6.7
EPS adj growth	23.0	2.6	5.3	-10.6	-26.8	12.5	-14.9	-5.5	69.2	17.3
Gross margin	96.3	97.5	97.7	97.3	96.2	96.6	97.0	97.3	97.3	97.5
EBITDA margin	34.5	36.9	36.4	35.9	35.7	29.0	30.5	30.0	37.6	40.0
EBITDA adj margin	35.7	36.9	37.2	35.9	35.7	66.5	30.3	33.0	39.0	41.3
Depreciation/revenues	-0.8	-0.7	-0.7	-3.2	-5.5	-5.7	-6.0	-6.0	-6.0	-5.9
EBIT margin	29.4	31.1	30.0	26.7	22.5	nm	17.9	15.7	23.3	25.8
EBIT adj margin	30.6	31.1	30.8	26.7	22.5	18.4	17.7	18.7	24.6	27.1
PBT margin	30.5	30.6	30.4	26.4	20.6	nm	17.4	15.4	22.7	25.2
Net profit margin	23.8	23.2	23.6	20.0	16.0	nm	13.7	9.0	17.3	19.2

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

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Adjustments to annual P&L

(SEKm)	2016	2017	2018	2019	2020	2021	2022	2023e	2024e	2025e
EBITDA	113	127	140	146	133	104	129	135	184	208
EBITDA adj	117	127	143	146	133	238	128	149	190	215
EBIT	97	107	116	108	84	-69	76	71	113	134
Other EBIT adjustments	-4	0	-3	0	0	-134	1	-14	-7	-7
EBIT adj	101	107	119	108	84	66	75	84	120	141
Net profit	78	80	91	81	59	-67	58	41	84	100
Other EBIT adjustments	-4	0	-3	0	0	-134	1	-14	-7	-7
Net profit adj	82	80	94	81	59	67	57	54	91	107
<i>Per share data (SEK)</i>										
EPS	6.18	6.33	6.67	5.96	4.36	-4.94	4.23	2.98	6.17	7.33
Recommended adjustment	0.00	0.00	0.00	0.00	0.00	9.85	-0.07	0.96	0.50	0.50
EPS adj	6.18	6.33	6.67	5.96	4.36	4.90	4.17	3.94	6.67	7.82

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

Cash flow

(SEKm)	2016	2017	2018	2019	2020	2021	2022	2023e	2024e	2025e
Net profit	78	80	91	81	59	-67	58	41	84	100
Depreciation and amortisation	17	20	25	37	49	172	53	63	63	67
Cash flow from operations (CFO)	114	124	93	106	118	132	128	134	149	164
Capital expenditure	-19	-19	-47	-84	-81	-74	-60	-46	-62	-68
Acquisitions/Investments	0	0	-171	-19	0	0	0	0	0	0
Divestments	0	0	0	0	0	0	0	0	0	0
Cash flow from investing (CFI)	-19	-38	-218	-102	-81	-74	-60	-46	-62	-68
Free cash flow (FCF)	95	86	-125	4	37	58	68	87	87	96
Net change in debt	0	0	0	30	6	1	1	0	0	0
Dividends paid	-88	-63	-68	-68	0	0	0	-21	-19	-32
Share issue (repurchase)	0	0	172	0	0	0	0	0	0	0
Other	0	0	4	-14	-30	-16	-40	-17	-8	-8
Cash flow from financing (CFF)	-88	-63	108	-52	-25	-15	-40	-37	-27	-40
Total cash flow (CFO+CFI+CFF)	7	23	-17	-49	12	42	29	50	60	56
<i>FCFF calculation</i>										
Free cash flow	95	86	-125	4	37	58	68	87	87	96
Less: acquisitions	0	0	171	19	0	0	0	0	0	0
Less: divestments	0	0	0	0	0	0	0	0	0	0
Growth (%)										
CFO	15.7	8.5	-25.3	14.1	12.0	11.1	-2.7	4.4	11.4	9.8
CFI	-3.3	-98.9	-478.5	53.0	20.4	9.0	19.6	22.5	-33.3	-9.8
FCF	18.5	-9.4	-244.7	102.8	957.1	55.4	19.0	27.9	-0.2	9.8
CFF	-39.0	28.5	270.4	-148.3	52.7	38.6	-162.3	5.6	28.2	-48.6

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

25 October 2023

Balance sheet

(SEKm)	2016	2017	2018	2019	2020	2021	2022	2023e	2024e	2025e
Assets	396	410	722	825	834	813	922	977	1,035	1,085
Inventories	6	5	7	7	6	10	11	9	11	10
Trade receivables	48	51	63	67	59	59	67	69	66	62
Other receivables	19	12	38	52	64	44	34	31	32	30
Cash and cash equivalents	99	120	106	61	68	113	148	198	259	315
Current assets	172	187	214	186	196	226	260	308	368	418
Property, plant and equipment	6	6	9	7	8	15	17	17	18	19
Other intangible assets	197	194	484	624	624	567	639	643	640	640
Deferred tax assets	16	3	13	5	4	3	3	5	5	5
Non-current financial assets	5	20	2	2	3	3	4	4	4	4
Non-current assets	224	223	508	639	638	587	663	668	667	667
Total assets	396	410	722	825	834	813	922	977	1,035	1,085
Equity and liabilities	396	410	722	825	834	813	922	977	1,035	1,085
Total equity	280	290	550	592	613	585	667	704	770	838
Trade payables	5	6	7	9	5	9	8	8	7	7
Other payables and accruals	92	86	131	117	111	133	146	157	159	149
Short-term debt	1	1	0	25	18	18	0	0	0	0
Total current liabilities	99	102	140	164	150	179	173	184	185	175
Long-term debt	2	2	1	41	32	20	50	37	29	21
Deferred tax liabilities	15	14	30	27	37	28	30	49	49	49
Other non-current liabilities	1	2	2	1	1	1	2	2	2	2
Total non-current liabilities	18	17	32	69	70	49	82	88	80	72
Total liabilities	116	120	172	233	220	228	255	272	265	247
Total equity and liabilities	396	410	722	825	834	813	922	977	1,035	1,085
<i>Key metrics</i>										
Net interest bearing debt	-97	-117	-103	18	-2	-57	-79	-142	-210	-274

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

25 October 2023

Valuation ratios

(SEKm)	2016	2017	2018	2019	2020	2021	2022	2023e	2024e	2025e
<i>Enterprise value</i>										
Share price (SEK)	206.00	189.00	243.00	186.00	139.80	117.80	150.40	87.50	87.50	87.50
Number of shares (m)	12.63	12.63	13.62	13.63	13.63	13.63	13.65	13.66	13.66	13.66
Market capitalisation	2,602	2,387	3,310	2,535	1,905	1,606	2,053	1,195	1,195	1,195
Net interest bearing debt	-97	-117	-103	18	-2	-57	-79	-142	-210	-274
Net interest bearing debt adj	-97	-117	-103	18	-2	-57	-79	-142	-210	-274
EV	2,505	2,270	3,206	2,554	1,904	1,548	1,974	1,053	985	921
EV adj	2,505	2,270	3,206	2,554	1,904	1,548	1,974	1,053	985	921
<i>Valuation</i>										
EPS	6.18	6.33	6.67	5.96	4.36	-4.94	4.23	2.98	6.17	7.33
EPS adj	6.18	6.33	6.67	5.96	4.36	4.90	4.17	3.94	6.67	7.82
DPS ordinary	7.00	5.00	5.00	3.00	0.00	0.00	1.50	1.38	2.33	2.74
DPS	7.00	5.00	5.00	3.00	0.00	0.00	1.50	1.38	2.33	2.74
P/E	33.4	29.8	36.4	31.2	32.1	-23.8	35.5	29.4	14.2	11.9
P/E adj	33.4	29.8	36.4	31.2	32.1	24.0	36.1	22.2	13.1	11.2
P/B	9.31	8.22	6.02	4.28	3.11	2.74	3.08	1.70	1.55	1.43
Average ROE	27.3%	28.1%	21.6%	14.2%	9.9%	-11.2%	9.2%	5.9%	11.4%	12.4%
Earnings yield adj	3.0%	3.4%	2.7%	3.2%	3.1%	4.2%	2.8%	4.5%	7.6%	8.9%
Dividend yield	3.4%	2.6%	2.1%	1.6%	0.0%	0.0%	1.0%	1.6%	2.7%	3.1%
Free cash flow yield	3.7%	3.6%	-3.8%	0.1%	1.9%	3.6%	3.3%	7.3%	7.3%	8.0%
EV/SALES	7.63	6.58	8.32	6.30	5.12	4.32	4.67	2.34	2.02	1.77
EV/SALES adj	7.63	6.58	8.32	6.30	5.12	4.32	4.67	2.34	2.02	1.77
EV/EBITDA	22.1	17.8	22.9	17.5	14.3	14.9	15.3	7.8	5.4	4.4
EV/EBITDA adj	21.4	17.8	22.4	17.5	14.3	6.5	15.4	7.1	5.2	4.3
EV/EBIT	26.0	21.1	27.7	23.6	22.7	-22.6	26.1	14.9	8.7	6.9
EV/EBIT adj	24.9	21.1	27.0	23.6	22.7	23.6	26.4	12.5	8.2	6.5
EV/capital employed	8.9	7.8	5.8	3.8	2.8	2.4	2.7	1.4	1.2	1.0
EV/NOPLAT	33.3	27.1	35.6	30.2	29.1	-29.0	33.4	19.1	11.1	8.8
EV/OpFCF (taxed)	32.8	26.8	45.6	66.6	57.9	10.4	37.9	12.4	9.6	7.9

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

25 October 2023

Key accounting ratios

	2016	2017	2018	2019	2020	2021	2022	2023e	2024e	2025e
<i>Profitability (%)</i>										
ROA	19.6	19.9	16.0	10.5	7.2	-8.2	6.7	4.3	8.4	9.4
ROCE	35.0	37.4	28.1	17.7	12.4	9.9	10.9	11.3	15.2	16.6
ROCE after tax	27.3	29.1	21.9	13.8	9.7	7.8	8.5	8.8	11.9	13.0
<i>Return on invested capital (%)</i>										
Net PPE/revenues	1.9	1.8	2.3	1.8	2.0	4.1	3.9	3.8	3.7	3.6
Working capital/revenues	-7.5	-6.9	-7.8	-0.2	3.4	-8.3	-10.1	-12.2	-11.5	-10.2
<i>Cash flow ratios (%)</i>										
FCF/revenues	29.0	25.0	-32.4	0.9	9.9	16.1	16.2	19.4	17.9	18.4
FCF yield (%)	3.7	3.6	1.4	0.9	1.9	3.6	3.3	7.3	7.3	8.0
CFO/revenues	34.8	35.9	24.0	26.1	31.8	36.8	30.3	29.7	30.6	31.4
CFO/market capitalisation	4.4	5.2	2.8	4.2	6.2	8.2	6.2	11.2	12.5	13.7
CFO/capex	614.0	652.1	197.9	126.4	145.5	177.6	214.8	293.1	241.8	241.7
CFO/current liabilities	115.8	121.1	66.2	64.4	78.9	73.7	73.9	72.7	80.6	93.6
Cash conversion ratio	122.2	107.9	-137.6	4.3	62.3	-85.3	118.3	214.9	103.6	95.8
Capex/revenues	5.7	5.5	12.1	20.6	21.9	20.7	14.1	10.1	12.6	13.0
Capex/depreciation	744.0	791.7	1800.0	648.1	401.0	363.2	233.7	169.1	209.7	219.1
OpFCF margin	30.0	31.4	25.1	15.3	13.8	45.8	16.2	22.9	26.4	28.3
Total payout ratio	113.3	78.9	75.0	50.4	0.0	0.0	35.4	46.3	37.8	37.4
<i>Leverage and solvency (x)</i>										
Net debt/EBITDA	-0.85	-0.92	-0.74	0.13	-0.01	-0.55	-0.61	-1.05	-1.15	-1.32
Total debt/total capital (BV)	0.01	0.01	0.00	0.08	0.06	0.05	0.05	0.04	0.03	0.02
LTD / (LTD + equity (MV))	0.00	0.00	0.00	0.02	0.02	0.01	0.02	0.03	0.02	0.02
<i>Cash conversion cycle</i>										
Inventory turnover days	167.5	223.3	267.7	223.1	147.6	289.0	322.2	279.9	303.9	285.3
Receivables turnover days	74.7	66.2	96.1	106.8	120.2	104.7	86.5	81.5	74.0	65.1
Credit period	158.6	244.8	296.1	310.9	129.4	279.8	239.5	233.3	202.6	190.2
Cash conversion cycle	83.7	44.8	67.7	18.9	138.3	113.8	169.2	128.1	175.3	160.2

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

25 October 2023

Important Information

Company: IAR Systems
 Coverage by Analyst: Joachim Gunell
 Date: 25/10/2023

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