Artificial Solutions

Sector: Software

A Mixed Quarter

Redeye reiterates its positive long-term stance on Artificial Solutions (AS) on the back of a mixed Q2-report, the key highlights of which was the sales and EBIT beat and the continued surging usage of Teneo solutions. However, order intake and order backlog was less encouraging due to challenges related to the pandemic. We consider the trend to be of a transient nature and do not extrapolate it into forecasts. On the contrary we would, make the point that in the slightly longer-term (i.e. 2021-), the net impact on conversational AI will be enhanced as CEOs are going to push for more automation and increased business continuity capabilities. The report motivates minor estimates revisions while the dilution from the recent share issue yields a slightly lower base case of **SEK 17 (18) per share.**

22% sales growth

Net sales grew by 22.2% y/y to SEK 15.3m (we forecast 12.9) and order intake was down 71% to SEK 6.5m (22.8). AS communicates that a number of deals expected to close in Q2 were delayed due to the pandemic, but have subsequently closed after the quarter ended. Usage revenues continued its positive trajectory and was up by 84% y/y to SEK 5.6m (representing 36% of net sales), although from low levels. The corresponding numbers in Q1'20 were SEK 3.9m (representing 26% of net sales). AS latest financial target expects usage sales to represent >80% of total net sales by 2022.

Operational efficiency

Despite turbulent times, AS shows evidence of an effective business: sales growth was accompanied with an opex decrease of ~14% and a strong gross margin of 69% (representing an expansion of 9% y/y and q/q). Better than expected sales, opex and gross margin resulted in a lower EBIT-loss at SEK -23.0m (we forecast -27.8).
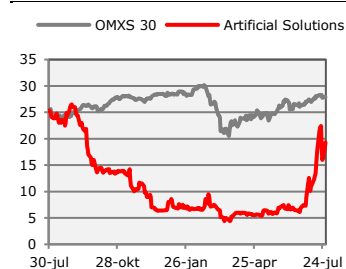
Underlying momentum intact

While the potential near-term fallout from the corona crisis is difficult to gauge, we believe investors should look to the company's underlying momentum, exemplified lately by new customer wins with large, multinational enterprises and the surge in usage of Teneo solutions. Our current-year forecasts (including growth of ~25%) and further customer wins should lend support to the stock if they materialize.

FAIR VALUE RANGE

BEAR	BASE	BULL
2.5	17.0	38.0

ASAI.st VERSUS OMXS30

REDEYE RATING

| People | Business | Financials |
| 4 | 3 | 1 |

KEY STATS

Ticker	ASAI.st
Market	First North
Share Price (SEK)	16.1
Market Cap (MSEK)	763
Net Debt 20E (MSEK)	208
Free Float	65 %

ANALYSTS

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KEY FINANCIALS (SEKm)	2017	2018	2019	2020E	2021E	2022E
Net sales	48	45	49	62	91	132
EBITDA	-65	-95	-112	-79	-60	-32
EBIT	-91	-119	-146	-93	-75	-48
EPS (adj.)	neg.	neg.	neg.	neg.	neg.	neg.
EV/Sales	n/a	n/a	neg.	neg.	neg.	neg.
EV/EBITDA	n/a	n/a	neg.	neg.	neg.	neg.
EV/EBIT	n/a	n/a	neg.	neg.	neg.	neg.
P/E	n/a	n/a	neg.	neg.	neg.	neg.

Artificial Solutions: Q2'20

Although the P&L numbers beat forecasts, the pandemic had an apparent effect on order intake, which decreased considerably (due to lengthened sales cycles and conservatism among IT departments to commit new spend). We consider the trend to be transient and do not extrapolate it into forecasts, especially as a number of deals expected to close in Q2 were subsequently closed after the quarter ended.

Artificial Solutions: Actuals and estimates, Q2'20

SEKm	Q2'19	Q2'20e	Q2'20a	Diff (%)	Diff. (abs.)	Q1'20
Net sales	**12.6**	**12.9**	**15.4**	**20%**	**2.5**	**15.3**
Capitalised costs	2.6	2.8	2.6	-7%	-0.2	3.9
Other income	0.0	0.0	0.6	n.a	0.6	0.0
Total income	**15.2**	**15.7**	**18.6**	**19%**	**2.9**	**19.2**
Total OPEX	-45.2	-40.0	-38.3	4%	1.7	-44.4
EBITDA	**-30.0**	**-24.3**	**-19.7**	**19%**	**4.6**	**-25.2**
D&A	-3.1	-3.5	-3.3			-3.4
EBIT	**-33.1**	**-27.8**	**-23.0**	**17%**	**4.8**	**-28.6**
Order intake	22.8	n.a	6.5			
Order backlog	50.7	n.a	44.6			
Net sales growth	11%	2%	22%			
Order intake growth	200%	n.a	-71%			
Order backlog growth	79%	n.a	-12%			
Gross margin	60%	61%	69%			
EBITDA margin	neg	neg	neg			
EBIT margin	neg	neg	neg			

Source: Redeye Reserach, Artificial Solutions

Usage revenue continued its positive momentum and reached SEK 5.6m (3.1), up from SEK 3.9m in Q1'20, demonstrating positive operational trends in line with AS communicated high-margin oriented strategy. The surge in usage of Teneo solutions also continued, as shown by the figure below. Note that this is not directly correlated to revenues, as some customers buy usage licenses on an up-front basis (i.e. not all usage increase translates to a corresponding increase in revenue). However, we would argue that the underlying engagement (i.e. usage) may be the most critical value driver as everything else stems from that.

Artificial Solutions: Total interactions for usage-based customers
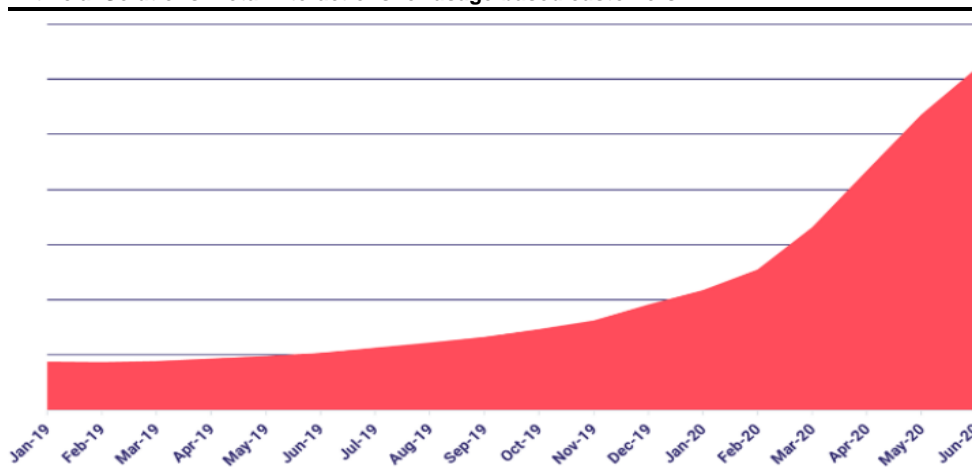
Source: Artificial Solutions

Moreover, AS had one additional customer win during the quarter and secured the closure of a new partnership with Tech Mahindra, a leading global systems integrator and infrastructure provider. AS also completed a SEK 27m share issue during the quarter to secure its near-term funding.

As order intake for the quarter fell below the value of revenue delivered, the backlog decreased by 12% compared to June 2019.

**Artificial Solutions: Order intake & backlog, end of quarter**

(SEKm)	Q2'19	Q2'20	change	Q1'20
License & Usage	16.6	3.5	-79%	16.8
% of total	*73%*	*54%*		*86%*
Services	6.1	3.0	-51%	2.7
% of total	*27%*	*46%*		*14%*
Total order intake	**22.7**	**6.5**	**-71%**	**19.5**

(SEKm)	Q2'19	Q2'20	change	Q1'20
License & Usage	41.1	38.0	-8%	48.7
% of total	*81%*	*85%*		*86%*
Services	9.7	6.6	-32%	7.7
% of total	*19%*	*15%*		*14%*
Total order backlog	**50.8**	**44.6**	**-12%**	**56.4**

Source: Redeye Research, Artificial Solutions

Gross margin associated with the backlog is 82% (well above AS guidance of 70% from 2020). Important to note here is that as some customers will buy usage and services "as used", the future revenues from existing customers may be beyond that included in backlog at any stage. The high gross margin numbers are a result of continued success related to AS partner strategy, revenues through partners in Q2 was at 53% (34%).

Artificial Solutions: Order backlog March 2020
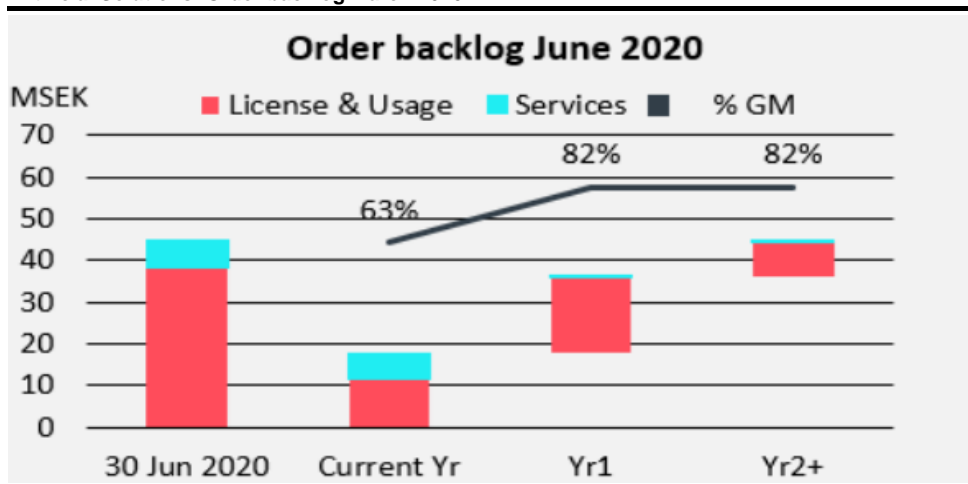
Source: Artificial Solutions

Financial Projections

Artificial Solutions: Profit and loss, at base case, '18-'22e

SEKm	2018	2019	Q1'20	Q2'20	Q3'20e	Q4'20e	2020e	2021e	2022e
Net sales	**44.9**	**49.0**	**15.3**	**15.4**	**14.1**	**17.1**	**61.8**	**90.9**	**131.8**
Capitalised costs	12.2	12.0	3.9	2.6	2.8	5.0	14.3	16.0	17.0
Other income	5.3	7.3	0.0	0.6	0.0	5.0	5.0	5.0	5.0
Total income	**62.4**	**68.4**	**19.2**	**18.6**	**16.9**	**27.1**	**81.1**	**111.9**	**153.8**
Other external costs	-51.5	-62.7	-12.7	-10.0	-10.0	-12.0	-44.7	-48.7	-53.1
Personnel costs	-105.9	-117.7	-31.7	-28.3	-27.0	-28.5	-115.5	-123.6	-132.2
Other operating costs	-0.1	-0.2	0.0	0.0	0.0	0.0	-0.2	-0.2	-0.2
EBITDA	**-95.1**	**-112.3**	**-25.2**	**-19.7**	**-20.1**	**-13.5**	**-79.1**	**-60.4**	**-31.6**
D&A	-23.7	-33.6	-3.4	-3.3	-3.6	-3.7	-14.0	-15.0	-16.2
EBIT	**-118.8**	**-145.9**	**-28.6**	**-23.0**	**-23.7**	**-17.2**	**-93.1**	**-75.4**	**-47.7**
Net financials	-27.3	-35.9	-2.7	-19.0	-7.0	-10.0	-38.7	-15.0	-15.0
EBT	**-146.1**	**-181.8**	**-31.3**	**-42.0**	**-30.7**	**-27.2**	**-131.8**	**-90.4**	**-62.7**
Tax	0.0	0.0	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Net Income	**-146.1**	**-181.8**	**-31.5**	**-42.0**	**-30.7**	**-27.2**	**-131.8**	**-90.4**	**-62.7**

Source: Redeye Research, Artificial Solutions

Valuation

We derive our fair value from a fundamental DCF analysis applied across three scenarios - base case (most likely), bear case (pessimistic) and bull case (optimistic). Following the recent directed share issue raising a total of SEK 26.9m the number of shares in our valuation amounts to 47.5m. The report motivates minor estimates revisions while the dilution from the share issue yields a slightly lower base case of **SEK 17 (18) per share.**

Bear Case 2.5 SEK

- Sales '29e: SEK340m
- Term growth rate: 2%
- Avg. EBIT margin ('23-'29): 10%
- Term EBIT margin: 14%
- WACC: 12%

In our bear case scenario, we see our bear points materialize. It mainly boils down to competition and technology risks, where we assume that Teneo will not sustain its competitiveness over the medium and long-term.

As a result, the shift towards more profitable revenue types do not occur, and the operating leverage is not realized.

These factors will contribute to AS lowering ambition and become a company with limited growth possibilities (i.e. a consultancy company with minor software sales). Reduced ambition will result in minor investments, employment, and marketing – leading to stable margins.

Base Case 17.0 SEK

Key assumptions ('23-'29):

- CAGR sales: 30%
- Term growth rate: 2%
- Sales '29e: SEK810m
- Avg. EBIT margin: 21%
- Term EBIT margin: 34%
- WACC: 12%

As the market develops, AS is well-positioned to benefit from its superior offering. As a result, our base case sees it growing with the market thanks to the competitive product and its revised go-to-market strategy.

The Company's high operating leverage will translate into significant profitability as we assume a low customer churn and favourable customer acquisition costs.

In base case, we anticipate positive cash flow from 2023.

Bull Case 38.0 SEK

- Sales '29e: SEK1 320m
- Term growth rate: 2%
- Avg. EBIT margin ('23-'29): 26%
- Term EBIT margin: 37%
- WACC: 12%

Our bull case factors in higher growth, driven by more customer wins and broader deployments at each customer (i.e. higher ACV).

Greater success will let AS to leverage its conversational data even further with a healthy rate of product innovation steaming from it – which ensures its competitiveness over a more extended period.

It's operating leverage, and lower churn assumptions (driven by greater stickiness from broader deployments) allows for higher margins, explaining our long-term profitability assumptions.

In bull case, we anticipate positive cash flow from 2022.

Summary Redeye Rating

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

Rating changes in the report: No changes

People: 4

Artificial Solutions has a highly experienced senior management team and holds a strong position in terms of technological know-how and products. The challenges ahead relate to good execution and management (go-to-market approach, customer acquisition, partner strategy etc.). Our assessment is that the team is well-equipped to capitalize on these opportunities. In addition to the CEO's experience from companies undergoing expansion, the majority of the team has been at AS for eight years or more. We consider the management team and the developers to be fundamental to the Company, which also represents a risk (dependency on key personnel). We would like the board and management team to have more skin in the game, to confirm their confidence in the Company's future and to align their interests with other shareholders'. As of now, their combined holding amounts to ~5.0%.

Business: 3

AS is active in a market that is exhibiting particularly rapid growth. The overall global intelligent virtual assistants market is set to grow ~40% a year until 2023, according to Tractica, making it clearly a favorable market to be part of. Two of AS's three revenue streams - licenses and usage fees - provide high gross margins (~90%) and recurring revenues. The Company's high operating leverage should translate into significant profitability if it succeeds in growing with its market while controlling customer churn and acquisition costs.

Financials: 1

We anticipate that the Company will need to raise additional capital for its ongoing operations before reaching profitability. Its balance sheet is strained with negative equity and considerable debt. AS has never before been able to reach profitability. In our estimates (base case), AS will reach profitability during 2023, at that point, the rating would start to gradually increase.

INCOME STATEMENT	2017	2018	2019	2020E	2021E
Net sales	48	45	49	62	91
Total operating costs	-113	-140	-161	-141	-151
EBITDA	-65	-95	-112	-79	-60
Depreciation	-1	-1	-1	-1	-1
Amortization	-24	-23	-33	-14	-14
Impairment charges	0	0	0	0	0
EBIT	-91	-119	-146	-93	-75
Share in profits	0	0	0	0	0
Net financial items	-14	-27	-36	-39	-15
Exchange rate dif.	0	0	0	0	0
Pre-tax profit	-105	-146	-182	-132	-90
Tax	0	0	0	0	0
Net earnings	-105	-146	-182	-132	-90

BALANCE SHEET	2017	2018	2019	2020E	2021E
Assets					
Current assets					
Cash in banks	4	47	4	12	5
Receivables	4	6	32	7	10
Inventories	0	0	0	0	0
Other current assets	10	17	0	0	0
Current assets	18	70	36	20	15
Fixed assets					
Tangible assets	2	2	2	2	2
Associated comp.	0	0	0	0	0
Investments	5	6	5	5	5
Goodwill	7	0	0	0	0
Cap. exp. for dev.	0	0	0	0	0
O intangible rights	30	29	31	31	33
O non-current assets	0	0	0	0	0
Total fixed assets	45	37	38	38	40
Deferred tax assets	0	0	0	0	0
Total (assets)	63	107	74	58	55
Liabilities					
Current liabilities					
Short-term debt	75	94	141	221	297
Accounts payable	36	47	49	52	54
O current liabilities	0	0	0	0	8
Current liabilities	112	141	190	273	359
Long-term debt	24	52	0	0	0
O long-term liabilities	0	0	0	0	0
Convertibles	0	0	0	0	0
Total Liabilities	136	193	190	273	359
Deferred tax liab	0	0	0	0	0
Provisions	0	0	0	0	0
Shareholders' equity	-73	-86	-116	-214	-305
Minority interest (BS)	0	0	0	0	0
Minority & equity	-73	-86	-116	-214	-305
Total liab & SE	63	107	74	58	55

FREE CASH FLOW	2017	2018	2019	2020E	2021E
Net sales	48	45	49	62	91
Total operating costs	-113	-140	-161	-141	-151
Depreciations total	-26	-24	-34	-14	-15
EBIT	-91	-119	-146	-93	-75
Taxes on EBIT	0	0	0	0	0
NOPLAT	-91	-119	-146	-93	-75
Depreciation	26	24	34	14	15
Gross cash flow	-65	-95	-112	-79	-60
Change in WC	23	1	-7	27	8
Gross CAPEX	-70	-16	-35	-15	-17
Free cash flow	-113	-109	-153	-67	-69

CAPITAL STRUCTURE	2017	2018	2019	2020E	2021E
Equity ratio	-115%	-81%	-157%	-368%	-559%
Debt/equity ratio	-137%	-169%	-121%	-103%	-97%
Net debt	95	99	136	209	293
Capital employed	22	13	20	-6	-12
Capital turnover rate	0.8	0.4	0.7	1.1	1.7

GROWTH	2017	2018	2019	2020E	2021E
Sales growth	39%	-6%	9%	26%	47%
EPS growth (adj)	0%	-44%	-59%	-28%	-31%

DCF VALUATION		CASH FLOW, MSEK	
WACC (%)	12.0 %	NPV FCF (2020-2028)	221
		NPV FCF (2029-)	802
		Net debt (20E)	-208
		Fair value estimate MSEK	815
		Nr. of shares	47.5
Assumptions 2020-2026 (%)			
Average sales growth	39.4 %	Fair value e. per share, SEK	17.0
EBIT margin	neg	Share price, SEK	16.1

PROFITABILITY	2017	2018	2019	2020E	2021E
ROE	0%	0%	0%	0%	0%
ROCE	-679%	-275%	-432%	-846%	14215%
ROIC	0%	-532%	-1140%	-460%	1289%
EBITDA margin	-137%	-212%	-229%	-128%	-66%
EBIT margin	-191%	-265%	-298%	-151%	-83%
Net margin	-221%	-325%	-371%	-213%	-99%

DATA PER SHARE	2017	2018	2019	2020E	2021E
EPS	-18.29	-10.28	-4.20	-3.05	-2.09
EPS adj	-18.29	-10.28	-4.20	-3.05	-2.09
Dividend	0.00	0.00	0.00	0.00	0.00
Net debt	16.56	6.98	3.15	4.82	6.77
Total shares	5.76	14.22	43.24	47.54	47.54

VALUATION	2017	2018	2019	2020E	2021E
EV	95.3	99.2	934.2	1,006.5	1,090.4
P/E	0.0	0.0	-4.4	-6.1	-8.8
P/E diluted	0.0	0.0	-4.4	-6.1	-8.8
P/Sales	0.0	0.0	16.3	12.9	8.8
EV/Sales	2.0	2.2	19.1	16.3	12.0
EV/EBITDA	-1.5	-1.0	-8.3	-12.7	-18.0
EV/EBIT	-1.0	-0.8	-6.4	-10.8	-14.5
P/BV	0.0	0.0	-6.9	-3.7	-2.6

SHARE PERFORMANCE		GROWTH/YEAR	18/20E
1 month	149.3 %	Net sales	1.4 %
3 month	229.5 %	Operating profit adj	26.7 %
12 month	-27.4 %	EPS, just	-52.1 %
Since start of the year	186.5 %	Equity	26.1 %

SHAREHOLDER STRUCTURE %	CAPITAL	VOTES
Scope	35.3 %	35.3 %
AFA Försäkring	5.4 %	5.4 %
SEB-Stiftelsen	4.4 %	4.4 %
C WorldWide Asset Management	2.8 %	2.8 %
Ulf Johansson	2.5 %	2.5 %
Johan A. Gustavsson	2.4 %	2.4 %
NLISIP	1.9 %	1.9 %
Nordnet Pensionsförsäkring	1.7 %	1.7 %
John Brehmer	1.6 %	1.6 %
Sven Härgestam	1.5 %	1.5 %

SHARE INFORMATION	
Reuters code	ASAI.st
List	First North
Share price	16.1
Total shares, million	47.5
Market Cap, MSEK	763.1

MANAGEMENT & BOARD	
CEO	Lawrence Flynn
CFO	Chris Bushnell
IR	Chris Bushnell
Chairman	Åsa Hedin

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Redeye Rating and Background Definitions

Company Quality

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

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

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

People

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

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

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

Business

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

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

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

Financials

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

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

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

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Redeye Rating (2020-07-31)

Rating	People	Business	Financials
5p	15	12	3
3p - 4p	108	84	33
0p - 2p	6	33	93
Company N	129	129	129

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CONFLICT OF INTERESTS

Havan Hanna owns shares in the Company: No

Viktor Westman 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.