

Update: Report Q1 2020

2020-05-08

Hövding: The pandemic delays growth story

- Disappointing sales and gross margin in Q1
- The company sees tentative signs of improvement in the market
- We expect lingering effects and cut our outlook and valuation range

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Stock ticker:	HOVD
Industry:	Consumer goods
Listed on:	Nasdaq First North
Latest stock price (SEK):	19,70
Market cap (MSEK):	464,8
Enterprise Value (MSEK):	449,4
Total number of shares (M):	23,59
- of which free float (M):	13,90

VHCF fair value per share

DCF model 14,40 - 21,30 SEK

Hövding Sverige AB

Address: Bergsgatan 33
214 22 Malmö
Webpage: hovding.se
CEO: Fredrik Carling

Main owners (31 Dec 2019)

Capital (%)

Safeyech International Holding AB	21,1
Fosielund Holding AB	17,2
Carl-Olof och Jenz Hamrins Stiftelse	10,3
VIH Sweden AB	10,2
Wikow Venture	3,4

Stock price history

Hövding Sverige AB vs. OMXS30

Performance Price (Indexed to 19.26)



Source: FactSet Prices

	-1m	-3m	-12m
Change (%)	33,8	-7,8	14,0
52 w k range (Low / Hi) - SEK		13,50 / 37,60	

Source: FactSet

We worried that COVID-19 and its ramifications would impact Hövding's Q1 sales numbers and that worry proved to be justified. In Wednesday's quarterly report, the company reported a net sales growth of only 7 percent compared with Q1 2019, which means that turnover in the month of March must have nosedived. Both sales and profits in Q1 came in far below our estimates, exacerbated by a surprising drop in gross margin. Not surprisingly, the company said it had abandoned its goal of reaching SEK 250 million in sales this year. Considering the lingering effects of the corona crisis and the likely deep recession ahead of us, we revise our outlook for Hövding and lower our fair value estimate for the share.

Hövding reported a promising start to the year with January and February sales up 43 percent over the corresponding period last year. For the quarter as a whole to grow only 7 percent, a fair guess is that sales in March must have fallen to about half of that of a year ago. This is dramatic, not least because we expect the lull to spill over into Q2 and beyond.

In Table 2 overleaf, we compare our estimated figures for the quarter with the actual outcome. Although we downgraded our sales forecast in our latest research update in mid-March, in hindsight that downgrade was not sufficient. The actual number of sold units amounted to 13 646, far below our estimate of 20 362 units. Total revenue therefore fell short by almost SEK 11 million compared with our estimate. Cost of Goods Sold was lower due to the lower volume while Personnel and Other Operating Expenses were fairly in line with our expectations. In total, Net Profit came in around SEK 6 million lower than anticipated.

Table 1: Financial Overview

MSEK	2 018	2 019	2020e	2021e	2022e
Net sales	92,5	112,9	144,8	259,4	345,0
Growth (%)	63,2%	22,0%	28,2%	79,2%	33,0%
Gross margin (%)	22,7%	26,1%	23,3%	28,3%	28,4%
EBIT	(41,5)	(51,0)	(39,4)	0,7	23,7
EBIT margin (%)	neg	neg	neg	0,3%	6,9%
Cash holdings	66,5	20,4	33,5	30,6	64,3
Total assets	95,7	78,8	95,3	117,0	163,6
Total equity	62,1	11,4	15,1	15,9	39,6
Solidity (%)	64,9%	14,4%	15,9%	13,6%	24,2%
P/E	neg	neg	neg	648,9	20,2
ROE	neg	neg	neg	4,6%	59,9%
EV/EBIT (x)	neg	neg	neg	628,1	19,6
EV/Sales (x)	5,0	4,1	3,2	1,8	1,3

Source: Västra Hamnen Corporate Finance

Disappointing gross margin in Q1

The gross margin in Q1 came in at only 15 percent, the lowest since 2016 and less than half the level from Q1 2019. This was a disappointment as we had expected a reading in the area of 25 percent. Many factors contributed to the margin squeeze, according to the company. First, supply disruptions in late 2019 forced the company to ship incoming goods by air, which contributed to higher unit cost compared to the usual sea transport. Second, the geographic sales mix in Q1 showed proportionally higher revenues in SEK while manufacturing costs are largely linked to EUR, implying a lower than usual cushion against a higher EUR/SEK exchange rate. Third, the channel mix had a high proportion of distributors, which is the channel with the lowest margins. And finally, the Danish market, which is the market with the best margins, constituted an unusually low share of revenues in Q1.

Table 2: Estimates vs actual, Q1 2020

kSEK	Q1 '19	Q1 '20est	Q1 '20act	Diff
Sold units	13 370	20 362	13 646	(6 716)
Net Revenues	19 640	31 466	20 953	(10 513)
Other Revenues	24	509	35	(474)
Total Revenues	19 664	31 975	20 988	(10 987)
Cost of Goods Sold	(13 477)	(23 522)	(17 881)	5 641
Personnel Expenses	(8 527)	(8 915)	(9 926)	(1 011)
Other Operating Expenses	(8 091)	(10 500)	(9 800)	700
Total OPEX	(30 095)	(42 937)	(37 607)	5 330
EBITDA	(10 431)	(10 962)	(16 619)	(5 657)
Amortisation and Depreciation	(531)	(899)	(1 196)	(297)
EBIT	(10 962)	(11 861)	(17 815)	(5 954)
Net Financial Items	32	-	(129)	(129)
EBT	(10 930)	(11 861)	(17 944)	(6 083)
Net Profit	(10 930)	(11 861)	(17 944)	(6 083)
Cash and Equivalents	53 332	26 838	5 647	(21 191)
Total Equity	51 204	22 498	16 684	(5 814)

Source: Västra Hamnen Corporate Finance

Low cash is explainable

The Cash and Equivalents shows a large deviation from our estimate, coming in at less than SEK 6 million. This is SEK 21 million less than our estimated figure. However, this can be explained by two factors. First, a part of the rights issue in March is still taken up as Subscribed but not paid-in capital on the balance sheet. When this capital is paid in it will add almost SEK 13 million to the cash balance. Secondly, the company's working capital has increased by almost SEK 7 million. The current assets have increased, in combination with current liabilities decreasing. Most notably, Inventory has swelled to a record high of almost SEK 36 million from 21 million at the end of 2019. This is understandable given the sudden drop in demand. The company has agreed with its main supplier to slow production for now and will reverse some of the inventory buildup in coming months, freeing up capital on the balance sheet.

Distress visible in main markets

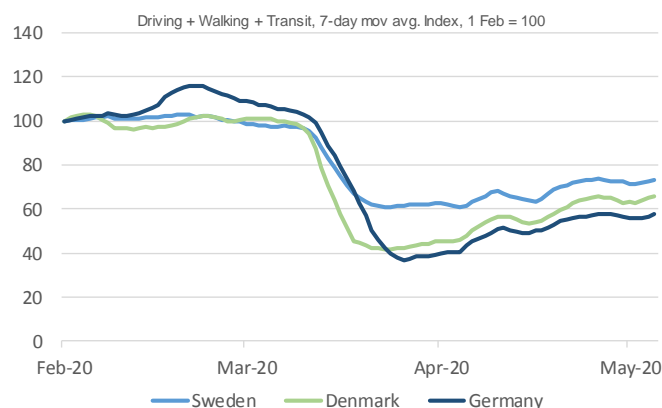
Looking ahead, we have once again chosen to revise down our sales forecast. The distress of the ongoing pandemic has become more obvious in Hövding's main markets, and we fear that more tough times are still to come. The sales split in Q1 was reported as 32 percent Sweden, 22 percent Denmark, 43 percent Germany and 4 percent UK and others. All three main markets were severely affected by the COVID-19 pandemic in March, although the latter two had more comprehensive lockdowns than Sweden. The effects were clearly visible in general macroeconomic data in March, eg. retail sales where both Sweden and Denmark reported around 30 percent seasonally adjusted drop in clothing sales compared with February. It is likely that market conditions in April was just as bad as March.

Very slow pickup in mobility

In the near-term sales forecast, we have chosen to take a more conservative stance in general. Germany and Denmark are slowly lifting their lockdown restrictions, and Apple Mobility Data (Figure 2 below) shows that the company's main markets are starting to improve in terms of mobility. Hövding also reports improvement in activity among its resellers, with nearly all physical outlets in all countries allowed to operate again. However, the rebound

is happening at a slow rate, and the low mobility in May further strengthens our belief that Q2 will be weak in terms of sales.

Figure 2: Apple Mobility Data

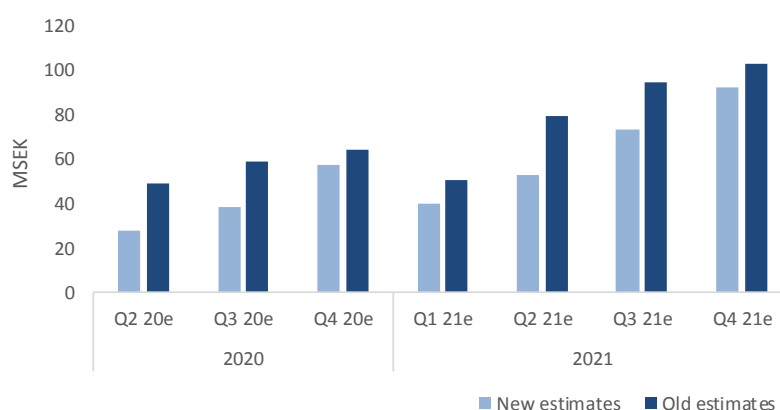


Source: Apple Mobility Trends Reports, www.apple.com/covid19/mobility

Sales goal 250 MSEK in 2020 abandoned - we see 145 MSEK

We therefore downgrade our Q2 sales forecast from SEK 50 million to SEK 28 million, cf. Figure 1. Looking past Q2, even if the restrictions are lifted in the near-term there will still be severe economic repercussions from the corona crisis, such as high unemployment which leads low consumer spending. When consumers cut down on spending, durable goods suffer more than other consumer items, motivating our downgraded sales forecast past Q2. Our full year sales forecast sums up to SEK 145 million for 2020 and SEK 259 million for 2021. The company abandoned its financial target of reaching SEK 250 million in sales in 2020 in the quarterly report, but as we emphasized in our latest research update, this was not entirely unexpected. On the cost side, we have lowered expenditure forecasts somewhat to reflect the decrease in travelling costs in combination with cost savings from short-term layoffs and other cost controls.

Figure 1: Revising the sales forecast



Source: Västra Hamnen Corporate Finance

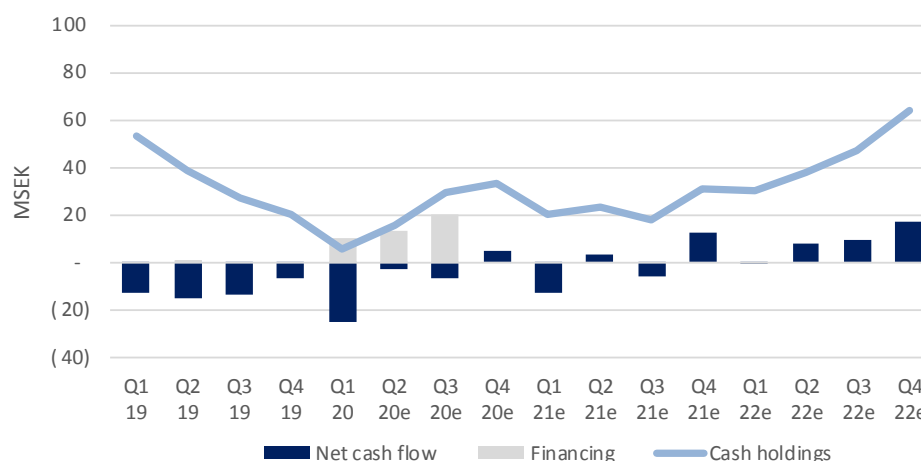
Gradual return to higher margins

We have forecasted a gradual improvement in margins in the coming quarters. According to the company, the negative impact of previous air freight costs should be exhausted by now. Further, as Denmark reopens, we should see a positive margin contribution from higher sales in that market. In addition, as more Hövding 3 units are added to the stock of active users, it is fair to assume that quality improvements lead to fewer returns, which in turn reduces the cost of provisions for future warranty claims. However, the looming recession could mean that the company is forced to offer various campaigns and discounts to keep volumes growing. We have therefore assumed a gradual margin increase quarter by quarter until reaching 28% in Q1 2021, where after we have assumed a constant gross margin.

Equity issue later this year?

The lower sales forecast, in combination with a lower gross margin, takes a big toll on the company's cash reserves in our valuation model. It is a close call whether or not the current liquidity will last until the company turns cash-positive without another capital injection. Even more concerning, Total Equity stood at only SEK 16.7 million at the end of Q1. This is less than the combined net loss of SEK 21.5 that we have forecast for quarters Q2 through Q4 this year. Therefore, if our forecast proves correct, Hövding has to raise new equity before the end of the year to avoid running into negative equity. In our model, we have penciled in a SEK 20 million new equity issue during Q3. We have not considered what form of issue that would be, directed or rights issue. A rights issue is normally discounted and therefore more dilutive. We expect the company to address this issue in due course.

Figure 3: Cash flow and cash holdings



Source: Västra Hamnen Corporate Finance

New valuation range SEK 14.40 - 21.30 per share

Hövding showed promising sales growth for the first two months of the quarter, before the corona crisis hit full force. We still believe in the long-term growth story, driven by a superior product and a rising long-term trend in bicycling, besides the increased focus on health and safety among consumers and legislators. The plummeting sales in March showed however that the crisis has hit the company and that the growth path will be delayed. With the lockdowns only gradually being lifted in Denmark and Germany, we fear that the coming months will be tough on the company. However, we see some light at the end of the tunnel as more and more people start moving around again, but the road back to normal will be long and challenging. To account for the challenges ahead, we have revised down our sales and gross margin forecast to reflect what we make of the impact so far. This affects our valuation of the company, and our valuation model now points to a lower value than before. **We therefore lower our fair value interval to SEK 14.40 – 21.30 per share, from previously SEK 16.20 – 23.60 per share.**

Income Statement - Annual Data

kSEK	2016	2017	2018	2019	2020e	2021e	2022e	2023e
Net revenues	35 723	56 694	92 536	112 919	144 757	259 364	344 966	396 711
Other revenues	9 615	10 289	2 076	571	142	148	154	160
Total revenues	45 338	66 983	94 612	113 490	144 899	259 511	345 120	396 871
Cost of goods sold	(37 721)	(44 359)	(71 535)	(83 490)	(111 068)	(185 899)	(246 888)	(283 921)
Gross profit	7 617	22 624	23 077	30 000	33 831	73 613	98 233	112 951
Personnel costs	(21 435)	(25 194)	(29 651)	(35 257)	(34 487)	(35 845)	(37 301)	(38 335)
Other external costs	(21 249)	(27 662)	(31 776)	(42 801)	(33 470)	(34 144)	(34 832)	(35 534)
Other operating expenses	(764)	(1 571)	(481)	(270)	(1 495)	-	-	-
EBITDA	(35 831)	(31 803)	(38 831)	(48 328)	(35 621)	3 623	26 099	39 081
Amortisation & depreciation	(9 417)	(9 227)	(2 656)	(2 654)	(3 734)	(2 885)	(2 424)	(2 049)
EBIT	(45 248)	(41 030)	(41 487)	(50 982)	(39 356)	738	23 675	37 033
Net financial items	137	42	7	53	(129)	-	-	-
EBT	(45 111)	(40 988)	(41 480)	(50 929)	(39 485)	738	23 675	37 033
Taxes	-	-	-	-	-	-	-	-
Net profit	(45 111)	(40 988)	(41 480)	(50 929)	(39 485)	738	23 675	37 033
Earnings per share (SEK)	(5,51)	(2,77)	(2,25)	(2,33)	(1,65)	0,03	0,96	1,50
Growth (%)								
Net revenues	na	58,7%	63,2%	22,0%	28,2%	79,2%	33,0%	15,0%
EBITDA	na	na	na	na	na	na	620,3%	49,7%
EBIT	na	na	na	na	na	na	3108,0%	56,4%
Net profit	na	na	na	na	na	na	3108,0%	56,4%
% of revenues (%)								
Gross margin	-5,6%	21,8%	22,7%	26,1%	23,3%	28,3%	28,4%	28,4%
EBITDA margin	neg	neg	neg	neg	neg	1,4%	7,6%	9,8%
EBIT margin	neg	neg	neg	neg	neg	0,3%	6,9%	9,3%
EBT margin	neg	neg	neg	neg	neg	0,3%	6,9%	9,3%
Profit margin	neg	neg	neg	neg	neg	0,3%	6,9%	9,3%
Personnel costs	60,0%	44,4%	32,0%	31,2%	23,8%	13,8%	10,8%	9,7%
Total OPEX	121,6%	96,0%	66,9%	69,4%	48,0%	27,0%	20,9%	18,6%
Profitability (%)								
ROE	neg	neg	neg	neg	neg	4,6%	59,9%	48,4%
ROIC	neg	neg	neg	neg	neg	17,3%	-3394,3%	-750,4%
ROCE	neg	neg	neg	neg	neg	1,7%	29,6%	28,2%

Source: Västra Hamnen Corporate Finance

Balance Sheet - Annual Data

kSEK	2016	2017	2018	2019	2020e	2021e	2022e	2023e
Subscr but not paid-in cap	-	-	-	-	-	-	-	-
Inventories	7 079	12 447	6 013	20 848	23 182	36 220	43 613	50 155
Account receivable	9 159	13 602	13 977	18 019	18 857	30 320	36 563	42 048
Tax receivables	422	599	717	775	1 130	1 816	2 190	2 519
Prepaid costs & accrued incom	3 810	5 550	1 175	159	1 457	2 342	2 825	3 248
Other receivables	89	1 005	151	585	1 644	2 643	3 187	3 665
Cash and cash equivalents	34 082	21 634	66 464	20 353	33 534	30 648	64 259	108 287
Total current assets	54 641	54 837	88 497	60 739	79 803	103 989	152 638	209 923
Tangible assets	930	960	641	2 474	2 156	2 127	2 104	2 085
Intangible assets	11 683	2 874	6 526	15 499	13 242	10 786	8 785	7 156
Financial assets	52	52	52	52	52	52	52	52
Total fixed assets	12 665	3 886	7 219	18 025	15 451	12 965	10 941	9 292
Total assets	67 306	58 723	95 716	78 764	95 253	116 955	163 579	219 215
Accounts payable	8 078	10 813	15 001	49 606	55 637	65 196	78 504	90 279
Accrued cost & prepaid income	7 496	3 196	5 653	5 865	10 324	14 756	17 794	20 463
Other liabilities	987	1 082	557	1 477	1 845	2 966	3 577	4 114
Total current liabilities	16 561	15 091	21 211	56 948	67 806	82 918	99 875	114 856
Other provisions	10 727	9 257	12 371	10 457	12 304	18 155	24 148	27 770
Total equity	40 018	34 375	62 134	11 359	15 143	15 881	39 556	76 589
Total equity and liabilities	67 306	58 723	95 716	78 764	95 253	116 955	163 579	219 215

Source: Västra Hamnen Corporate Finance

Cash flow statement

kSEK	2016	2017	2018	2019	2020e	2021e	2022e	2023e
Operating activities	(26 486)	(33 231)	(35 710)	(50 189)	(33 648)	9 475	32 092	42 704
Changes in working capital	4 506	(14 114)	17 290	17 384	4 720	(11 961)	1 920	1 724
Investing activities	(1 056)	(447)	(5 966)	(13 460)	(1 160)	(400)	(400)	(400)
Financing activities	38 608	35 345	69 239	153	43 269	-	-	-
Cash flow for the period	15 572	(12 447)	44 853	(48 099)	13 181	(2 886)	33 612	44 028
Beginning cash balance	18 696	34 082	21 634	66 464	18 365	31 546	28 660	62 271
Adjustments	(186)	(1)	(23)	-	-	-	-	-
Ending cash balance	34 082	21 634	66 464	18 365	31 546	28 660	62 271	106 299

Source: Västra Hamnen Corporate Finance

Income Statement - Quarterly Data

kSEK	Q1 2019	Q2 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020e	Q3 2020e	Q4 2020e
Net revenues	19 640	28 229	18 583	46 467	20 953	27 815	38 633	57 356
Other revenues	24	30	13	504	35	35	36	36
Total revenues	19 664	28 259	18 596	46 971	20 988	27 851	38 668	57 392
Cost of goods sold	(13 477)	(20 122)	(13 627)	(36 264)	(17 881)	(21 619)	(29 261)	(42 307)
Gross profit	6 187	8 137	4 969	10 707	3 107	6 232	9 407	15 085
Personnel costs	(8 527)	(8 808)	(8 258)	(9 664)	(9 926)	(6 992)	(8 828)	(8 741)
Other external costs	(7 989)	(13 215)	(11 325)	(10 272)	(8 305)	(8 347)	(8 388)	(8 430)
Other operating expenses	(102)	(121)	(47)	-	(1 495)	-	-	-
EBITDA	(10 431)	(14 007)	(14 661)	(9 229)	(16 619)	(9 107)	(7 809)	(2 086)
Amortisation & depreciation	(531)	(538)	(605)	(980)	(1 196)	(887)	(845)	(807)
EBIT	(10 962)	(14 545)	(15 266)	(10 209)	(17 815)	(9 994)	(8 654)	(2 892)
Net financial items	32	1	(52)	72	(129)	-	-	-
EBT	(10 930)	(14 544)	(15 318)	(10 137)	(17 944)	(9 994)	(8 654)	(2 892)
Taxes	-	-	-	-	-	-	-	-
Net profit	(10 930)	(14 544)	(15 318)	(10 137)	(17 944)	(9 994)	(8 654)	(2 892)
Earnings per share (SEK)	(0,53)	(0,65)	(0,69)	(0,45)	(0,76)	(0,42)	(0,35)	(0,12)
Y-o-Y Growth (%)								
Net revenues	138,9%	12,1%	(37,6%)	58,3%	6,7%	(1,5%)	107,9%	23,4%
EBITDA	na	na	na	na	na	na	na	na
EBIT	na	na	na	na	na	na	na	na
Net profit	na	na	na	na	na	na	na	na
% of revenues (%)								
Gross margin	31,4%	28,7%	26,7%	22,0%	14,7%	22,3%	24,3%	26,2%
EBITDA margin	neg	neg	neg	neg	neg	neg	neg	neg
EBIT margin	neg	neg	neg	neg	neg	neg	neg	neg
EBT margin	neg	neg	neg	neg	neg	neg	neg	neg
Profit margin	neg	neg	neg	neg	neg	neg	neg	neg
Personnel costs	43,4%	31,2%	44,4%	20,8%	47,4%	25,1%	22,9%	15,2%
Total OPEX	84,6%	78,4%	105,6%	42,9%	94,1%	55,1%	44,6%	29,9%
Profitability (%)								
ROE	neg	neg	neg	neg	neg	neg	neg	neg
ROIC	neg	neg	neg	neg	neg	neg	neg	neg
ROCE	neg	neg	neg	neg	neg	neg	neg	neg

Source: Västra Hamnen Corporate Finance

Balance Sheet - Quarterly Data

kSEK	Q1 2019	Q2 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020e	Q3 2020e	Q4 2020e
Subscr but not paid-in cap	-	-	-	-	12 902	-	-	-
Inventories	7 594	2 051	16 389	20 848	35 821	11 846	16 034	23 182
Account receivable	5 974	12 953	11 127	18 019	5 425	9 145	12 701	18 857
Tax receivables	447	556	666	775	520	548	761	1 130
Prepaid costs & accrued income	1 152	717	549	159	1 780	706	981	1 457
Other receivables	936	809	330	585	743	797	1 107	1 644
Cash and cash equivalents	53 332	38 246	26 687	20 353	5 647	15 394	28 995	33 534
Total current assets	69 435	55 332	55 748	60 739	49 936	38 436	60 579	79 803
Tangible assets	759	678	2 660	2 474	2 292	2 227	2 191	2 156
Intangible assets	7 016	10 444	11 975	15 499	15 445	14 673	13 939	13 242
Financial assets	52	52	52	52	52	52	52	52
Total fixed assets	7 827	11 174	14 687	18 025	17 789	16 952	16 182	15 451
Total assets	77 262	66 506	70 435	78 764	80 627	55 388	76 761	95 253
Accounts payable	8 807	11 313	33 207	49 606	48 646	31 984	38 481	55 637
Accrued cost & prepaid income	5 493	6 079	5 316	5 865	5 254	5 007	6 954	10 324
Other liabilities	555	908	696	1 477	621	895	1 243	1 845
Total current liabilities	14 855	18 300	39 219	56 948	54 521	37 886	46 677	67 806
Other provisions	11 203	11 393	9 720	10 457	9 422	10 813	12 048	12 304
Total equity	51 204	36 813	21 496	11 359	16 684	6 690	18 036	15 143
Total equity and liabilities	77 262	66 506	70 435	78 764	80 627	55 388	76 761	95 253

Source: Västra Hamnen Corporate Finance

Cash flow statement

kSEK	Q1 2019	Q2 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020e	Q3 2020e	Q4 2020e
Operating activities	(11 567)	(13 816)	(18 481)	(8 530)	(17 528)	(7 716)	(6 574)	(1 830)
Changes in working capital	(426)	2 462	9 052	6 514	(6 585)	4 611	250	6 444
Investing activities	(1 139)	(3 885)	(4 118)	(4 318)	(960)	(50)	(75)	(75)
Financing activities	-	153	-	-	10 367	12 902	20 000	-
Cash flow for the period	(13 132)	(15 086)	(13 547)	(6 334)	(14 706)	9 747	13 601	4 539
Beginning cash balance	66 464	53 332	38 246	26 687	20 353	5 647	15 394	28 995
Adjustments	-	-	-	-	-	-	-	-
Ending cash balance	53 332	38 246	26 687	20 353	5 647	15 394	28 995	33 534

Source: Västra Hamnen Corporate Finance

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