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Interim Report January – March 2024 - Teqnion AB

Short form report TEQ 2024 Q1

Teqnion Group is pushing through a rough first quarter with sales increasing 8% but organically it's down 1,5%. EBITA margin decreased to 9,5% (11,7%). The profit for the period is down by 27% and the earnings per share is down by approximately 32%. No fun! Time to fight harder. On the positive side we have three new colleagues in the TEQ team and order intake has swooped up, which has resulted in a solid order backlog.

Events during the quarter

- Nubis Solutions Limited was acquired
- Anneli Andersson recruited as Accounting Expert
- Patrick Olsson recruited as CEO coach with focus on our international companies
- Jonathan Alexandersson recruited as Chief Controlling Officer

Events after the quarter

- Nothing significant… just everyday grinding…

Teqnion financial development, Msek	2024 Q1	2023 Q1	Δ%
FCF excluding acquisitions	-18,3	6,8	n.a.
EPS (sek)	1,23	1,80	-32%
Diluted EPS (sek)	1,22	1,79	-32%
Profit for the period	21,1	29,0	-27%
Profit before taxes	25,0	36,9	-32%
EBITA	36,3	41,2	-12%
EBITA margin (%)	9,5%	11,7%	n.a.
Net sales	381,8	352,1	8%
Net debt / EBITDA	0,9	1,1	-21%
RoE R12 (%)	21,9%	26,1%	n.a.

CEO Letter – *Johan's thoughts*

Hi Teqniåns,
I wish my first letter in English could be written in a time where all the arrows were pointing upwards. My drive for building Teqnion is for it to constantly improve, grow and strengthen. In periods as this when we fail to deliver on that, I feel pain. I am certain that this is a short-term issue, however, when you are in it, I´m reminded that the long-term is just a lot of short-terms strung together. Now, when seas are stormy, we need to be extra good at pushing and motivating each other to do more and better. Since we are aiming far and high there is plenty to do, and therefore I am happy to announce that we now have strengthened the TEQ team with three new extremely energetic and experienced colleagues with vastly different personalities and skillsets – please join me in welcoming Anneli Andersson, Patrick Olsson, and Jonathan Alexandersson!

I don't see any substantial deviations in our operational activities since the last report, even though overall order intake has turned upward, especially in defense and, joyfully enough, in construction. However, I want to point out that things are still very tough for our house builders, even though we've managed to secure better order intake with jobs lined up until summer, albeit at very low margins. The construction industry in Sweden is going through the worst time in decades and I don't expect any uptick until interest rates take a significant downward turn.

The two subsidiaries that moved location during the fall are now settling into their new premises but still have some matters to sort out before they're firing on all cylinders in terms of productivity and profitability. Slow progress can be frustrating, but we'd rather get it right than get it done quickly. Free cash flow is clearly being squeezed in the first quarter due to a significant increase in accounts receivables following increased sales, as well as the cyclical larger payouts of taxes and annual bonuses from last year to employees. It's all going to work out just fine. We're on it. But words are cheap. Actions speak louder. Cash flow over time speaks the loudest.

I rarely plunge into accounting rules, but for reasons explained below, I found it fitting to do so this time. I'm pretty certain it won't become a habit...

As you can see from the income statement, we are clearly underperforming year-on-year. Part of that is tougher economic conditions, part of that is self-inflicted pain but there are also some accounting anomalies that I want to flesh out, helping you gain a better understanding of what you own. In the first quarter, the depreciation of the Swedish krona significantly affected our accounting profit.

It's exciting that we're becoming more international and, as a result, more resilient. However, due to current accounting rules, we must reevaluate our balance sheet every quarter, even though it doesn't reflect our operations. In the first quarter, our acquisition loans in euros and pounds, as well as the earnouts we hope to pay out in local currencies in the future, were reevaluated on the balance sheet, leading to a reduction in accounting profits on the income statement (more info on the Wipeboard p.8).

Another thing that blasted our accounting profit this quarter was the positive news that we increased the reserve for the upcoming earnout for a newly acquired company, since it significantly outperforms our initial assumptions from the PPA (Purchase Price Allocation) compilation. The increase of the reserve has an equivalent accounting cost on the group income statement (more info on the Wipeboard p.8). On the flip side, if a newly acquired company were to underperform in comparison to the PPA, we would see the opposite effect. That is, the reserve on the balance sheet would decrease, leading to a higher accounting profit. However, please recognize that in both our world and the realm of taxation, neither of these profits is considered tangible or real.

Since a significant part of what we do is acquiring companies, I sometimes get questions about how we view the goodwill that arises in such activities. An answer to that can be quite lengthy or super lengthy, so I'll try to aim for the former.

When a company is acquired, we are requested under IFRS accounting rules to perform a PPA for the company with the purpose to determine what we actually bought and divide that up in different asset categories. Since we almost always pay more than the book value due to the fact that we value companies on their cash flows and avoid companies with heavy balance sheets, a surplus arises on the consolidated group balance sheet. The surplus is the magical part of a high quality company that isn't visible or tangible but gives the company the ability to generate good results despite low capital commitment i.e. what we call goodwill. The magnitude of the goodwill is of course impacted by the price we pay. Since goodwill is not amortized as some other intangible assets, the consolidated group balance sheet gives the reader a full picture of what has been paid and therefore a better understanding of what the returns on assets, capital employed and equity is over time i.e. are we good capital allocators or not?

The IFRS regulations require that the goodwill arising from an acquisition to be split up to provide a more accurate picture of the surpluses paid for. To carve out an intangible asset from a surplus, three criteria must be met. The asset must be identifiable, which means it is either separable or arises from a contract, it must be under the company's control, and it must give rise to future economic benefits. Simple huh? Your objective is to identify a non-monetary asset without physical form and ensure that it is possible to individually dispose of it at a specified price at the time of valuation. Examples of identifiable non-monetary assets without physical form can include framework agreements, patents, trademarks, but also business models, processes, and expertise, etc. Assets should be recorded at fair value, i.e., the price you would receive if you sold the asset at the valuation date, and then amortized over its useful life. How accurately can this task be performed? I would love to learn if anyone similar to us have ever managed to sell one of these so called marketable intangible assets…

We often find that the largest portion of our surpluses consists of experience, human drive, and knowledge within and between employees in the acquired company and its partners (note that the most important asset, people cannot be put on the balance sheet due to the control premise). The company has built a reputation for delivering what customers want during its journey, establishing a significant measure of genuine, not merely accounting-defined, goodwill. Such attributes cannot be separated, much less sold, and therefore cannot be classified as intangible assets. Instead, they become accounting goodwill within the group. Our goodwill is then annually evaluated against a utilization value calculation, and if the value cannot be defended, goodwill is written down. The intangible assets we have identified according to IFRS are amortized over the asset's useful lifespan.

Does splitting into intangible assets provide a more accurate picture of the surpluses paid in a corporate acquisition? I find it difficult to see, but even if it does, is it relevant? Does it provide investors with better decision-making tools? My view is a clear, no.

Below are my bullets to consider when it comes to goodwill:

- Goodwill is not written off and don't distort results or the balance sheet. Most other intangible assets are written off, temporarily reducing results but due to reductions of the balance sheet, increase returns permanently, all else being equal.
- Comparing surpluses between companies is difficult if the regulations are not strictly standardized. It becomes even more challenging when buyers pay exceptionally different prices for comparable acquisitions with similar tangible net assets and earnings generation.
- Tax authorities simply disregard amortizations of intangible assets in the consolidated group accounts since the group remains non-taxable.
- Surpluses do not become easier to understand or track over time if you slice the item into different intangible assets with individual names and then amortize the different parts with different time horizons. Good luck understanding the balance sheet when the asset still generates cash but doesn't exist in the books anymore.
- If you want to read something worthwhile on the subject, I recommend the appendix to Warren Buffett's letter from 1983.

Now, let's go out and work with our companies and find new ones to acquire. It's all about the long term. We're just getting started.

Run far, be nice!

Johan Steene
CEO and founder

The report is attached to this press release and is available via the following link:
https://www.teqnion.se/en/investor-relations/financial-reports/

Q&A

You are welcome to ask us questions about the report and anything else you would like to know about Teqnion today, April 23rd at 9:38 AM when we open a Teams meeting. We will be present on the screen with Johan Steene and Daniel Zhang.
Warmly welcome!

To participate, please press here or by the Teams meeting ID below.
Meeting ID: 349 543 557 47
Passcode: oSTF2A
Send in questions to the Q&A session, e-mail: QA@teqnion.se

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About Teqnion

Teqnion AB is an industrial group that acquires stable niche companies with good cash flows to develop and own with an eternal horizon. The subsidiaries are managed decentralized with support from the parent company. We operate in many industries with leading products, which gives us good resistance to economic fluctuations as well as solid industrial know-how. For us, it is central to focus on profitability and long-term sustainable business relationships. Teqnion's shares TEQ are traded on the Nasdaq First North Growth Market.

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