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ENEAST - Atos Convergence Creators, Enea AB (publ) - M&A Call

EVENT DATE/TIME: DECEMBER 20, 2018 / 10:00AM GMT



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Daniel Forsgren *Enea AB (publ) - SVP of Product Strategy*

CONFERENCE CALL PARTICIPANTS

Viktor Westman *Redeye AB, Research Division - Analyst*

PRESENTATION

Operator

Ladies and gentlemen, welcome to the Enea conference call. (Operator Instructions) Today, I'm pleased to present the CEO, Anders Lidbeck.

Anders Lidbeck - *Enea AB (publ) - President & CEO*

Thank you, very much. Good morning, everyone, and thank you for giving me this opportunity to walk you through the announcement we did today. This morning, we announced that we have made an offer to acquire a global software business unit from Atos, or more precise, from Atos Convergence Creators. This is an acquisition that will cost us EUR 18 million, and we would finance it through cash and bank loans. The acceptance of this offer is conditional by Atos, from their finalizing the process with the relevant employee bodies within Atos. It's also subject to normal closing conditions, and if everything goes well, we hope to be able to close this in March next year, and it will be consolidated in Enea from March next year. In this deal, we would also license our technology from Atos relative to provision and service activation.

This is a very strategic acquisition for us. And we -- with this acquisition, we would get more solutions, and we would build-out the Enea solution for the 4G network. We will get products that have a leading position in the global telco market today for authentication, for policy management. And they're known as AAA, PCRF and ENUM products, and we'll come back to this in a bit here during this presentation.

But we would also get a even stronger position for creating a 5G solution. Already with the Openwave acquisition, we have a great basis for cloud data and management product, and we actually have that product live with a select number of operators. As you know, 5G is now being built-out and being offered. With this acquisition, we'll further strengthen that, and we will have applications also in the service based architecture, and we'll come back to that also in a bit during the presentation.

These products are today present in 3 out of the 4 Tier 1 mobile operators in the U.S. and Germany. So they have a very strong position already today. And the products are typically bundled in larger solutions offerings and sold indirectly to the user -- to the end-user. So this business, this unit has an indirect sales channel.

It's around 90 employees in this business unit. It's headquartered in Vienna, and they have sales and development sites in Croatia, Germany and in the U.S. The biggest development operation is in Croatia. Some of the original people are in Germany, headquartered in Vienna and the sales and support office in the U.S. This comes from Atos, but Atos got this unit from Nokia Siemens and before that, it was within Siemens. So it has long time telecom heritage, this business unit.

For us, this is strategic because the ones of you who have followed Enea know that our strategy is to move up the software stack, to move up the value chain and its move to closer to the end user of our product. We have a long history. We celebrate our 50-year anniversary this year. And our software platform and the history of our software business started with operating systems, which is in the lower layers of the software stack. And what we want to do with, I would argue, all the acquisition we've done, both during my time, which, I guess, I think is most important here, is to move up the stack and buy and acquire software pieces that works on top of the operating systems or even further up the software stack.



Our original business is as an OEM software component, so we are selling a software component to someone else building a solution. And the strategy is to also, in that perspective or from that perspective, to move up the value chain and add new pieces or new software components for us to be able to build a more complete solution. And also being an embedded software provider, selling operating systems, you're also often selling through someone else building that end product. And what we want to do in a landscape and in an environment where the supply chain is changing very rapidly is to move closer to the end user.

This acquisition that we're presenting -- we're announcing today and our offer to make this acquisition is giving us several new applications for the 5G and 4G core networks. These are ready applications, these are not embedded components, these are ready applications that can be used by the operator. This -- the acquisition also enable us to build a larger solution. On top of the Openwave platforms, we now have applications that we can take to the operators. This acquisition does not have a direct sales channel, which, in this perspective, we hear -- in this context, is actually, to some degree good news because that we have through the Openwave sales channel. So here, we get a -- we get new software applications, higher up the software stack, we are able to build a more complete solution. And when we go to the end user, we have a better offering for them. So we can become a more relevant partner in this space. So this is a very strategic and very complementary acquisition for Enea.

So I'm not going to go into detail. I'd be happy to take any questions on this afterwards. And with me, I have Daniel Forsgren, who is our VP of -- Senior Vice President of Product Strategy. He can talk more to this picture. But I just want to show you the architecture, the 4G architecture on the left-hand side of this slide and the 5G architecture on the right-hand side of this slide.

And in light blue here, you see where Enea with the Openwave capabilities can play. We can play in the 5Gi-LAN box on the 4G side. And we're building a UPF product for the 5G side or we already have a 5G product for UPF on the 5G side. But with -- which starts with orange here, with the business that we intend to acquire, in the 5G architecture, we have applications on top of the data management -- subscriber data management product that we have.

You can also see that also in the Qosmos product, the traffic identification product works in the 4G architecture and fits well for us when we are building this more complete offering for the operators on the 5G side. So it's very strategic and very complementary for us, this acquisition.

The focus in Enea has always been on organic growth. We do acquisitions, but we don't -- we're not forgetting the existing business. That's the basis to have a sound, profitable and well-developing organic business. But clearly, as we have communicated to the shareholders -- to our shareholders and to the investors for some years now, acquisitions is important for the continued evolution and development of our company.

IP Devel, I have on this slide, that's a very successful acquisition we did in Romania, back in 2008. It's been important for us to create the bottom line that we have today. It's been important for us to deliver some key projects on a global scale and it's been important for us to develop the products we have. It took some years and then, in 2016, we did Qosmos. It was an operation that generated or has revenues of EUR 14 million at the time of the acquisition, with 90 employees. We closed that in December 2016 and it's been hugely successful for us so far.

Likewise, with Openwave, that we did in 2017, but close to another -- we negotiated 2017 and we closed the deal in March 2018. A little bit bigger, more revenue USD 28 million, 140 people and closing date March 2018. Now a year later, we hope to be able to close this acquisition subject to the closing condition. Revenues here on an annual basis are EUR 12 million, again, some 90 employees and it is expected to close in March next year.

Now, here you should note that these EUR 12 million of revenues are coming through an indirect channel, so therefore, the numbers might look little bit different. But it's also why, if we look on the next slide, that we expect this acquisition to be earning per share accretive already this year. It's a profitable business. A very small sales and marketing CapEx in the company because -- sorry, OpEx in the company because again, it's selling through indirect model. So a strong R&D operation, but majority of that located in Croatia. So a profitable business. We're paying EUR 18 million for this. Cash, we will pay EUR 10 million up front and the remaining EUR 5 million in cash, December, next year. But we would also assume liabilities, primarily deferred revenues of approximately EUR 3 million. And that adds up to the EUR 18 million in consideration.

I said it before, but I reiterate it again, this is conditional to the finalization of the process with the relevant employee bodies within Atos. And the transaction is subject to the customary closing conditions that we're going to work on during first quarter next year and again, hoping to close

before end of Q1 next year. We think, we can -- this will contribute roughly EUR 10 million for us in new revenues next year. And as I said the beginning of this slide, we think that this will be accretive or the plan is that it will be earning per share accretive already in 2019.

From an integration perspective, we're acquiring a business unit, it's well-managed business unit with a very similar culture to the rest of Enea. Also the same challenges, being a smaller business unit in a big world, selling to big customer. So together, we will be stronger. And the #1 objective we have here is to protect the acquired business, the customers. The customers should know that the road map that they're buying into today will stay the road map to going forward. The employees should know that the road map and the targets and commissions they're working on starting next year will stay the same and so on.

And after that, we will work on synergies. Now this acquisition is slightly different to Qosmos and Openwave. Based on the fact that here, actually synergies going forward are kind of important. So going into 2020 and 2021, we actually will have a joint portfolio that our direct sales channel will take to market. So a little twist on this going forward, but important from our perspective is to make sure that we protect business that we're buying.

And I just want to finalize with this slide. You will know that operating systems is the cash cow of this company. That's the platform of our business. We have customers in many different segments. But the red here in the middle is telecom and networking. That's also the majority of the business from an operating systems perspective. We acquired the capabilities within traffic intelligence and cybersecurity 2 years ago. That forms the middle layer. And on top of that, we now have applications directly targeted to the operators. That's the tip of our operation today. That's the focus -- sorry, that's the direction of the operations today and that's really focused area within Enea. To become the cloud native networking software vendor is the direction and that's what we're working on.

So thank you for that, and I would be happy to take any questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We have a question from Viktor Westman of Redeye.

Viktor Westman - Redeye AB, Research Division - Analyst

A question on the business model here. Is this traditional software license business model similar to Openwave, where you get large upfront payments? Or can you tell us a little bit more about the business model.

Anders Lidbeck - Enea AB (publ) - President & CEO

Yes, the business model is very similar, the go-to-market model is different. So the go-to-market model here is going through channels. But it's a traditional software license model, where you get perpetual license and on that you get support and maintenance. But it's a company that's been around for quite some time within Atos, within Nokia Siemens and within Siemens. So it's a higher portion of support and maintenance, so it's a higher portion of recurring revenues in this business.

Viktor Westman - Redeye AB, Research Division - Analyst

Okay. Any number there you would like to share? [As per semper].



Anders Lidbeck - Enea AB (publ) - President & CEO

No. No.

Daniel Forsgren - Enea AB (publ) - SVP of Product Strategy

No.

Anders Lidbeck - Enea AB (publ) - President & CEO

Absolutely.

Viktor Westman - Redeye AB, Research Division - Analyst

Okay. Okay. And on the -- and yes, okay. So on the market side here -- on the market growth side, this -- I mean, are there any numbers you have calculated or you have seen regarding the market growth here in this space? Is this a small niche segment similar to Qosmos for instance?

Anders Lidbeck - Enea AB (publ) - President & CEO

No, this is a very key segment for this market. This is the -- this is how you build networks today and going forward. I mean, we're entering into now is a shift from 4G networks to 5G networks. Our position is that we will still sell products into the 4G networks for a -- if we see it in future. But there's a rather rapid change over the coming years for operators now starting to invest in 5G networks. But these are key components in both the 4G and the 5G networks.

Viktor Westman - Redeye AB, Research Division - Analyst

So there are some -- my question was more related maybe to the virtual AAA and PCRFs? What's the -- how much legacy is on the market now in terms of hardware-based stuff? And where is Atos, in this sense, is it -- are they like the first move in the virtualization space? So can you just put that into perspective, their positioning?

Anders Lidbeck - Enea AB (publ) - President & CEO

Yes. I will give you a 30 seconds introduction to that answer, and then I will hand over to Daniel. So Atos has a long legacy in this market, and I think that you can clearly come to that conclusion also based on the history. So Atos has a strong and long legacy in this business, and that's also why the support and maintenance revenues are stronger in this operation than in the others. So going forward, for us to generate the bigger growth numbers, we will assess that during the presentation. Meet and build a joint portfolio based on Qosmos, Openwave and this acquisition for revenue, starting 2020, 2021 and onwards. So Daniel, did you want to elaborate a bit?

Daniel Forsgren - Enea AB (publ) - SVP of Product Strategy

Yes. And to your question here, initially, just to clarify, all of this that we're talking about now is software-based. They are not selling hardware solutions. So I mean, let's make that clear. I mean, all these functions, whether we talked about the 4G or the 5G, we are selling software. And of course, as we move into the 5G deployment here, this becomes more of a layered, and in some cases, virtualized solution, where you sort of decouple some of these front-end applications from the back end that manages the actual data and the databases themselves. So it's in the middle -- or in a bit of a transition. But from our perspective, this is a pure software business.

Operator

(Operator Instructions) And we go to our next question from the line of Viktor Westman of Redeye.

Viktor Westman - Redeye AB, Research Division - Analyst

I will continue then. I found some data on the growth in the PCRF space, and it seems most of it is happening in Asia. Can you talk a little bit about their geographical regions and how strong Atos is in Asia, for instance? And if there any other important markets for them?

Daniel Forsgren - Enea AB (publ) - SVP of Product Strategy

Yes. So where we talk about PCRF explicitly, I mean, keep in mind here that PCRF is one node or one well-defined function within the fourth generation of networks. And this you can say -- this is an established market. So this is not where we sort of expect to see any kind of explosive growth. And of course, where we see new deployment of PCRF solutions that is where in the regions and areas where you see new networks being deployed in general. When it comes to the, sort of, big future growth, that is more on what was the right-hand side of the very technical picture that Anders showed you. That is not necessary the exact box that is called PCRF, but that box has evolved into other functions named as PCF and so on in the fifth generation of mobile networks.

Viktor Westman - Redeye AB, Research Division - Analyst

Yes. Okay. Great. And on the -- can we break down a little bit the revenue here. You asked -- you mentioned in the press release a lot of different VNFs in the 5G part. But how much of the business that you're acquiring now is -- how much revenue is related to that? Or is it just the 4G PCRF and AAA, is that a 100% revenue today?

Anders Lidbeck - Enea AB (publ) - President & CEO

The vast majority comes from the 4G components.

Daniel Forsgren - Enea AB (publ) - SVP of Product Strategy

But of course all the growth is -- would be in the box in the 5G.

Anders Lidbeck - Enea AB (publ) - President & CEO

Not all the growth, as I said, and as Daniel reiterated, and as I think you said also, Viktor, you found data on the PCRF growth and you find that majority may be in Asia. We do think that there is opportunities for us to find growth also within the 4G networks within the foreseeable future. But clearly, a lot of the investments, especially from the big operators will be on the 5G side. And it will be big investment area also for Enea for the next couple of years to build out the portfolio for the 5G networks.

Viktor Westman - Redeye AB, Research Division - Analyst

So -- and so a quick question. How much work is there to be done in the 5G space for this -- the new VNFs? You have -- seems like you have a -- the portfolio is ready and then the business is in the 4G. But how much do you need to invest in the 5G, if I put it that way?



Anders Lidbeck - Enea AB (publ) - President & CEO

Yes. So big -- I don't want to give you numbers here because it's not part of the press release and it's -- we haven't discussed the numbers broken down in details before. But we have discussed and you can find that on our website. We put in some serious dollars behind our stratum product, our cloud data management product. That is a 5G product within the Openwave product line. That's a huge investment for us. And then we will continue. We have some traction. We will continue to work on that. Also within this business unit, within Atos, again, without sharing any numbers in some details, we have, already today, investments on 5G.

I think that's shown by the famous technical slide, where we have colored the boxes that we were actually working on. So it's part of the R&D investment. If you want to aggregate these numbers on an Enea level, which I think makes sense from an investor perspective, we will not increase our R&D spend going into next year from a percentage perspective. Instead, we're increasing the size of the company. We keep the percentage the same so we can spend more money on R&D. But we also have divided our business kind of pretty clear. As we showed in the triangle, we have the cash cow, that's the basis for this business. That's a market that's not growing as fast anymore. So there we invest in new product development from that perspective. Then we have the middle layer that's important, both as a stand-alone business but also for building these applications on top. There we have a certain percentage that we invest in R&D. And then the tip of the -- of our business and the focus of our business, and obviously, we would potentially invest a little bit more from a percentage perspective in R&D. But from an aggregated Enea perspective, there's not more percentage that would be spent on R&D going forward.

Viktor Westman - Redeye AB, Research Division - Analyst

Yes. And on the competitive landscape here, I noticed there are the big usual [soft base], Huawei, Cisco, Ericsson, they're working in this space as well. What's your -- how do you differentiate here and what's the edge for Atos?

Anders Lidbeck - Enea AB (publ) - President & CEO

Yes. So again, let me introduce that answer for 30 seconds, and then Daniel can elaborate. So this whole food chain is changing, Viktor, as you well know. And what you once sold, all captured in the metal chassis in the box, is now broken up and sold in pieces. And not only like that, but it's also being software defined rather than being hardware and software in a box. So it is changing. That has nothing to do with Enea or the usual suspects. I would say, it's driven actually by the operators. And if you look at who actually invented this from a -- in the telecom industry, it was coming from one of the leading operators that started an initiative to try -- to tack it -- to create and then -- the architecture. But -- so our advantage here is really the essence of the company. We are a pure software company. And as Daniel said a few minutes ago let's be very clear on that, we are a pure software company. Everything we're selling is software. We are VNFs for cloud native in what we're doing. We're thinking that. We don't think that we will sell everything. All our software is built to fit within the architecture of an operator, where someone probably much larger than us are creating the bigger solution. So our edge is being the best on the difficult -- the different software components that we're building. Being agile, being flexible. And actually proving the point that the bigger players are providing a solution where you can plug in other software components, and that is what the operators want. They want to build something where they actually can plug in best-of-breed software components, some midsized, agile companies like Enea. Daniel would you like to elaborate?

Daniel Forsgren - Enea AB (publ) - SVP of Product Strategy

No, I think you covered most of items. This is a changing landscape, and within that landscape, we have multiple different ways now to reach the customer. Both going directly and here also working together with partners and the main players indirectly. So there are multiple opportunities in that new landscape for us.

Viktor Westman - Redeye AB, Research Division - Analyst

Yes, okay. And coming back to the market growth once again. The historical market growth numbers for the PCRF and the AAA, are those relevant, I mean, for going forward also? Or are there any challenges, I mean that -- I guess the -- in the need for this to -- I mean, there should be a huge need for a long time for this kind of product. So just to...

Anders Lidbeck - Enea AB (publ) - President & CEO

So Viktor, firstly, you should -- I don't think you can take historic numbers, because as we've said a couple of times now, there is a transformation in the market moving from all 4G to 4G and 5G and more and more 5G going forward. So I think you can also work this out from the financial logic in this deal. So we're paying EUR 18 million for something that's profitable and have the revenue of EUR 12 million, as we think it would be EPS accretive from day 1. That will say something about the growth in this business. So this is, at this moment, not a high growth business. But we think it's a very profitable and very good business for us, where we can create significant growth in our offering going forward in 2020, 2021 and 2022. It's also important for us because it -- as Daniel just said, it position us with more things in this market. We do not only have the traffic management solution and the cloud data management solution. We also have applications on top of this, so we can become a even more relevant partner from an operator's perspective in this changing landscape. We don't want it to be dependent on one little product, now we have a portfolio of applications for the operators. But don't use historic numbers for AAA and PCRF because the market is changing going forward.

Viktor Westman - Redeye AB, Research Division - Analyst

Yes, okay. Just to -- your last question, I will let you go. On the indirect business model, will you keep this or will there be any change here?

Anders Lidbeck - Enea AB (publ) - President & CEO

So from an integration perspective or from the 1 plus 1 is 2 perspective, it's very similar to the approach we have with Qosmos and Openwave. We will keep the model. We like this company. We like the management team. Or we like this business unit. We like the management team. And we like the space they're working in. So we will keep that and protect that. They don't have a direct sales organization. We will not build that. So this business unit within Enea will operate indirectly. But we will present them with a new channel, and that's the Openwave business unit in Enea, that has a strong global direct sales organization. And these guys will become a channel for this organization, if the acquisition closes in March. And that's also -- just as a side note, Viktor, back to your comments about Asia. So this business unit has no presence in Asia. It's U.S. and Europe or Europe and the U.S. So obviously, we hope that our presence in Asia can help us take part of that PCRF growth that we're talking about in Asia.

Viktor Westman - Redeye AB, Research Division - Analyst

Makes sense. Congrats on this very interesting acquisition, and fingers crossed you get all the improvements.

Operator

And there are no further questions at this time. Please go ahead, speakers.

Anders Lidbeck - Enea AB (publ) - President & CEO

All right. Then thank you very much, and thank you for listening. Thanks for the questions, and hope to talk to you soon. Bye-bye.

Operator

This now concludes our conference call. Thank you for attending. Participants, you may disconnect your lines.



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