

Scandinavian Enviro Systems

Mangold Insight - Research note - Update 29-09-2020

MANGOLD

Roll-out picks up

Green tech company Scandinavian Enviro Systems (Enviro), which develops, builds and operates plants for tyre recycling, has despite the impact of the pandemic evolved its business. The company has seen a growing interest in its patented technology, which contributes to a more sustainable economy. Worth noticing is also that French Michelin, world-leading tyre manufacturer, recently has become the largest shareholder. A final letter of intent regarding the strategic partnership between the parties will be negotiated in the autumn of 2020. We see the new partnership as confirmation that Enviro's technology is truly unique and as a commercial driving force that will open the door to opportunities on a global market.

Improved conditions

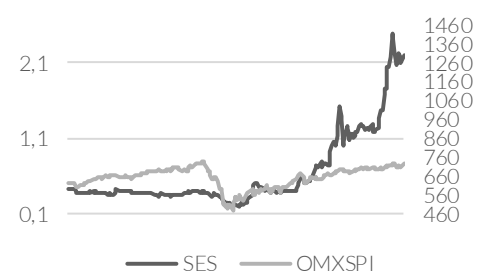
During the spring, Enviro has made a number of investments to support an increased quantity of recovering oil and to diversify the areas of usage of the oil, i.e. pyrolysis oil which is a supplement to fossil fuel. Mangold sees a potential in the company given the improved market conditions and we expect recycling plants revenues to increase significantly in 2021 and the years ahead.

Raised target price

Mangold expect the Michelin partnership to add value. Together with improved growth prospects we raise the target price to SEK5.00 per share (1.50). The new target price provides an upside of 130 percent in the stock. In our base-case scenario, Enviro will have 24 of its own plants in operation by 2029 and one plant in collaboration with Michelin. In a scenario where Michelin increases the number of plants, the value of the stock would increase further.

Information

Rec./Target price (SEK)	Buy 5.00
Risk	High
Price (SEK)	2.2
Market cap. (MSEK)	1 254
Number of shares (M)	580.8
Free float	71%
Ticker	SES
Next report	26-11-2020
Web address	envirosystems.se
Analyst	Fia Andersson



Price trends

	1m	3m	12m
SES	84.5	205.3	421.4
OMX SPI	2.3	12.0	16.0

Key ratios

	2019	2020F	2021F	2022F	2023F
Revenue (MSEK)	1.2	1.9	165.0	220.0	605.0
EBIT (MSEK)	-44	-49	-166	-219	-138
Profit before tax (MSEK)	-45	-49	-166	-234	-154
EPS, adjusted (SEK)	-0.07	-0.07	-0.07	-0.07	-0.07
EV/Sales	nm	nm	7.4	5.5	2.0
EV/EBITDA	neg	neg	neg	neg	neg
EV/EBIT	neg	neg	neg	neg	neg
P/E	neg	neg	neg	neg	neg

Ownership structure

	Shares	Capital
Michelin	116M	20.0%
Pegroco Invest	44M	7.6%
Avanza Pension	34M	5.9%
Nordnet Pension	17M	3.0%
Lennart Persson	7 142 715	2.1%
Theodor Jeansson	6 000 000	1.0%
Stig-Arne Blom	4 800 649	0.8%
Lars Thunell	4 000 000	0.7%
Totalt	580 826 115	100%

Enviro - Investment case

Sustainability and profitability go hand in hand

Mangold sees potential in Scandinavian Enviro Systems (Enviro) and hereby decides to raise the 12-month forward target price to SEK5.00 per share. This is an upward adjustment from the initial analysis (SEK1.5 per share) and an upside of 130 percent from the current market price. We base our recommendation on the following arguments:

Target price raised to SEK5.00 per share

Environmental considerations are increasing in significance

Tyres present a major problem in terms of the environment and waste. The amount of end-of-life tyres is expected to increase in line with growth in the vehicle fleet across the globe. Several leading, global tyre manufacturers have increased their goals for environmental sustainability and have made tyre recycling a top priority. Therefore, there is tremendous interest in the industry to contribute to a sustainable economy. Central governments and consumers are also continuously tightening demands in terms of the negative impact tyres have on the environment. The recycling of end-of-life tyres is one of the most important aspects of this effort.

Environmental requirements increase in the tyre industry along with interest in sustainability

Recycling has tremendous potential for profitability

Enviro designs and constructs plants that they can build independently or through partnerships. Mangold predicts that the company will have initiated and completed 24 plants by 2029 with an annual turnover per plant of SEK220 million. With its patented technology, Enviro can achieve a gross margin of 70 percent. Because tyre manufacturers and carbon black companies are able to offer financing, they can work in collaboration with Enviro to bring in a good revenue source in addition to their regular business activities.

Tyre manufacturers can contribute to and invest in profitable recycling

A growth market with few players

There are currently a handful of companies actively engaged in tyre recycling, but only a few of these companies use advanced pyrolysis technology, Enviro being one of them. Recycled carbon black accounts for just 0.03 percent of all carbon black production. The company now has a great opportunity to establish its technology and get ahead of the competition. The market is in its infancy, and there is tremendous potential for growth for many years into the future.

Enviro is one of the few players on a new, large market

Michelin plans to come along for the journey

Michelin has set clear sustainability goals. Of all the material Michelin uses in its tyres, 80 percent must come from sustainable sources by 2050. In the spring of 2020, Michelin became the largest shareholder in Enviro, and as of this fall, the companies are in the final stages of negotiations for a letter of intent regarding a strategic partnership. Michelin's interest in Enviro confirms that there is a demand for the company's technology and its commercial potential, and provides Enviro with an opportunity to break through on the global market. The partnership also adds value from a marketing perspective.

Letter of intent with Michelin creates opportunity for global breakthrough

Enviro - Update

Michelin now the largest shareholder and potential partner

Enviro started 2020 with intensive negotiations that culminated in a letter of intent regarding a strategic partnership with the French tyre manufacturer Michelin. The collaboration encompasses the following four items:

- Equity investment of totally 20 percent
- Development agreement
- Joint project to build a new plant
- Joint supply agreement between the parties

The pandemic has pushed back negotiations for the final agreement. Michelin made a major investment in the company this spring and is now the largest shareholder. This occurred through a private placement, which was carried out last spring. The private placement brought in SEK32.5 million to Enviro. The finalisation of the letter of intent has been postponed until the end of October and concerns the remaining items; exclusivity was also extended in line with the postponed negotiations.

Letter of intent for strategic collaboration with Michelin

Michelin now the largest shareholder in company

Pyrolysis oil contributes to increased revenues

During Q2 2020, the company made investments in production, which resulted in lower production and sales figures. Normal production capacity is expected to be resumed in Q3 or Q4. By further developing its technology, the company aims to increase the amount of oil it recovers from end-of-life tyres and identify new areas of use. Enviro's goal is to certify the recovered oil and make it more commercially viable. The company believes market conditions are improving for its pyrolysis oil, which may increase revenue from the company's recycling plants. Pyrolysis oil was previously intended to be sold at a discount but can now command a price higher than that for Brent crude.

Improved market conditions for pyrolysis oil

The pandemic dampens sales...

During the first two quarters of 2020, Enviro's net turnover increased to SEK0.9 million in comparison with SEK0.2 million in the same period last year. Operating loss has increased to SEK23.4 million in the first half of 2020 from SEK21.2 million in the same period last year. Higher fixed costs relating to legal and consultancy services, operating expenses related to the demonstration plant and higher payroll costs are behind the decrease.

Continued growth

SES - QUARTERLY FORECASTS

(SEK thous.)	2 019				2020F				2 019	2020F
	Q1	Q2	Q3	Q4	Q1	Q2	Q3F	Q4F		
Net turnover	123	168	189	609	681	233	302	682	1 089	1 898
Growth	-37%	-60%	-25%	131%	454%	39%	60%	12%	-4%	74%
EBIT	-9 825	-11 365	-10 162	-13 083	-11 585	-11 852	-10 584	-14 324	-44 435	-48 345
EBIT margin				-2148%	-1701%	-5087%	-3500%	-2100%	nm	-2546%

Source: Mangold Insight

Enviro - Market

... but interest in sustainability increases

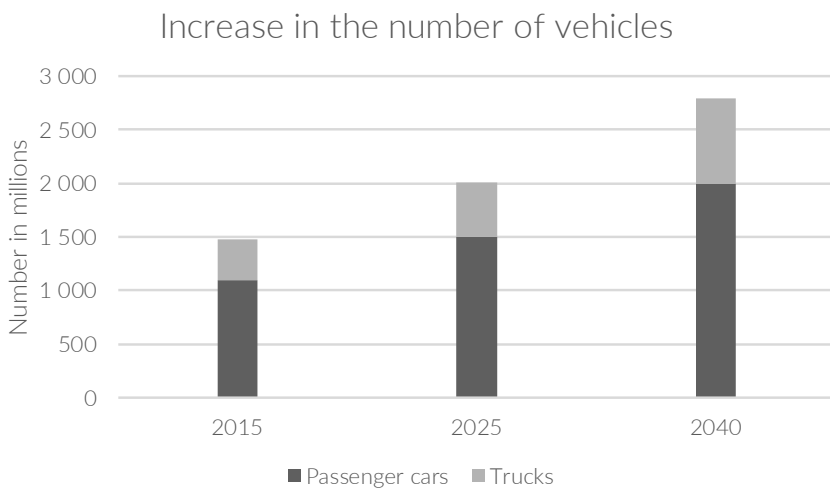
The pandemic has shown us how vulnerable our world is. Climate change is a threat that we can no longer ignore. During the pandemic, we have seen some encouraging signs in our local environment. The crisis has generated an increased interest in sustainable solutions and an opportunity to make the changes necessary for a sustainable environment. The Energy Transitions Commission (consisting of some of the world's largest companies) has called on governments around the world to invest in the "economy of the future" during the crisis, i.e. solutions that reduce carbon dioxide emissions.

Increased interest in sustainable solutions – favourable conditions for Enviro

No shortage of end-of-life tyres

About 1.6 billion tyres reach the end-of-life stage every year. According to Enviro, the market for end-of-life tyres has grown by an average of about 2 percent per year between 2010 and 2015, and there is no indication that this trend will diminish. The majority of these end-of-life tyres come from passenger cars and trucks. Both the number of vehicles and the number of newly manufactured tyres are expected to grow for the foreseeable future. According to Business Insider, the number of passenger cars and trucks is expected to grow from about 1.5 billion to about 2.8 billion by 2040 (see graph below). The global tyre market is expected to grow by 3.4 percent annually from 2017 to 2022. The annual volume of tyres manufactured is therefore expected to reach 2.7 billion tyres in 2022, according to the market research company Smithers.

Growing vehicle fleets and an increased number of end-of-life tyres



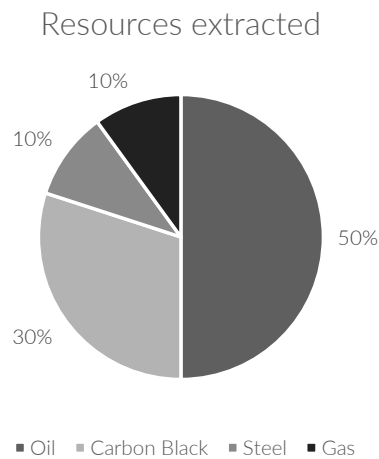
Source: Business Insider

Enviro - Market cont.

Recycling of end-of-life tyres

Using its patented recycling process, Enviro is able to recover four valuable resources from end-of-life tyres (see graph below). Recovered carbon black and oil account for the majority of sales value from Enviro's plants.

Four valuable resources recovered

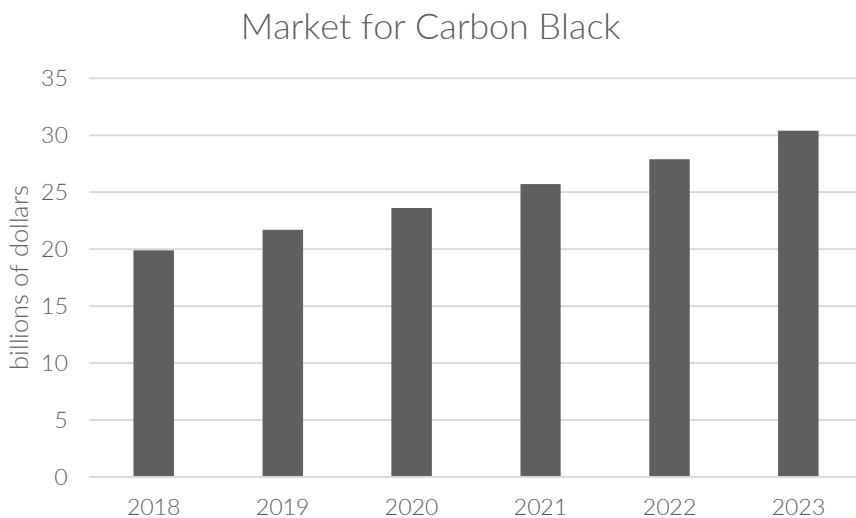


Source: Enviro

Carbon black

Carbon black is produced from fossil resources and is used as a reinforcing filler, mainly in rubber products. The global market for carbon black amounted to 16.6 million tonnes in 2017 or a value of approximately USD 20 billion per year. The value of the market is expected to grow by almost 9 percent annually through 2023 and the volume by an average of 4.3 percent per year, according to independent analyst Pal Arjunans (see graph below).

Carbon black market expected to grow by 9% annually



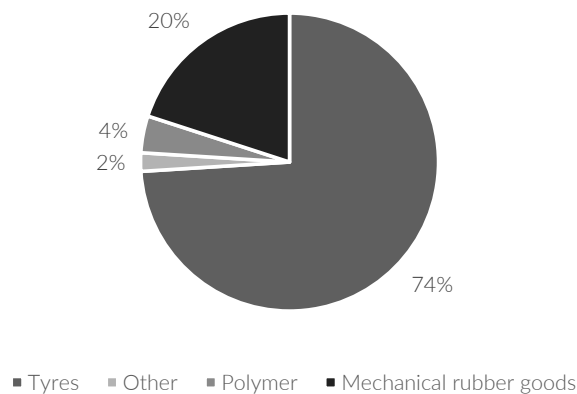
Source: Enviro

Enviro - Market cont.

Carbon black's properties make it an attractive resource for the tyre and automotive industries. According to independent analyst Pal Arjunan, these two industries accounted for the largest share of carbon black consumption in 2017 (see graph below).

Significant portion of manufactured carbon black goes to the tyre industry

End use of carbon black, market share



Source: Pal Arjunan (independent analyst)

Today's carbon black producers are not investing in sustainability

Despite increased pressure to adopt sustainable practices, recycled carbon black only accounts for 0.03 percent of all carbon black production. This means that none of the major producers today have adjusted their production practices. The three largest carbon black producers (Cabot, Birla and Orion) control more than a third of the market. This is expected to change in the future. The tyre industry, one of the largest consumers of carbon black, is increasingly demanding recycled materials. We therefore find ourselves in a situation where the largest consumers and the largest producers are not speaking the same language, which opens the door to opportunities for other players, such as Enviro.

Current carbon black manufacturers are not meeting the needs of tyre manufacturers

Michelin invests in sustainability

Many of the world's leading tyre manufacturers have now adopted clear sustainability goals. Michelin is one of these companies. The company strive to use 80 percent of the material used in its tyres to come from sustainable sources by 2050. One example of Michelin's ambitious and innovative commitments is "the blackcycle", which is a major European project that aims to recycle end-of-life tyres into materials that can be used for the production of new tyres. And their commitment to sustainability also includes partnerships with players like Enviro, which offers a solution for recycling end-of-life tyres.

Michelin has set clear sustainability goals

Michelin views its involvement in motorsport as a perfect opportunity to test new technologies and materials under extremely demanding conditions. The sport of MotoE, a class of motorcycle racing that uses only electric motorcycles, is thus in line with the company's strategic vision. New tyres with natural and recycled biomaterials have been introduced in this sport, an initiative that Enviro has been involved in. MotoE racing shows that sustainable materials can work in even the most demanding environments and serves as a platform to promote the advancement of technology and the transformation of the tyre manufacturing industry.

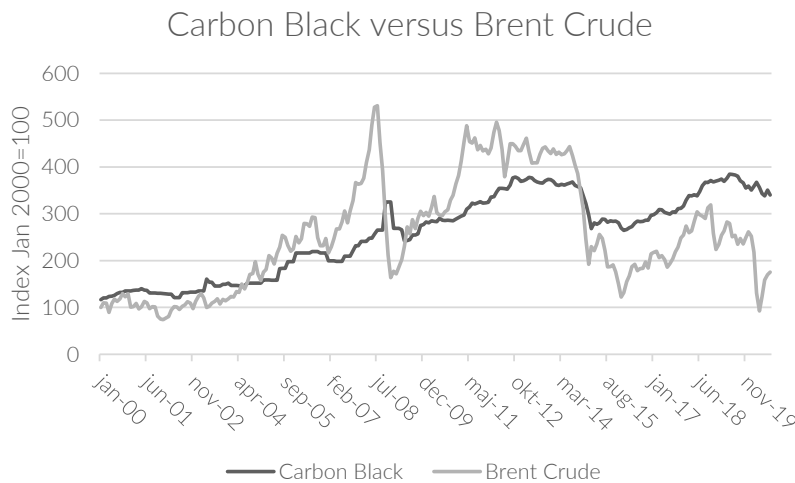
Enviro's technology and materials have been tested in motorcycle tyres used for track racing

Enviro - Market cont.

Carbon black prices higher than Brent crude

Carbon black prices have historically followed the price of Brent crude, with minor fluctuations. After 2018, however, we see that prices increasingly drift apart in favour of carbon black. Demand for carbon continues to grow, which means that producers can command higher prices for the material (see graph below). Mangold predicts that this new price trend will hold moving forward.

Carbon black priced higher than Brent crude



Source: Federal Reserve Economic Data

Climate change driving demand for pyrolysis oil

Oil is one of the world's most sought after raw materials. Due to the potential threat caused by climate change, pressure is mounting on both consumers and politicians to reduce the use of fossil resources. And alternative resources need to emerge to take the place of fossil resources. The EU has set a goal to increase the use of advanced biofuels from 0.2 percent in 2022 to at least 3.5 percent by 2030. Due to growing interest and stricter requirements, interest in Enviro's recycled pyrolysis oil with its high bio content is also increasing. It is a good alternative to fossil resources. Enviro predicts that, in the near future, the price of pyrolysis oil may reach levels that far exceed that of Brent crude. This marks a major departure from how pyrolysis oil has historically been viewed, where the oil was not expected to account for a large portion of sales and was instead sold at a discount.

Increased interest in pyrolysis oil improves price outlook

Enviro - Quantafuel case

Quantafuel shows the way

Quantafuel is a Norwegian company active in the plastic recycling industry. It is listed on the Oslo Stock Exchange, Merkur market. Plastic presents one of the biggest environmental challenges we face today. According to Quantafuel, as much as 32 percent of all plastic packaging ends up in the natural environment and only 14 percent is recycled. Yet the market for plastics is expected to continue to grow. The EU has introduced a number of goals, for example: plastic recycling need to increase to 50 percent by 2025. Regulatory pressure and need for environmental solutions speaks in favour for Quantafuel, and therefore also for Enviro.

Quantafuel has developed a technology for transforming plastic into fuels and chemicals that are friendly for the environment, thereby contributing to the circular economy of plastic waste. In order to secure capital, knowledge commercialization the company has brought in strategic partners. These are currently the Dutch/Swiss commodity trading company Vitol, the German chemical group BASF and the Danish investment and holding company KIRKBI. The company has a test plant in Mexico and a first commercial production plant in Denmark. Quantafuel expects to have six production facilities up and running by 2023. In addition to their own plants, additional plants are being planned with their partners. Mangold considers Quantafuel's business journey to be very reminiscent of Enviro's strategy and journey.

By comparison, Quantafuel has a market cap of approximately NOK9 billion. Enviro has a market cap of approximately SEK1 billion. Mangold believes that this spread will shrink in favour of Enviro once a plant is in place.

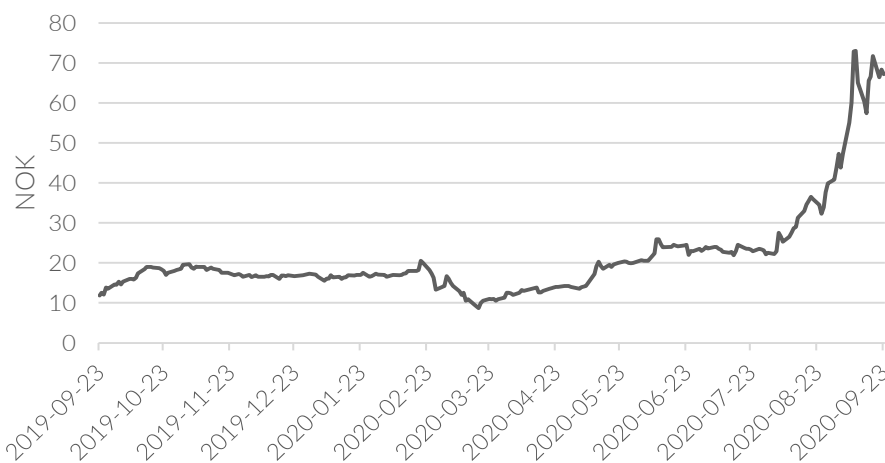
Quantafuel operates in the plastic recycling industry

Has developed its own technology

Has strategic partners

Great potential for environmentally friendly companies like Quantafuel and Enviro

Quantfuel price development over one year



Source: Mangold Insight

Enviro - Forecasts

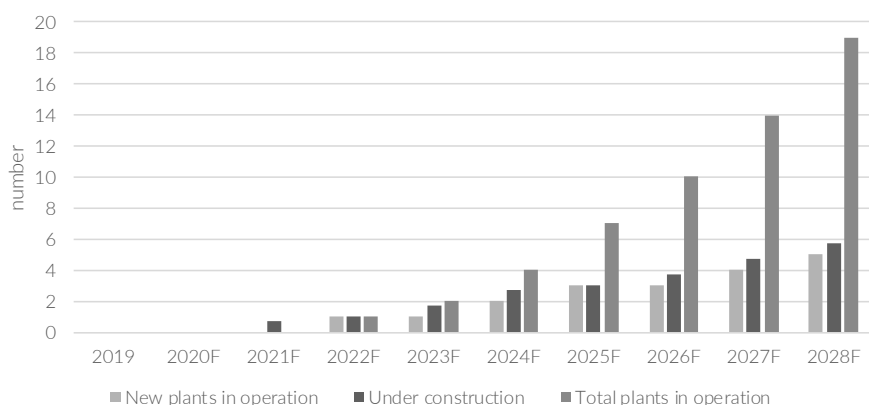
Plant assumptions

At present, Michelin is Enviro's top priority. Mangold expects an agreement to be concluded with Michelin in the autumn. We therefore expect that Enviro's first plant will be constructed in collaboration with Michelin. The construction of this plant is assumed to begin 2021 and be operational in 2022. This hypothetical plant is treated in the same way as the company's own plants. A plant is estimated to take 18 months to construct. Mangold also predicts that the company will start a second plant in 2022. The number of plants constructed per year will then increase from one to six. By 2029, the company will therefore have 24 completed plants in addition to those that will be built with Michelin. Mangold assumes a 50 percent ownership stake in all plants.

Plant constructed with Michelin is starting point

An estimated 24 plants will be built by 2029

Enviro - Plants under construction and in operation



Source: Mangold Insight

Revenue from the operation of plants

Mangold forecasts that each plant will have a turnover of SEK220 million. This turnover will be dependent on the price of carbon black and oil and its development over time.

A single plant is expected to have a turnover of SEK 220 million

Cost assumptions

Since end-of-life tyres are an environmental and waste disposal problem, Enviro can hold down its raw material costs. Mangold therefore expects a gross margin of 70 percent. The cost of a single plant is estimated at SEK300 million. This cost is expected to decrease as the number of plants increases.

Low raw material costs equal high margins

Financing

Mangold has assumed that the company will need to raise capital in the future. It is not yet clear how this will occur, but it could occur jointly with partners or through a consortium.

Financing with partners or through a consortium

Enviro - Valuation

Continued upside

Mangold has valued Enviro using a DCF model and a discount rate of 15 percent. This results in a target price per share of SEK5.00 and an upside of approximately 130 percent from the current market price. The target price is therefore adjusted upwards by 230 percent from the target price in the initial analysis of SEK1.5 per share. The higher valuation results from a higher sales growth rate, higher revenues and a higher gross margin as well as the fact that the patented technology has been validated by Michelin.

Target price SEK 5.00 per share

SES - DCF VALUATION

(SEK thous.)	2020	2021	2022	2023	2024	2025	2026	2027	2028
EBIT	-48 919	-166 002	-218 940	-138 423	-116 946	235 495	616 402	1 118 280	1 661 632
Free cash flow	-50 438	-165 966	-246 529	-198 061	-185 990	110 850	354 516	736 673	1 124 084
Terminal value									9 367 364
Assumptions	Discount rate	Growth	Tax						
	15%	3%	22%						
Fair value									
Enterprise value	2 842 836								
Equity value	2 894 390								
Target price per share	5.00								

Source: Mangold Insight

Upside without Michelin agreement

In our base-case scenario, the company will construct one plant with Michelin and 24 plants independently. If the Michelin agreement goes through, and Michelin and Enviro construct more plants than the one in the agreement, for example two more, there is an upside of 160 percent.

Upside of 90 percent without Michelin agreement

SES - Sensitivity analysis with respect to sales

	0 Michelin plants	1 Michelin plants	3 Michelin plants
	24 plants 2029	24 plants 2029	24 plants 2029
Value per share (SEK)	4.2	5.0	5.6
Market cap. (MSEK)	2 411	2 894	3 248

Source: Mangold Insight

Sensitivity analysis

The valuation is impacted by the discount rate. When the discount rate is reduced, the target price increases by about 20 percent. If we raise it instead, the target price will decrease by 15 percent.

Reduced discount rate increases target price

SES - Sensitivity analysis

Discount rate	14%	15%	16%
DCF value per share	5.88	5.00	4.25

Source: Mangold Insight

Enviro - Peer Group Valuation

Peer group valuation

Mangold has selected a number of companies within the energy and the environment sector in the international market for the comparison. Enviro has a EV/Sales multiple of 11.7x while the group average is at 35.6x in 2020. Enviro is in an earlier stage of development and one can therefore expect a faster rate of growth in sales and earnings. This valuation provides a perspective on how high the valuation is for larger companies in these sectors and the potential that exists.

EV/Sales below average for energy and environmental companies

SES - PEERS		Market Cap.	EV/Sales	
Company	Country	SEK	2019	2020F
Plug Power	USA	47 521	17	13
Nel	Norway	22 297	37	24
ITM Power	UK	15 373	78	40
PowerCell	Sweden	11 473	99	76
Quantafuel	Norway	8 738	624	58
SFC Energy	Germany	2 037	3	3
Peer Median			57	32
Peer Average			143	36
Scandinavian Enviro Systems	Sweden	1 011	nm	12

SWOT Analysis

Strengths

- Unique, patented technical process for recycling of end-of-life tyres
- More stringent environmental regulations are in line with the company's strategy
- Enviro already has satisfied customers in recycled carbon black

Weaknesses

- Enviro is a newcomer in an established global industry dominated by large, strong players
- Initially, the company only has the capacity to handle the construction of one plant at a time

Opportunities

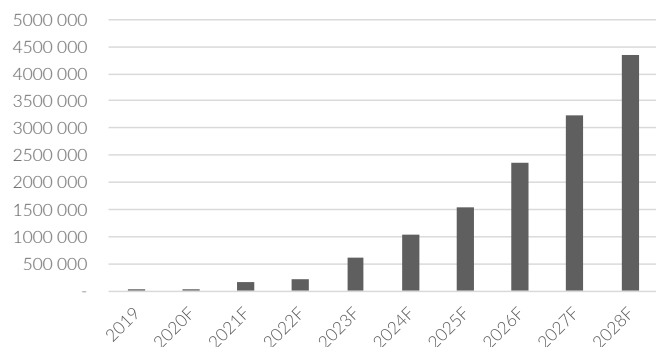
- Tyre manufacturers are striving to become more environmentally friendly in their production
- "First mover advantage" in getting a couple of plants to the production phase
- Evolving the quality of the carbon black and oil derived in the recycling process can have a positive impact on price

Threats

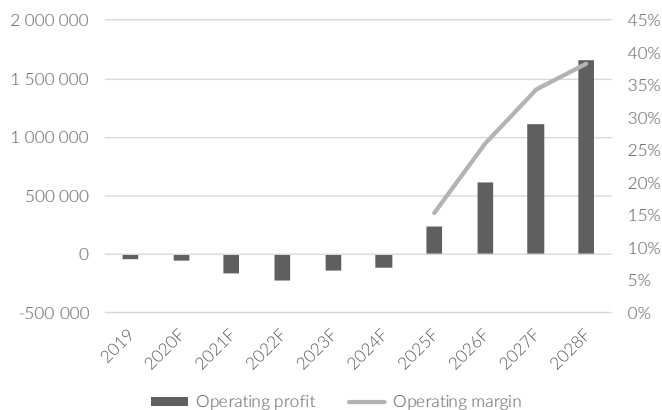
- Major industrial groups are seeking to develop their own in-house technology
- Environmental policy causes lower growth or unfavourable price movements, especially for carbon black

Enviro - Appendix

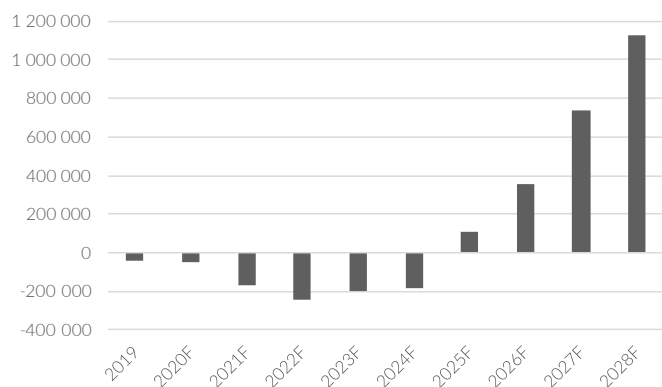
Enviro - Sales (SEK thous.)



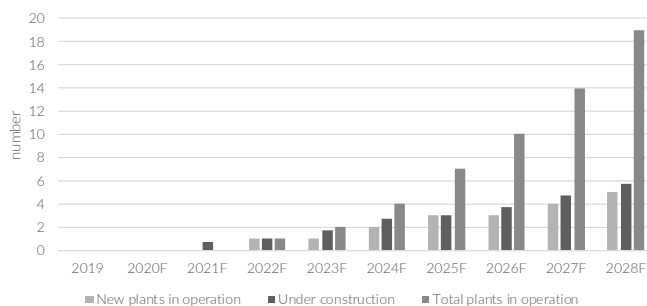
Enviro - Operating profit (SEK thous.) and margin



Enviro - Free cashflow (SEK thous.)



Enviro - Plants under construction and in operation



Income statement and balance sheet

Income Statement	2018	2019	2020F	2021F	2022F	2023F	2024F	2025F
Revenue	1 457	1 187	1 898	165 000	220 000	605 000	1 045 000	1 540 000
Cost of goods sold	-600	-621	-570	-49 500	-66 000	-181 500	-313 500	-462 000
Gross profit	857	566	1 329	115 500	154 000	423 500	731 500	1 078 000
Gross margin	59%	48%	70%	70%	70%	70%	70%	70%
Personnel costs	-13 693	-16 888	-19 421	-22 799	-31 243	-39 687	-48 131	-56 575
Other costs	-10 608	-15 393	-19 421	-22 799	-31 243	-39 687	-48 131	-56 575
Depreciations	-12 653	-12 719	-11 405	-10 905	-10 454	-10 049	-9 684	-9 356
Plant costs	0	0	0	-225 000	-300 000	-472 500	-742 500	-720 000
Operating profit/loss	-36 097	-44 434	-48 919	-166 002	-218 940	-138 423	-116 946	235 495
Operating margin	-2477%	-3743%	-2577%	-101%	-100%	-23%	-11%	15%
Net interest income	-2 689	-320	-356	-356	-15 356	-15 356	-15 356	-25 356
Profit after net interest income/expense	-38 786	-44 754	-49 274	-166 358	-234 296	-153 778	-132 301	210 139
Taxes	0	0	0	0	0	0	0	-46 231
Profit/loss after tax	-38 786	-44 754	-49 274	-166 358	-234 296	-153 778	-132 301	163 909
Share of earnings	0%	0%	0%	50%	50%	50%	50%	50%
Net profit	-38 786	-44 754	-49 274	-83 179	-117 148	-76 889	-66 151	81 954

Balance Sheet	2018	2019	2020P	2021P	2022P	2023P	2024P	2025P
Assets								
Cash & bank balances	24 869	58 666	40 372	257 229	112 492	-24 036	40 769	144 309
Subscribed but unpaid share capital	45 069	0	0	0	0	0	0	0
Short-term receivables	3 006	3 413	1 040	45 205	60 274	165 753	286 301	421 918
Stock	276	659	52	4 521	6 027	16 575	28 630	42 192
Fixed assets	115 737	114 054	109 049	104 544	100 489	96 840	93 556	90 601
Total assets	188 957	176 792	150 513	411 499	279 283	255 133	449 257	699 019
Liabilities								
Accounts payable	10 280	7 112	7 112	307 112	307 112	307 112	507 112	607 112
Liabilities	20 679	10 545	1 040	45 205	30 137	82 877	143 151	210 959
Total liabilities	30 959	17 657	8 152	352 317	337 249	389 989	650 263	818 071
Shareholders' equity								
Restricted equity	5 281	18 586	51 086	51 086	51 086	51 086	51 086	51 086
Non-restricted equity	152 717	140 549	91 275	8 096	-109 052	-185 941	-252 092	-170 138
Total equity	157 998	159 135	142 361	59 182	-57 966	-134 855	-201 006	-119 052
Total liabilities and equity	188 957	176 792	150 513	411 499	279 283	255 133	449 257	699 019

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