

Hanza Holding

Sector: Capital Goods

Set for Earnings Growth

Redeye raises its Base Case and forecasts slightly for Hanza following its Q1 report showing strong growth. While margins came in somewhat short of our expectations, we believe the factors hurting margins are largely temporary.

Strong Sales, Soft Margins

Sales beat our forecasts by 19% as both Main and Other Markets had stronger organic growth than we expected. While EBITA was in line with our estimate, margins fell short, especially in Other Markets. High sick leave due to Omicron, material shortages, and the completion of the new facility in Tartu, Estonia, hurt margins in the quarter.

Set for Solid Earnings Growth

As we believe most of the factors negatively affecting the margins were temporary, we believe the strong sales growth and outlook set Hanza for solid earnings growth for the rest of 2022 and 2023. However, some of Hanza's customers have significant exposure to the economic cycle, and an economic downturn might risk our assumption. Considering Hanza's order book and outlook, there are no signs of such a scenario at this point. Also, the trend of moving production back to Europe serve as a hedge in such a scenario.

New Base Case SEK 48 (47)

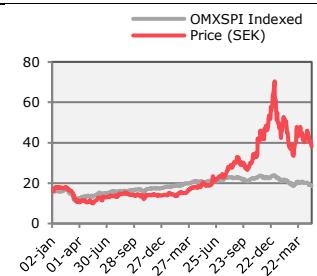
We raise our Base Case to SEK 48 (47), following raised forecasts for mainly 2023E. We expect quarterly reports showing solid organic growth with gradually improving margins to be the main catalyst going forward.

Key Financials (SEKm)	2020	2021	2022E	2023E	2024E
Sales	2155	2515	3056	3178	3305
Sales Growth	4%	17%	21%	4%	4%
EBITA	46	135	186	222	242
EBITA margin	2.1%	5.4%	6.1%	7.0%	7.3%
EBIT	31	128	172	207	227
EPS	-0.64	2.38	3.16	4.19	4.68
EV/EBITA		14.9	11.5	9.4	8.3
EV/EBIT		15.8	12.5	10.1	8.9
EV/Sales		0.8	0.7	0.7	0.6

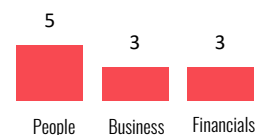
FAIR VALUE RANGE

BEAR	BASE	BULL
30	48	62

HANZA VERSUS OMXS30



REDEYE RATING



KEY STATS

Ticker	HANZA
Market	Small Cap
Share Price (SEK)	38.00
Market Cap (SEKm)	1378
Net Debt (SEKm)	310
Free Float (%)	58
Avg. daily volume ('000)	5 830

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Strong Sales, Soft Margins

Actuals vs Forecast - 1Q22				
(SEKm)	1Q21	1Q22A	1Q22E	Diff
Net sales	567	824	694	18.7%
<i>Growth YoY</i>	-5.3%	45.2%	22.3%	
Main Markets	301	482	401	20.2%
<i>Growth YoY</i>		60.1%	33.3%	
Other Markets	267	342	293	16.7%
<i>Growth YoY</i>		28.4%	10.0%	
Adj. EBITA	28.5	41.2	41.9	-1.6%
<i>Adj. EBITA margin</i>	5.0%	5.0%	6.0%	
Main Markets	19.0	37.5	32.0	17.0%
<i>Adj. EBITA margin</i>	6.3%	7.8%	8.5%	
Other Markets	10.4	4.6	8.8	-47.7%
<i>Adj. EBITA margin</i>	3.9%	1.3%	3.0%	
EBITA	22.5	41.2	41.9	-1.6%
<i>EBITA margin</i>	4.0%	5.0%	6.0%	

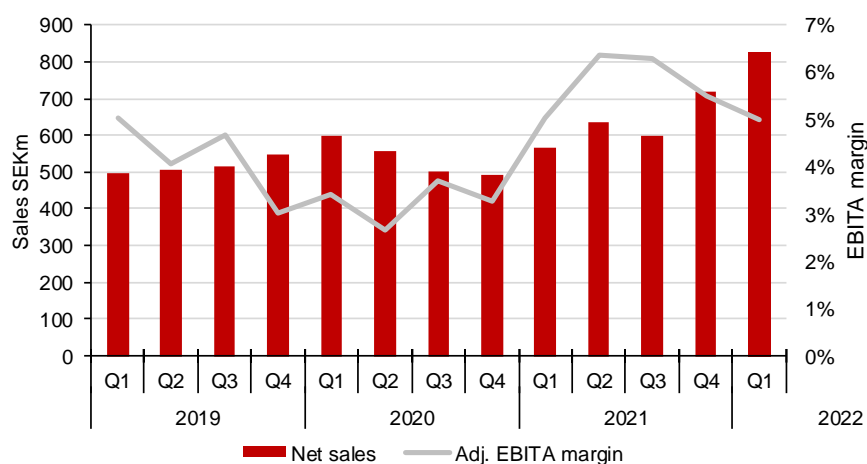
Source: Redeye Research, Hanza

Group level Sales grew by 45% and beat our forecasts by 19%. Organic sales growth was impressive 26%, following solid organic growth in both Main (27%) and Other Markets (24%). Shortages of components and materials rather than demand were the quarter's limiting factor. Also, high sick leave at the beginning of the quarter due to the Omicron, hurt sales. Thus, demand is most likely at very solid levels thanks to a combination of strong economic conditions and greater interest in manufacturing close to the end customers – due to the pandemic and Russia's invasion of Ukraine.

Group level EBITA came in line with our expectations. However, considering the strong sales beat, margins were lower than we anticipated in both segments. While some segment-specific factors, which we will get back to, likely were the main reason for the deviation, the high sick leave and material shortages probably had a somewhat higher negative impact than we assumed. Although the material shortages likely will continue, we believe the other factors, including the segment specifics, to be transitional, at least the effect of the high sick leave.

Combining the strong sales trend, which we believe will continue, with the improved margins, we believe Hanza paves the way for substantial earnings growth throughout 2022.

Net sales and EBITA margin - Group

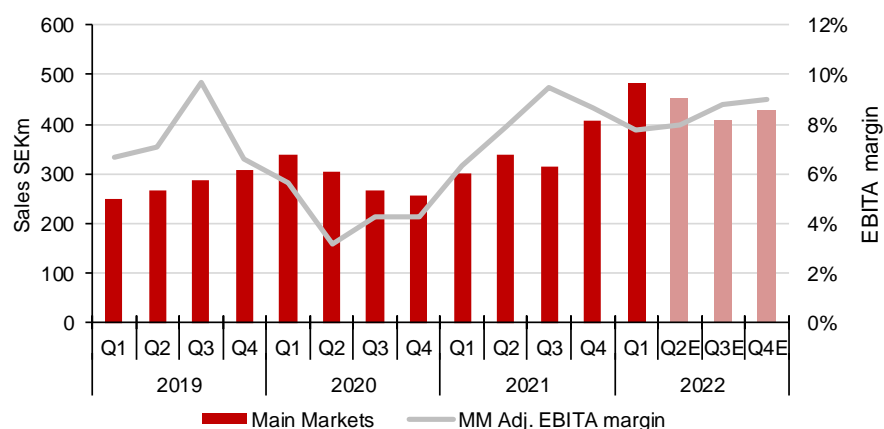


Source: Redeye Research, Hanza Group

Main Markets

Main Markets had strong acquired and organic growth, beating our forecasts. While EBITA came in somewhat above our expectations, the margin was slightly lower at 7.8% (6.3) compared to our forecast of 8.5%. We might have overestimated how fast Hanza could turn Beyers profitable, nevertheless, management expect it to have a positive earnings contribution by the end of 2022, at least.

Net sales and EBITA margin - Main Markets



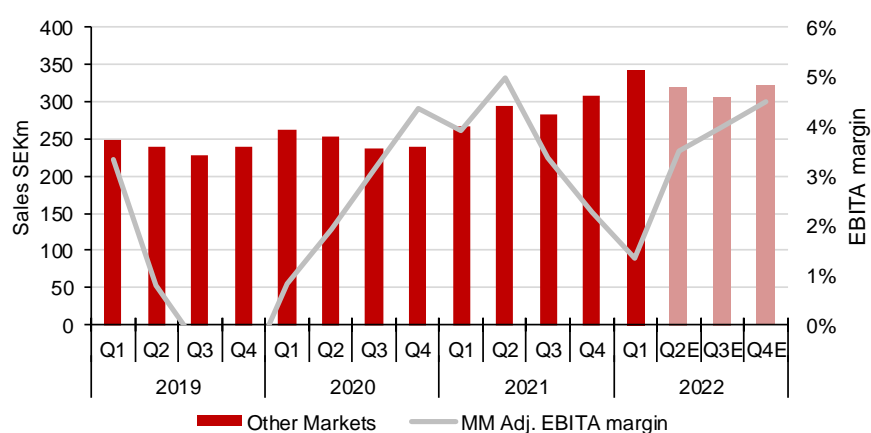
Source: Redeye Research, Hanza Group

After some weak quarters in the German cluster following decreased demand from a customer exposed to the fashion industry, the order volumes reached an all-time-high in the quarter, and management seems optimistic regarding the German market.

Other Markets

Other Markets missed our EBITA forecast following a decreasing margin q/q. In addition to a high sick leave and component and material shortages, the Estonian cluster has moved to a new larger facility in Tartu. Although the construction of the new facility proceeded according to plan and within budget, the impact on margins during Q1 was probably large than we thought. While Hanza has initiated and prepared some other expansions in Other Markets, we do not expect a similar impact from those initiatives. Instead, we expect margins in Other Markets to rise from here.

Net sales and EBITA margin - Other Markets



Source: Redeye Research, Hanza Group

Considering the currently favorable demand situation, we expect the opening of the new facilities in Tartu to affect sales and earnings positively. Also, according to management, the new facilities' capacity will be needed basically immediately.

Financial Forecasts

We raise our sales forecasts by ~7% for 2022E and 2023E, following the solid demand outlook. For 2022, we hold our earnings forecasts roughly unchanged, as our previous assumptions likely were somewhat over-optimistic regarding the margin in both segments. However, for 2023E, we raise our earnings forecast by ~11%, as we expected the transitional effects hurting margins in this quarter would fade. We believe in a significant improvement in Other Markets as the Roadmap 2021 should be finished.

Estimate revisions Q1 2022

(SEKm)	2022			2022		
	New	Prev.	Change	New	Prev.	Change
Net sales	3056	2861	6.8%	3178	2976	6.8%
<i>Growth</i>	21%	14%		4%	4%	
Adj. EBITA	186	183	2.0%	222	200	11.3%
<i>Adj. EBITA margin</i>	6.1%	6.4%		7.0%	6.7%	
EBIT	172	169	1.7%	207	186	11.7%
<i>EBIT margin</i>	5.6%	5.9%		6.5%	6.2%	

Source: Redeye Research

In 2022, we forecast a sales growth of ~20% with a ~67/33 mix between organic and acquired sales growth, thanks to strong demand and the new facilities. Also, we expect margins to increase in both Main Markets and Other Markets gradually.

Financial forecasts Base-case

(SEKm)	2021	1Q22	2Q22E	3Q22E	4Q22E	2022E	2023E	2024E
Net sales	2515	824	770	712	749	3056	3178	3305
<i>Growth YoY</i>	16.7%	45.2%	21.5%	19.2%	4.6%	21.5%	4.0%	4.0%
Adj. EBITA	145.8	41.2	46.3	47.0	52.0	186.5	222.1	241.9
<i>Adj. EBITA margin</i>	5.8%	5.0%	6.0%	6.6%	6.9%	6.1%	7.0%	7.3%
EBIT	127.5	36.9	42.8	43.5	48.5	171.7	207.3	227.1
<i>EBIT margin</i>	5.1%	4.5%	5.6%	6.1%	6.5%	5.6%	6.5%	6.9%

Source: Redeye Research, Hanza

Investment Case

Unique take on manufacturing

With its 'All you need is one' cluster-based strategy, Hanza and its experienced management take a unique approach that differentiates it among manufacturing service companies. By gathering several manufacturing technologies in a single location (often near the end-customer), Hanza can reduce costs, lead times and environmental footprint.

Hanza offers consultant services, such as MIG, that help product companies streamline their use of manufacturing services. MIG plays an important role in acquiring new customers but has not yet reached its full potential.

While our meetings with cluster management suggest that 'All you need is one' has yet to be fully implemented, we are positive to Hanza's unique, long-term strategy. While its stock market journey had a bumpy start, industry-leading margins in its Nordic segment and an impressive customer list prove the strength of its concept.

Expanding into Germany

By the acquisition of Ritter in 2019, Hanza established presence in Germany. Europe's industrial powerhouse, Germany offers Hanza significant growth opportunities with its so-called Mittelstand (Hanza's focus segment). Also, as many German businesses are cautious about entering China directly, Hanza's Chinese factories offer a smooth outsourcing alternative. Some have already moved production to its cluster in China.

Backsourcing benefit

Hanza benefits from several trends that are moving manufacturing back to Europe, such as Environmental, Social and Governance (ESG) issues, trade wars and increasing labor costs in distant regions. With the bulk of its manufacturing facilities within the EU, we believe Hanza can meet high ESG standards better than most production in distant, often undemocratic regions. Moreover, its cluster strategy has an inherently lower environmental footprint.

Counter-thesis

Lack of transferability

Hanza's success in the Nordics may not result from its 'All you need is one' cluster strategy, but rather follow from smart acquisitions and a management team with close connections to several Nordic product companies. If so, it may struggle to achieve solid profitability outside of the Nordics. However, it has already established successful presences outside the Nordics, such as in Tartu, Estonia.

Unsuccessful expansion

In the summer of 2019 Hanza acquired Ritter in Germany and expanded its central European cluster significantly. As Hanza is aiming for a full integration, the risk and potential reward is higher than on a typical decentralized acquisition. Employees, management and/or customers could oppose Hanza's plans. However, as Hanza has experience of taking over businesses successfully, we view the risk as limited.

Valuation

Bear Case 30 SEK

- Average sales growth of ~5.5% 2022-2027 in Main Markets
- Average EBITA margin of ~6.5% 2022-2027 in Main Markets
- Average sales growth of ~3% 2022-2027 in Other Markets
- Average EBITA margin of ~4-5% 2022-2027 in Other Markets
- Average sales growth of ~4% 2022-2027 on the group level
- Average EBITA margin of ~5.5% 2022-2027 on the group level
- Terminal sales growth of 2%
- Terminal EBITA margin of ~6%

Base Case 48 SEK

- Average sales growth of ~6% 2022-2027 in Main Markets
- Average EBITA margin of ~8% 2022-2027 in Main Markets
- Average sales growth of ~4% 2022-2027 in Other Markets
- Average EBITA margin of ~6% 2022-2027 in Other Markets
- Average sales growth of ~5% 2022-2027 on the group level
- Average EBITA margin of ~7% 2022-2027 on the group level
- Terminal sales growth of 2%
- Terminal EBITA margin of ~7.5%

Bull Case 62 SEK

- Average sales growth of ~8% 2022-2027 in Main Markets
- Average EBITA margin of ~9% 2022-2027 in Main Markets
- Average sales growth of ~6% 2022-2027 in Other Markets
- Average EBITA margin of ~7.5% 2022-2027 in Other Markets
- Average sales growth of ~7% 2022-2027 on the group level
- Average EBITA margin of ~8% 2022-2027 on the group level
- Terminal sales growth of 2%
- Terminal EBITA margin of ~9%

We raise our Base Case to SEK 48 (47). While margins fell somewhat short of our expectations, we believe that is transitory. Combined with the strong outlook, we believe Hanza is set for substantial earnings growth if the economic cycle remains reasonably strong.

While raising our WACC somewhat due to a higher risk-free rate, a slightly higher rating following Hanza's improved operational performance neutralizes the effect. Although the 5/3/3 rating for Hanza remains unchanged, we make some adjustments resulting in a slightly lower risk premium for Hanza.

9x EBIT 2023 is in line with some peers but significantly below the median and average. We believe that indicates there is more potential in Hanza's multiple if the operational momentum continues.

Company	EV	EV/SALES			EV/EBIT (x)			Sales growth			EBIT margin		
	(local)	22E	23E	24E	22E	23E	24E	22E	23E	24E	22E	23E	24E
Incap	381	1.7	1.6	1.4	12	10	9	31%	10%	8%	14.7%	15.3%	15.5%
Kitron	3 554	0.6	0.6	0.5	9	8	7	56%	11%	11%	6.6%	7.3%	7.3%
Nolato	15 166	1.3	1.3	1.2	14	11	11	-3%	7%	6%	9.8%	11.0%	11.3%
Scanfil	422	0.5	0.5	0.5	9	8	8	11%	2%	4%	5.9%	6.4%	6.7%
Inission	579	0.5	0.5	0.4	9	7	7	19%	5%	4%	5.5%	6.4%	6.8%
NCAB	10 751	2.4	2.3	2.2	22	19	17	38%	5%	7%	11.1%	12.4%	12.8%
Median	2 067	1.0	0.9	0.8	10	9	8	25%	6%	7%	8%	9%	9%
Average	5 142	1.2	1.1	1.0	12	11	10	25%	7%	7%	9%	10%	10%
Hanza Holding	1 378	0.7	0.7	0.6	11	9	9	21%	4%	4%	5.6%	6.5%	6.9%

Source: Redeye, FactSet

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: None

People: 5

Hanza receives a high rating for people, as both management and owners have favorable characteristics. CEO Erik Stenfors has vast experience of the manufacturing service industry, including being the founder and CEO of both Note and Hanza. Hanza's largest shareholder is Gerald Engström, the founder and majority owner of Systemair. As a result, Hanza also has the support of a product company veteran.

Business: 3

Lacking clear differentiators, competition in the manufacturing service industry is typically tough. While Hanza has a unique take on the industry, we believe it is still difficult for it to increase prices for example. All the same, Hanza is a close and important partner for several of its customers. Moreover, it has decent diversification across both sectors and customers. Overall, Hanza receives an average rating for Business.

Financials: 3

While Hanza's near-term financial performance is strong, the long-term track-record has been weak, which lowers the Financials rating. Its solid financial position is positive, while the low-margin nature of its business is negative for the rating. In summary, Hanza receives an average rating for Financials. Several consecutive years of solid performance would lift the rating, though.

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 (2022-05-05)

Rating	People	Business	Financials
5	32	15	4
3-4	155	137	48
0-2	5	40	140
total	192	192	192

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Fredrik Nilsson owns shares in the company : No

Jacob Svensson owns shares in the company : No

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