Hanza: Ambitious Targets and Solid Outlook

Hanza **Research Update** 2022-11-10 06:45 **Updated** 2022-11-10 06:46

Redeye takes a positive stance towards Hanza following a solid Q3 report, new ambitious financial targets combined with a falling share price. While our forecasts are somewhat more defensive than the new targets, the targets indicate management sees solid prospects for sales growth and margin expansion over the next few years.


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EBITA as Expected

While sales beat our estimate by 8%, following a solid organic sales growth of 26% y/y, the margin came in somewhat soft. However, EBITA matched our forecast, and both sales and margins were affected by increasing costs of energy and some materials, which have been passed on to customers.

New Financial Targets

In conjunction with the Q3 report, Hanza announced new financial targets, with the highlights being the SEK5bn sales and >8% EBITA margin in 2025 targets. While our forecasts are somewhat more defensive, we believe the new targets are realistic. We believe the new and raised targets imply that management sees solid prospects for sales growth and margin expansion over the next few years.

Base Case Unchanged at SEK55

We leave our Base Case at SEK55 despite increasing the WACC to 9.5% (9), following an increased risk-free rate from 2% to 2.5%. The somewhat higher EBITA forecast offsets the negative effect of the WACC raise. We are surprised by the weak share price performance since the report. Although investors probably are worried about the potential negative impact of macroeconomics in 2023, management's solid outlook should have dampened that worry somewhat.

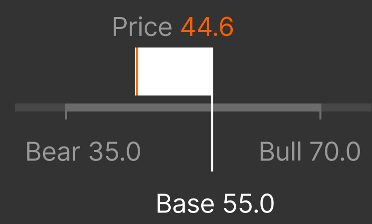
SEKm	2020	2021	2022E	2023E	2024E
Revenues	2,155	2,515	3,336	3,461	3,634
Revenue Growth	4.2%	16.7%	32.6%	3.8%	5.0%
EBITDA	138	232	301	345	377
EBIT	31	128	183	224	252
EBIT Margin	1.5%	5.1%	5.5%	6.5%	6.9%
Net Income	(22)	85	117	172	194
EV/Revenue	0.2	1.0	0.6	0.5	0.5
EV/EBIT	16.4	19.5	10.4	8.2	7.1

Solid EBITA as We Expected

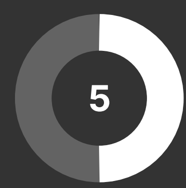
REDEYE

REDEYE QUALITY RATING

FAIR VALUE RANGE



TIMELINESS



KEY STATS

Market Cap	1.6 BSEK
Entprs. Value (EV)	1.8 BSEK
Net Debt	183.6 MSEK
30 Day Avg Vol	98 K
Shares Outstanding	35.8 M
EV / Sales	0.7
EV / EBIT	14.1
Price / Earnings	18.7
PEG	N/A
Dividend Yield	1.1%

IMPORTANT INFORMATION

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	Q3E 2022	Q3A 2022	Diff	Q3A 2021	Q2A 2022
Net sales	**776.0**	**838.0**	**8.0%**	**597.4**	**886.0**
Y/Y Growth (%)	29.9%	40.3%		18.7%	39.8%
Main Markets	423.1	447.5	*5.8%*	315.1	484.5
Y/Y Growth (%)	34.3%	42.0%		18.6%	43.0%
EBITA (MM)	33.0	31.7	*(3.9%)*	29.8	36.7
EBITA margin	7.8%	7.1%		9.5%	7.6%
Other Markets	352.9	390.5	*10.7%*	282.3	401.3
Y/Y Growth (%)	25.0%	38.3%		18.9%	36.1%
EBITA (OM)	19.4	20.2	*4.1%*	9.5	22.6
EBITA margin	5.5%	5.2%		3.4%	5.6%
EBITA	**50.9**	**50.2**	***(1.4%)***	**37.4**	**57.4**
EBITA Margin (%)	6.6%	6.0%		6.3%	6.5%
EBIT	**46.7**	**45.9**	***(1.8%)***	**33.4**	**53.1**
EBIT Margin (%)	6.0%	5.5%		5.6%	6.0%
Diluted EPS	0.99	0.72	*(27.0%)*	0.56	1.00

Source: Fortnox & Redeye Research

Sales increased by 40% y/y to SEK838m (597), beating our forecast by 8%, as Main- and Other Markets grew slightly better than we estimated. Hanza's diverse customer base, including mining, gas turbines, defense, reverse vending, and medical devices, had a strong demand during the quarter, driving solid organic growth of 26% y/y. Also, the order intake remained at a high level throughout the quarter.

EBITA was SEK50.2m (37.4), corresponding to an EBITA margin of 6.0% (6.3). EBITA matched our forecast, while the margin came in somewhat short. Both sales and margins were affected by increasing costs of energy and some materials, which have been passed on to customers. The effect on sales was positive, while margins were negatively affected as Hanza does not take any margin on forwarded costs, which is reasonable. Thus, considering that the EBITA matched our forecasts, we argue the underlying performance is solid and in line with our expectations.

On the segment level, both Main- and Other Markets had slightly lower margins than we expected. However, compared to Q3 2021, Other Markets improved significantly to 5.2% (3.4), partly thanks to the completion of the expansion projects in Poland, Czech Republic, and China. Following a weak Q1 2022, Other Markets now has two consecutive quarters of EBITA margins >5%. While below the new 2025 target of >8%, the 5% level is substantially above Other Market's historical average. Main Markets declined from the record-high 9.5% EBITA margin in Q3 2021. Apart from Beyers with zero margins joining the numbers, coordination projects in Germany negatively impacted Main Markets margins.

New Financial Targets for 2025

- **Growth: Sales of at least SEK5bn by 2025.**
  Previously: Average sales growth of at least 10% per year over a business cycle.
- **Profitability: Operating margin (EBITA) of at least 8%**.
  Previously: Average operating margin (EBIT) at least 6% over a business cycle.
- **Capital structure: An equity ratio of at least 30%.**
  Unchanged target.
- **Debt: Net interest-bearing debt/EBITDA must not exceed 2.5.**
  New target defined as net interest-bearing debt at the end of the period divided by rolling 12-month EBITDA.
- **Dividend policy: The annual dividend shall be equal to 30% of the profit after tax, taking into account the financial position of the company.**
  Unchanged policy.

The sales growth target is significantly above our 2025 sales forecast of SEK3.8bn, indicating our estimates are too defensive. However, the target includes M&A, which our forecast does not. Also, achieving SEK5bn in sales with the current number of shares is something other than fueling sales growth by acquisitions paid mostly with shares. In our discussion with management, we get the impression Hanza is willing to finance acquisitions partly by shares to align the seller's interests. However, management points out that EPS growth is the overall target. Thus, we see no reason to believe the SEK5bn sales target would risk EPS growth; instead, we see it as an indication of management growth plans, both organic and M&A. The SEK5bn target implies a sales CAGR of ~14%, given our forecast for FY 2022.

We expect Hanza to focus its growth initiative on organic and acquired growth in the current cluster to reach the 2025 target. However, by the end of the period until 2025, management is open to adding a cluster. While it is too early to decide on geographical locations for an eventual new cluster, we believe the US is a likely location considering management's statement in the Q3 call.

While the new margin target concerns EBITA and the old was regarding EBIT, the difference between them is small in Hanza, typically about 0.5%-points. Thus, the like-for-like increase is about 1.5%-points or 25%, which is a rather substantial increase. However, as Main Markets has had full-year margins of about 8% and almost 10% in single quarters, we know Hanza is capable of those levels. Nevertheless, the new target implies Hanza is confident Other Markets will reach above 8% and that the initiatives in the German cluster will payoff no later than 2025. While we expected increasing margins in Hanza, our previous EBITA margin forecast for 2025 was 7.3%. The other three targets are mostly a matter of taste. However, we believe 2.5x EBITDA is reasonable for a company like Hanza, as it allows for some extra acquisitions without adding any substantial financial risk. Regarding dividends, we believe a company should have an opportunistic dividend policy. Invest if you find investments with high ROI; if not, pay dividends. However, Hanza's approach is common among listed companies and reasonable.

Financial Forecasts

We raise our sales and EBITA forecasts by about 3% for 2023e, following the solid demand outlook. The ~4% growth we expect in 2023e might seem defensive compared to management's strong outlook and the high order intake. However, despite Hanza having a diversified customer base, we believe it is reasonable to take a more defensive stance considering the weak macroeconomic outlook.

We expect margins to increase in both Main- and Other Markets. Regarding Main Markets, we expect gradually improved profitability as the integration initiatives in Germany are complete by the end of this year. For Other Markets, we expect a positive effect from completing the expansion projects in Poland, the Czech Republic, and China.

Estimate Revisions	FYE 2022	Old	Change	FYE 2023	Old	Change
Net sales	**3 336.0**	**3 274.0**	***1.9%***	**3 461.4**	**3 372.2**	***2.6%***
Y/Y Growth (%)	32.6%	30.2%		3.8%	3.0%	
Main Markets	**1 861.9**	**1 837.6**	***1.3%***	**1 932.3**	**1 892.7**	***2.1%***
Y/Y Growth (%)	36.7%	34.9%		3.8%	3.0%	
EBITA (MM)	**139.5**	**143.1**	***(2.5%)***	**152.6**	**149.6**	***2.1%***
EBITA margin	4.2%	4.4%		9.4%	4.5%	
Other Markets	**1 474.0**	**1 436.4**	***2.6%***	**1 529.1**	**1 479.5**	***3.4%***
Y/Y Growth (%)	27.9%	24.6%		3.7%	3.0%	
EBITA (OM)	**66.1**	**66.3**	***(0.3%)***	**91.8**	**88.9**	***3.3%***
EBITA margin	4.5%	4.6%		38.8%	34.0%	
EBITA	**199.5**	**203.5**	***(2.0%)***	**238.4**	**232.4**	***2.6%***
EBITA Margin (%)	6.0%	6.2%		6.9%	6.9%	
EBIT	**182.6**	**186.7**	***(2.2%)***	**223.8**	**218.0**	***2.7%***
EBIT Margin (%)	5.5%	5.7%		6.5%	6.5%	
Diluted EPS	3.2	3.6	*(9.5%)*	4.7	4.6	*2.6%*

Source: Fortnox & Redeye Research

We expect Hanza to reach SEK3.8bn in sales in 2025, which is below SEK5bn. However, our forecasts do not include future M&A. Assuming Hanza can acquire at 0.5x sales, slightly above the historical average, the roughly SEK400m in free cash flow we assume Hanza will generate until 2025 is enough to add about SEK800m in sales. Thus, adding some growth in the acquisitions and a small portion of share-based payment, we believe the SEK5bn target is reasonable.

Regarding EBITA margin, we expect Hanza to reach 7.6% in 2025. Somewhat below the >8% target, but still a significant improvement relative to the current ~6% level. If successful in expanding and developing the less mature clusters, we believe 8% is well within reach, considering the +10% levels seen in the Swedish cluster.

Income Statement	FYA 2021	Q1A 2022	Q2A 2022	Q3A 2022	Q4E 2022	FYE 2022	FYE 2023	FYE 2024	FYE 2025
Net sales	**2 515**	**824**	**886**	**838**	**788**	**3 336**	**3 461**	**3 634**	**3 816**
Y/Y Growth (%)	16.7%	45.2%	39.8%	40.3%	10.0%	32.6%	3.8%	5.0%	5.0%
Main Markets	1 362	482	485	448	448	1 862	1 932	2 029	2 130
Y/Y Growth (%)	17.0%	60.1%	43.0%	42.0%	10.0%	36.7%	3.8%	5.0%	5.0%
EBITA (MM)	114	38	37	32	34	140	153	167	179
EBITA margin	8.3%	7.8%	7.6%	7.1%	7.5%	7.5%	7.9%	8.2%	8.4%
Other Markets	1 153	342	401	391	340	1 474	1 529	1 606	1 686
Y/Y Growth (%)	16.5%	28.4%	36.1%	38.3%	10.0%	27.9%	3.7%	5.0%	5.0%
EBITA (OM)	41.6	5	23	20	19	66	92	103	118
EBITA margin	3.6%	1.3%	5.6%	5.2%	5.5%	4.5%	6.0%	6.4%	7.0%
EBITA	**143**	**41**	**57**	**50**	**51**	**200**	**238**	**264**	**291**
EBITA Margin (%)	5.7%	5.0%	6.5%	6.0%	6.4%	6.0%	6.9%	7.3%	7.6%
EBIT	**128**	**37**	**53**	**46**	**47**	**183**	**224**	**252**	**280**
EBIT Margin (%)	5.1%	4.5%	6.0%	5.5%	5.9%	5.5%	6.5%	6.9%	7.3%
Diluted EPS	2.4	0.5	1.0	0.7	1.0	3.2	4.7	5.4	6.0

Source: Hanza & Redeye Research

Valuation

We leave our Base Case at SEK 55 despite increasing the WACC to 9.5% (9), following an increased risk-free rate from 2% to 2.5%. The somewhat higher EBITA forecast offsets the negative effect of the WACC raise.

Peer Valuation

At 8x EBIT 2023, Hanza is trading below the average and median of our peer group. Considering Hanza's recent strong operational performance, we believe Hanza deserves a valuation at least on par with the median.

	EV	EV/SALES			EV/EBIT (x)			Sales growth			EBIT margin		
Company	(local)	22E	23E	24E	22E	23E	24E	22E	23E	24E	22E	23E	24E
Incap	493	2.2	2.0	1.9	15	13	12	31%	10%	8%	14.7%	15.3%	15.5%
Kitron	4 728	0.8	0.7	0.7	12	10	9	56%	11%	11%	6.6%	7.3%	7.3%
Nolato	12 989	1.2	1.1	1.0	12	10	9	-3%	7%	6%	9.8%	11.0%	11.3%
Scanfil	382	0.5	0.5	0.5	8	7	7	11%	2%	4%	5.9%	6.4%	6.7%
Inission	534	0.4	0.4	0.4	8	7	6	19%	5%	4%	5.5%	6.4%	6.8%
NCAB	10 162	2.3	2.2	2.0	21	18	16	38%	5%	7%	11.1%	12.4%	12.8%
Median	**2 631**	**1.0**	**0.9**	**0.8**	**12**	**10**	**9**	**25%**	**6%**	**7%**	**8%**	**9%**	**9%**
Average	**4 881**	**1.2**	**1.2**	**1.1**	**13**	**11**	**10**	**25%**	**7%**	**7%**	**9%**	**10%**	**10%**
Hanza Holding	**1 900**	**0.6**	**0.5**	**0.5**	**10**	**8**	**7**	**33%**	**4%**	**5%**	**5.5%**	**6.5%**	**6.9%**

Source: Redeye, FactSet

Income Statement

SEKm	2020	2021	2022E	2023E	2024E
Revenues	2,155	2,515	3,336	3,461	3,634
Cost of Revenue	1,148	1,531	2,069	2,146	2,253
Operating Expenses	869	753	966	970	1,004
Exchange Rate Differences	-	-	-	-	-
EBITDA	138	232	301	345	377
Depreciation	57	49	57	66	71
Amortizations	4	16	17	15	12
EBIT	31	128	183	224	252
Shares in Associates	-	-	-	-	-
Interest Expenses	(25)	(30)	(43)	(7)	(7)
Net Financial Items	27	32	43	7	7
Non Recurring Income Expense	-	-	-	-	-
EBT	9	100	140	217	245
Income Tax Expenses	(2)	(20)	(23)	(45)	(50)
Net Income	(22)	85	117	172	194

Balance Sheet

SEKm	2020	2021	2022E	2023E	2024E
Accounts Receivable	77	107	167	173	182

SEKm	2020	2021	2022E	2023E	2024E
Average Inventories	383	503	732	801	801
Other Current Assets	44	55	134	169	217
Total Current Assets	584	870	1,172	1,279	1,371
Property, Plant and Equipment (Net)	270	242	495	539	582
Invested Capital	761	916	1,310	1,354	1,405
Goodwill	298	362	384	384	384
Right-of-Use Assets	138	188	188	188	188
Other Long Term Assets	27	22	7	7	7
Total Non-Current Assets	830	907	1,164	1,193	1,224
Total Assets	1,414	1,778	2,336	2,472	2,596
Short Term Debt	163	229	356	356	356
Accounts Payable	200	373	467	485	509
Other Current Liabilities	124	190	250	260	273
Total Current Liabilities	530	835	1,116	1,143	1,180
Long Term Debt	-	-	-	-	-
Other Long Term Lease Liabilities	154	154	136	136	136
Shareholder's Equity	-	-	36	179	330
Non Controlling Interest	-	-	-	-	-
Total Liabilities and Equity	939	1,366	1,626	1,796	1,984
Cash Equivalents	121	46	71	136	172

Cash Flow

SEKm	2020	2021	2022E	2023E	2024E
Change in Working Capital	80	(124)	(122)	(14)	(20)
Operating Cash Flow	182	126	134	246	234
Capital Expenditures	(60)	(186)	(133)	(110)	(114)
Investing Cash Flow	(60)	(186)	(133)	(110)	(114)
Financing Cash Flow	(63)	(22)	16	(71)	(84)
Free Cash Flow	122	(60)	1	136	120

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 longterm 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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