Hanza: Softer Market and Integrations Hurting Short-Term

Hanza **Research Update** 2024-05-13 06:45 **Updated** 2024-05-13 06:46

Redeye retains its positive stance towards Hanza despite a softer Q1 report than expected, resulting in lowered forecasts and Base Case. The softer market and the integration of Orbit One are hurting margins somewhat more than we anticipated, reducing our short-term forecasts. On the other hand, management seems very confident in the 2025 targets despite the somewhat softer market.


Fredrik Nilsson


Fredrik Reuterhäll

Integrations Hurting Short-Term EBITA

Sales was 6% short of our expectations and amounted to SEK1253m (1065). The organic growth was -6% y/y. The softer macroeconomic environment resulted in lower demand from customers in some areas. EBITA (adjusted for restructuring and a write-down of the Orbit One earn-out) was SEK67m (88), corresponding to an EBITA margin of 5.3% (8.3). Our forecast was SEK96m and 7.2%. Main Markets was only slightly softer than expected, while Other Markets was hurt by a combination of integration work and by having less mature clusters than Main Markets, making it harder to adapt to changes in demand.

Confident in 2025 Targets Despite Somewhat Softer Market

Despite the softer market, management is confident in reaching its 2025 targets of SEK6.5 billion in sales (including future M&A) and an 8% EBITA margin. The company is getting promising signals from its customers, who are expecting to increase their volumes by autumn. Also, management seems confident in gaining new deals during the rest of 2024, thanks to companies continuing to evaluate their production chains, which might be more appealing in a somewhat softer market environment.

New Base Case SEK73 (90)

We lower our Base Case somewhat to SEK 73 (90) on the back of reduced forecasts and a softer outlook. Nevertheless, we keep our positive view and see substantial upside potential. Despite the strong operational performance in recent years, with high growth and improving margins during 2023, Hanza is still trading at a discount to the average, although often bigger, manufacturing service companies. We believe the discount will decrease further, given that Hanza will continue its strong operational performance.

Key financials

SEKm	2023	2024e	2025e	2026e	2027e
Revenues	4,154.0	5,158.2	5,611.9	5,947.9	6,304.1
Revenue Growth	16.4%	24.2%	8.8%	6.0%	6.0%
EBITDA	464.7	485.0	605.4	655.6	713.0
EBIT	328.0	311.7	424.1	468.2	514.3
EBIT Margin	7.9%	6.1%	7.6%	7.9%	8.2%
Net Income	215.0	139.6	215.3	251.9	290.2
EV/Sales	0.9	0.6	0.5	0.5	0.4
EV/EBIT	11.2	9.5	6.6	6.0	5.3

REDEYE

REDEYE QUALITY RATING

People	Business	Financials
4	3	3

FAIR VALUE RANGE

Price 59.2

Bear 23.0 Base 73.0 Bull 99.0

TIMELINESS

2

KEY STATS

Market Cap	2.5 BSEK
Entprs. Value (EV)	3.0 BSEK
Net Debt (2024e)	419.0 MSEK
30 Day Avg Vol	122 K
Shares Outstanding	43.7M
Price / Earnings	18.3x
PEG	N/A
Dividend Yield	1.3%

Data from 2024-05-13 06:48

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Review of Q1 2024

Estmates vs. Actuals					
Sales	**Q1E 2024**	**Q1A 2024**	**Diff**	**Q1A 2023**	**Q4A 2023**
Net sales	1334	1253	-6%	1065	1056
Y/Y Growth (%)	33%	18%		29%	5%
Main Markets	735	770	5%	594	605
Y/Y Growth (%)	21%	30%		23%	6%
EBITA (MM)	61	54	-11%	58	63
EBITA margin	8.3%	7.0%		10%	10%
Other Markets	599	480	-20%	468	447
Y/Y Growth (%)	34%	3%		37%	2%
EBITA (OM)	37	16	-56%	30	29
EBITA margin	6.1%	3.3%		6%	6%
Earning					
EBITA	96	67	-30%	88	76
EBITA Margin (%)	*7.2%*	*5.3%*		*8.3%*	*7.2%*
EBIT	92	61	-34%	84	71
EBIT Margin (%)	*6.9%*	*4.9%*		*7.9%*	*6.7%*
Diluted EPS	1.32	0.77	-42%	1.48	1.09

Softer Than Expected

Sales was 6% short of our expectations and amounted to SEK1253m (1065). The organic growth was -6% y/y. The softer macroeconomic environment resulted in lower demand from customers in some areas. EBITA (adjusted for restructuring and a write-down of the Orbit One earn-out) was SEK67m (88), corresponding to an EBITA margin of 5.3% (8.3). Our forecast was SEK96m and 7.2%.

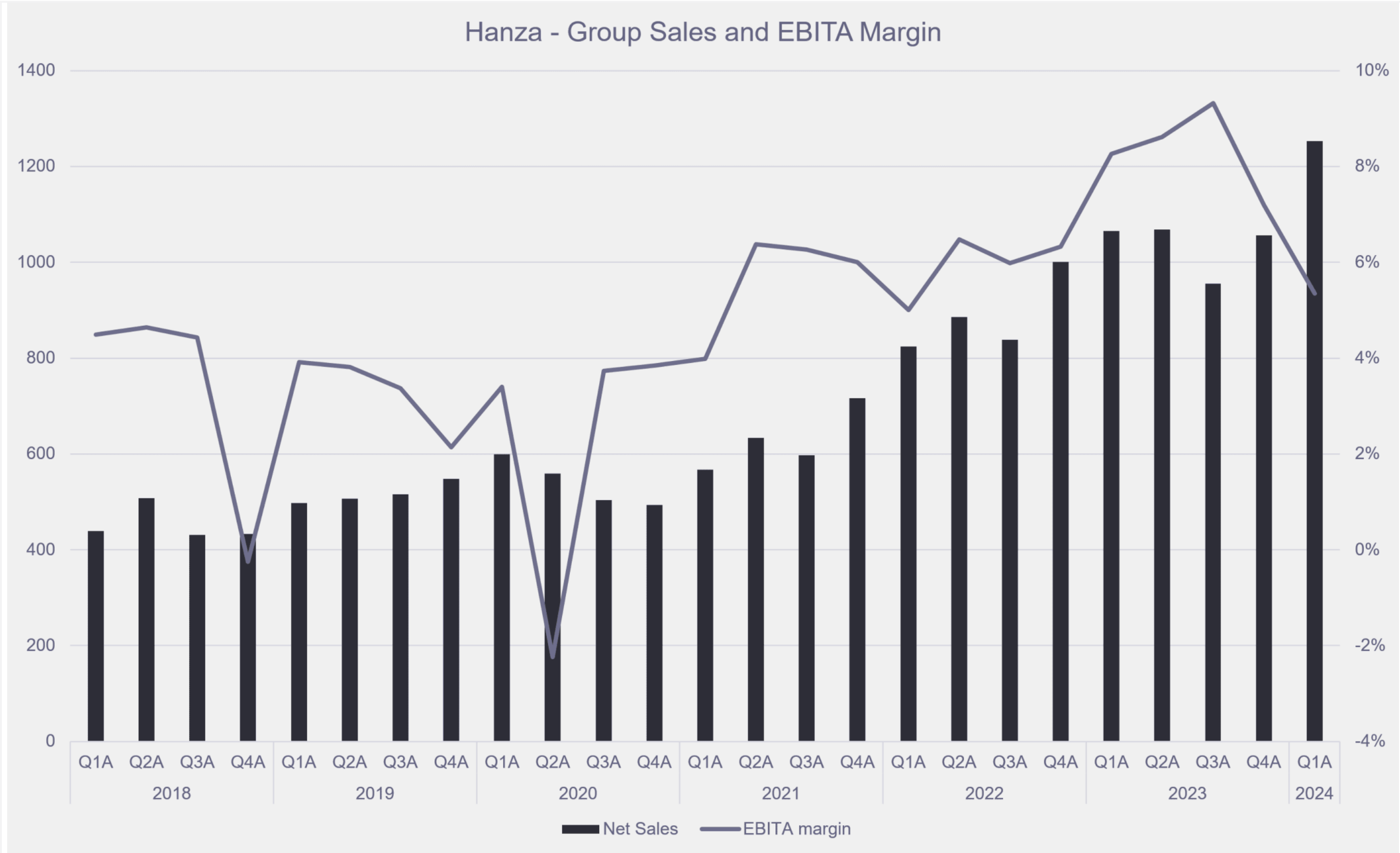
Main Markets beat our sales forecasts by 5%, while EBITA came in 11% short. We believe the EBITA contribution from Orbit One was lower than we anticipated, as management states that the EBITA contribution in Q1 was limited. Thus, the like-for-like EBITA development was rather solid at 8.2% vs 8.8% Q1 2023 (excluding subsidiaries). Organic growth was 1%. Once again, Main Markets shows it has the ability to obtain healthy results despite large integrations and changes in demand.

Other Markets came in below in terms of both sales and EBITA. Organic growth was -14%, and the EBITA margin fell to 3.3% overall and 4.9% (6.4) like-for-like. Our forecast was 6.1%. The growth and margin were negatively affected by the ongoing integration of Orbit One's Polish operations, which usually take one year and could possibly be completed in Q3 if done well. In addition, the smaller clusters within Other Markets are not as mature and, therefore, not as resistant to changes in demand as Main Markets.

Management sees a mixed market where some sectors, like defence and energy, continue to do well, while others like mining and industrials, are softer. Hanza saw lower volumes from some customers while others increased their volume. However, considering the negative organic growth, customers reducing volumes seem to dominate. Also, Hanza has not lost any customers, meaning that the decline in sales is fully due to lower volumes from current customers. Although Hanza plans for the market environment to remain unchanged, it is getting promising signals from its customers, who expect to increase their volumes by autumn.

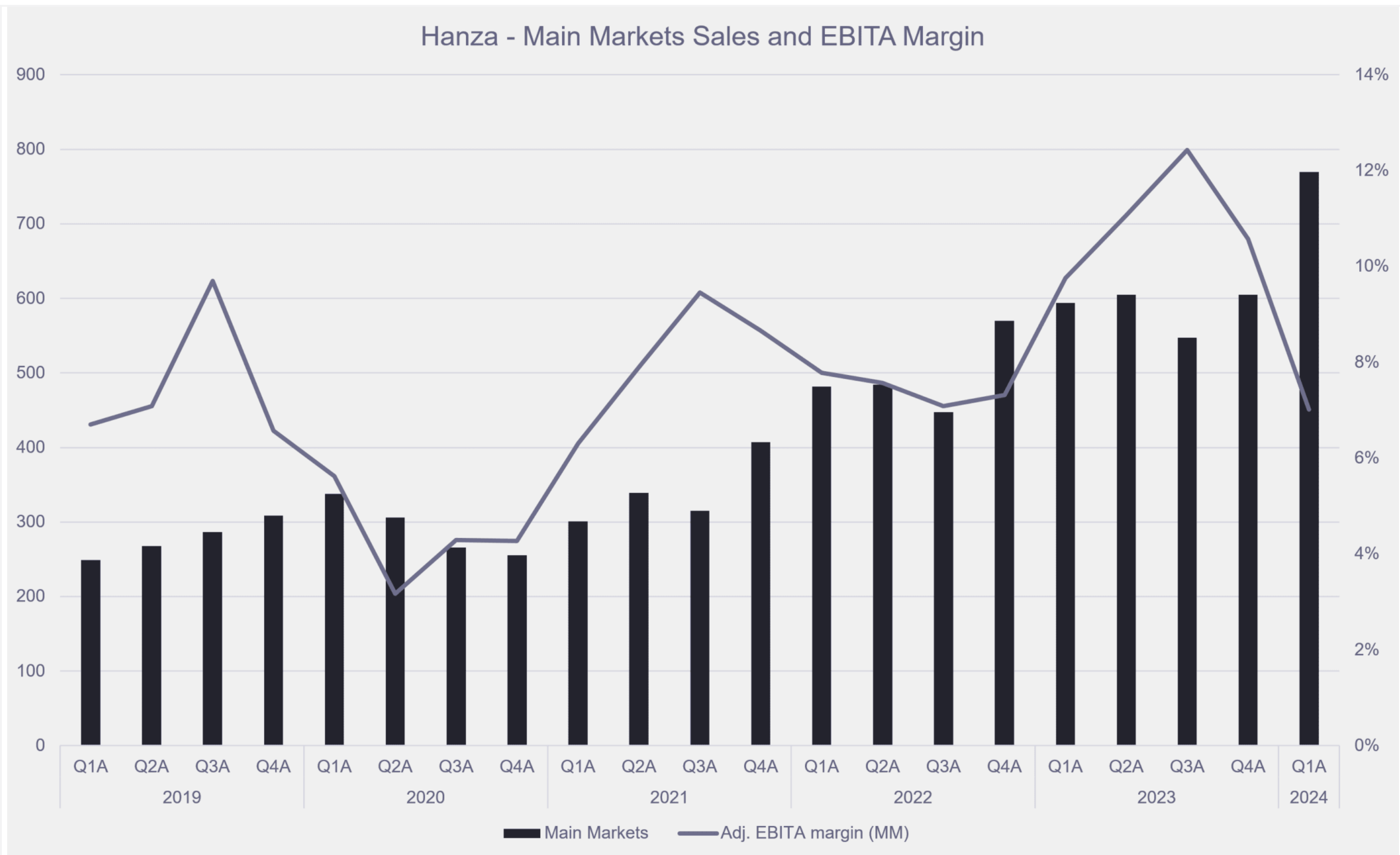
Also, management highlights that softer macroeconomic conditions can trigger product companies to evaluate their production chains – leaving opportunities for Hanza to gain market share. In addition, the interest in regionalised production remains high, which seems reasonable considering the increasing geopolitical turmoil in many areas, for example. The backsourcing or regionalisation is mostly about new production for the European/American markets being manufactured in those regions rather than production moving back from Asia, although that happens sometimes as well. Management seems confident in gaining new deals thanks to these trends during the rest of 2024.

All in all, management clearly believes that its 2025 targets of SEK6.5bn in sales (inc. future M&A) and the 8% EBITA margin target hold even in this somewhat softer market, suggesting high confidence in reaching the targets.



Source: Hanza

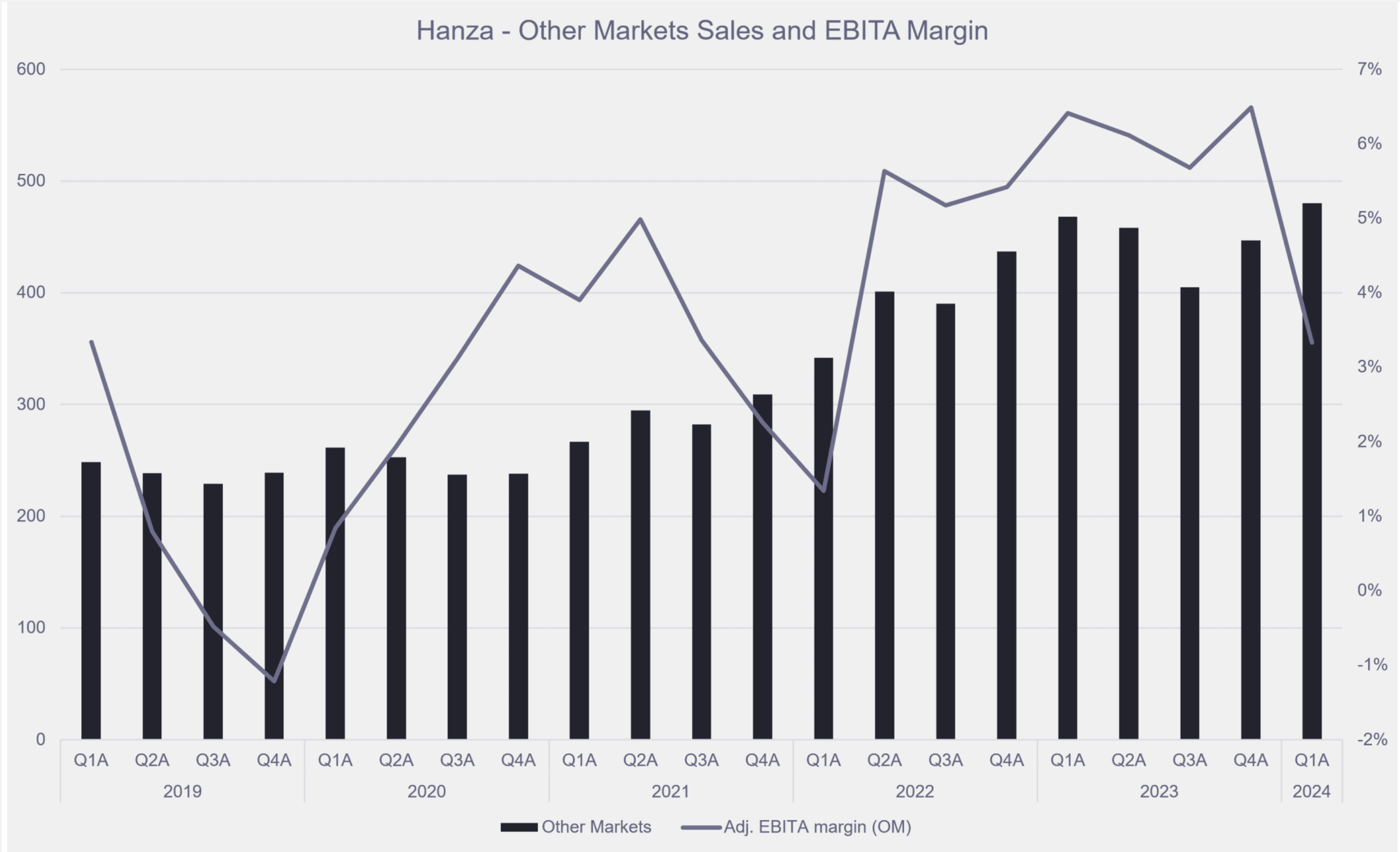
Main Markets



Source: Hanza

Main Markets consist of the Swedish, Finnish, and German clusters. The Swedish cluster is the largest and the most profitable cluster, with manufacturing facilities mainly located in Årjäng and Töcksfors, Värmland, along with the recently acquired facility in Ronneby, Blekinge. The German cluster is less mature but has seen substantial improvements in profitability during the last year. The Finnish cluster is somewhere in between, in terms of maturity and profitability.

Other Markets

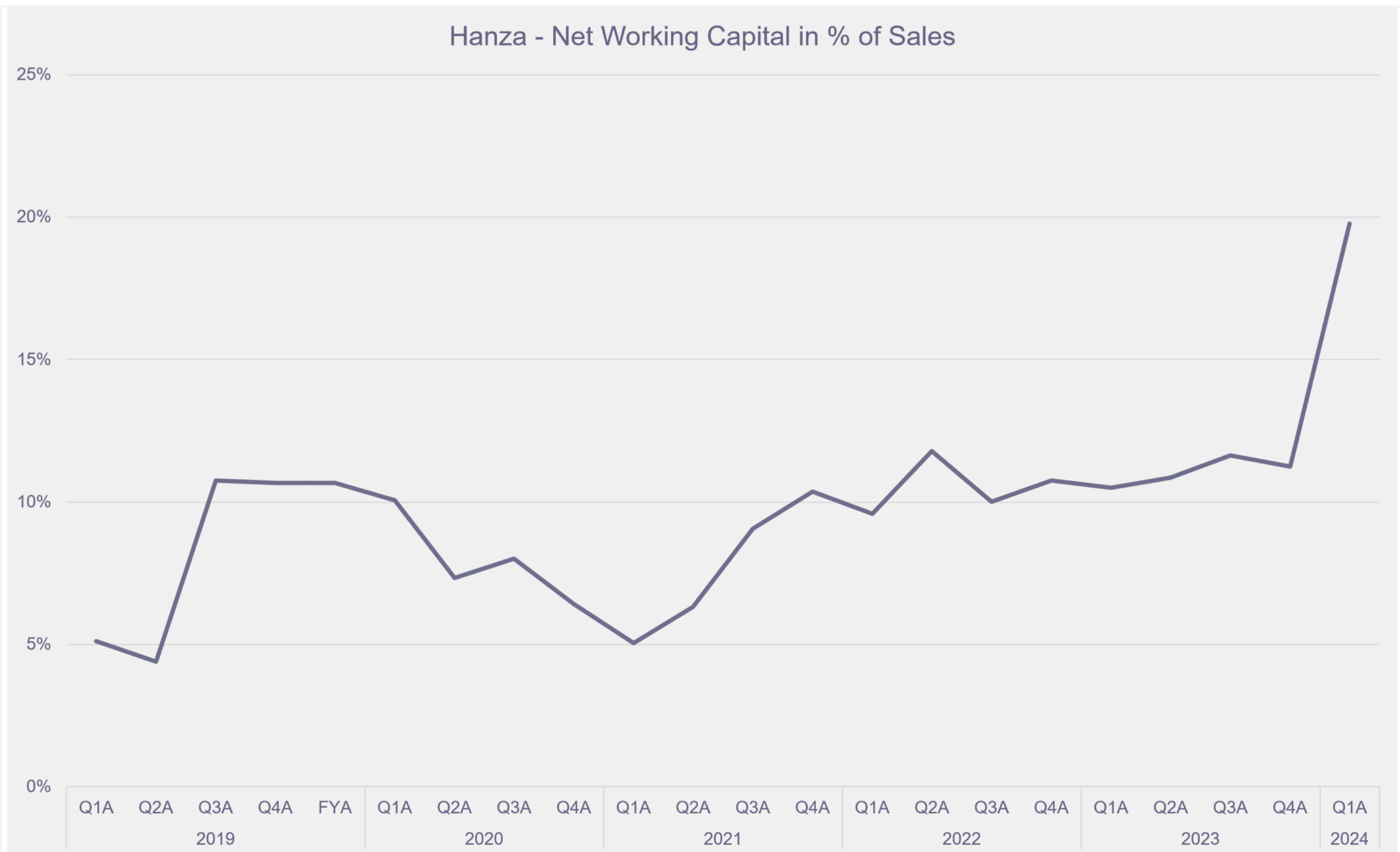


Source: Hanza

Other Markets consist of the Baltic, Central European, and Chinese clusters. The Baltic cluster is the largest and likely the most profitable, with manufacturing facilities in Tartu and Narva, Estonia. The Central Europan cluster is less mature but will increase significantly in size with the recently acquired Orbit One factory in Poland. The Chinese cluster is Hanza's smallest and the only cluster outside of Europe.

Large Inventory in Orbit One

Orbit One has a much larger net working capital compared to "old Hanza", mostly due to its large inventory. Management believes it will be able to adjust Orbit One's inventory to align with levels seen previously in Hanza over time, which will boost Hanza's cash flow.



Source: Hanza

Estimate Revisions: Reduced Forecasts for 2024 and 2025

We lower our sales forecasts by 3-7% for 2024-25 and our EBITA estimates by 14-20%. The following changes mainly drive the revisions in addition to the softer Q1, affecting 2024 numbers:

- While management sees potential for a rebound in volumes in the autumn and has a positive outlook regarding additional deals, the lower activity seen in Hanza and its peers makes us somewhat more cautious regarding our sales expectations. Also, prior to its full integration, we believe the EMS-focused Orbit One is more sensitive to softer economic conditions.
- The lower sales volumes and us likely underestimating the negative margin impact from the integration work result in reduced margin forecasts, mainly for 2024.

Based on our revised forecasts, we expect SEK5.6bn in sales (with no future M&A) and 8.0% in EBITA margin in 2025. This margin is in line with Hanza's >8% target but somewhat lower sales than the SEK6.5bn target. However, our forecasts do not include any future M&A, and we interpret management as the target is likely to be reached by a combination of organic and acquired growth. Thus, despite our forecast cuts, we still expect Hanza to perform in line with its financial targets.

Estimate Revisions

Sales	**FYE 2024**	**Old**	**Change**	**FYE 2025**	**Old**	**Change**
Net sales	5138	5312	*-3.3%*	5600	6016	*-6.9%*
Y/Y Growth (%)	24%	28%		9%	13%	
Main Markets	3121	2971	*5.0%*	3401	3351	*1.5%*
Y/Y Growth (%)	33%	26%		9%	13%	
EBITA (MM)	227	258	*-11.9%*	299	318	*-6.0%*
EBITA margin	7%	9%		9%	10%	
Other Markets	2018	2341	*-13.8%*	2199	2665	*-17.5%*
Y/Y Growth (%)	13%	32%		9%	14%	
EBITA (OM)	99	153	*-35.1%*	154	195	*-20.9%*
EBITA margin	5%	7%		7%	7%	
Earning						
EBITA	338	405	*-16.6%*	447	507	*-11.8%*
EBITA Margin (%)	*6.6%*	*7.6%*		*8.0%*	*8.4%*	
EBIT	312	392	*-20.4%*	424	495	*-14.3%*
EBIT Margin (%)	*6.1%*	*7.4%*		*7.6%*	*8.2%*	
Diluted EPS	3.23	5.72	*-43.5%*	4.98	7.70	*-35.3%*

Source: Hanza & Redeye Research

Forecasts

Sales	**FYA 2023**	**Q1A 2024**	**Q2E 2024**	**Q3E 2024**	**Q4E 2024**	**FYE 2024**	**FYE 2025**	**FYE 2026**
Net sales	4144	1253	1286	1249	1354	5138	5600	5936
Y/Y Growth (%)	17%	18%	20%	31%	28%	24%	9%	6%
Main Markets	2351	770	788	751	812	3121	3401	3605
Y/Y Growth (%)	19%	30%	30%	37%	34%	33%	9%	6%
EBITA (MM)	256	39	59	60	69	227	299	324
EBITA margin	11%	5%	8%	8%	9%	7%	9%	9%
Other Markets	1778	480	498	498	542	2018	2199	2331
Y/Y Growth (%)	13%	3%	9%	23%	21%	13%	9%	6%
EBITA (OM)	110	12	22	30	35	99	154	170
EBITA margin	6%	3%	5%	6%	7%	5%	7%	7%
Earning								
EBITA	345	67	80	88	103	338	447	489
EBITA Margin (%)	*8.3%*	*5.3%*	*6.2%*	*7.1%*	*7.6%*	*6.6%*	*8.0%*	*8.2%*
EBIT	328	61	73	82	96	312	424	468
EBIT Margin (%)	*7.9%*	*4.9%*	*5.7%*	*6.5%*	*7.1%*	*6.1%*	*7.6%*	*7.9%*
Diluted EPS	4.98	0.78	0.61	0.78	1.06	3.23	4.98	5.83

Source: Hanza & Redeye Research

Valuation

We lower our Base Case somewhat to SEK 73 (90) on the back of reduced forecasts and a softer outlook. Nevertheless, we keep our positive view and see substantial upside potential if the 2025 targets are reached.

Fair Value Range - Assumptions			
	Bear Case	**Base Case**	**Bull Case**
Value per share, SEK	**23**	**73**	**99**
Sales CAGR			
2024 - 2031	4%	6%	7%
2031 - 2041	1%	3%	3%
Avg EBIT margin			
2024 - 2031	7%	8%	9%
2031 - 2041	5%	8%	9%
Terminal EBIT Margin	6%	8%	9%
Terminal growth	2%	2%	2%
WACC	10%	10%	10%

Source: Redeye Research

Peer Valuation

Manufacturing	EV	Sales	EV/SALES			EV/EBIT			Sales growth			EBIT margin		
Company	(SEKm)	24e	24e	25e	26e	24e	25e	26e	24e	25e	26e	24e	25e	26e
Incap	4 113	2 782	1.4	1.1	1.0	12.4	9.5	8.0	5%	18%	9%	11%	12%	12%
Kitron	7 357	8 469	0.9	0.8	0.7	10.5	8.6	7.5	-7%	12%	10%	8%	9%	9%
Nolato	17 711	9 941	1.8	1.7	1.5	18.9	16.4	14.4	4%	7%	7%	9%	10%	11%
Scanfil	5 850	10 242	0.6	0.5	0.5	8.5	7.5	6.8	-5%	5%	5%	7%	7%	7%
Inission	1 543	2 348	0.7	0.6	0.5	9.2	8.1	7.0	7%	5%	5%	7%	7%	8%
NCAB	14 936	4 068	3.7	3.2	3.0	27.1	22.9	20.4	0%	11%	7%	14%	14%	15%
Hanza	2 943	5 138	0.6	0.5	0.5	9.4	6.6	5.9	24%	9%	6%	6%	8%	8%
Average	**7 779**	**6 141**	**1.4**	**1.2**	**1.1**	**13.7**	**11.4**	**10.0**	**4%**	**10%**	**7%**	**8.9%**	**9.5%**	**9.8%**
Median	**5 850**	**5 138**	**0.9**	**0.8**	**0.7**	**10.5**	**8.6**	**7.5**	**4%**	**9%**	**7%**	**8.3%**	**8.8%**	**8.9%**

Source: Redeye, Company reports, FactSet

Despite the strong operational performance in recent years, with high growth and improving margins during 2023, Hanza is still trading at a discount (~20% on EV/EBIT) to the average, although often bigger, manufacturing service companies. We believe the discount will decrease further, given that Hanza continues its strong operational performance.

Investment thesis

Case

Riding the Back-Shoring Trend with its Unique Cluster Strategy

With its 'All you need is one' cluster-based strategy, Hanza, and its experienced management take a unique approach that differentiates it from manufacturing service companies. By gathering several manufacturing technologies in a single location, Hanza can reduce costs, lead times, and environmental footprint. Having almost every cluster in the end market or in close-by low-cost countries, Hanza is set to benefit from the ongoing back-shoring trend. Quarterly reports with strong operational performance, particularly improvements in immature clusters, are the main catalysts.

Evidence

Proven Track-Record in Mature Clusters

The Main Markets segment, including the mature Swedish and Finnish clusters as well as the newly established German cluster, has an EBITA margin of about 8% - implying sector-leading margins in the mature Swedish and Finnish clusters. As the other clusters mature, we expect their margins to approach Swedish levels gradually. Since late 2021, Hanza has seen a surge in organic sales growth following the pandemic. While a rebound from the pandemic has a positive effect, we believe the strong numbers also result from increasing interest in back-shoring.

Challenge

Cyclical Exposure Through Customers' Volume Fluctuations

While Hanza seldom loses customers, its revenues depend on the customers' volumes. During the pandemic in 2020, organic sales fell by about 10%, putting pressure on margins. Thus, Hanza is, to some extent, exposed to market cycles. However, following recent acquisitions and organic customer intake, we believe the diversification between sectors has improved. In addition, the back-shoring trend should help Hanza attract new customers in economic downturns.

Challenge

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 a successful presence outside the Nordics, such as in Tartu, Estonia.

Valuation

Fair Value SEK 73

Our DCF model shows a fair value of SEK 73, which is also supported by a peer valuation. While Hanza has been trading at a discount to peers historically, considering its improvements regarding organic sales growth and margins, we believe Hanza should trade on par with peers.

Quality Rating

People: 4

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 sharholder 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.

Financials

Income statement

SEKm	2023	2024e	2025e	2026e	2027e
Revenues	4,154.0	5,158.2	5,611.9	5,947.9	6,304.1
Cost of Revenue	2,334.0	3,120.7	3,472.0	3,680.3	3,901.1
Operating Expenses	1,345.3	1,532.5	1,522.6	1,600.1	1,678.0
EBITDA	464.7	485.0	605.4	655.6	713.0
Depreciation	65.6	77.0	87.4	96.1	111.3
Amortizations	17.0	26.4	23.0	20.4	16.6
EBIT	328.0	311.7	424.1	468.2	514.3
Shares in Associates	0.00	0.00	0.00	0.00	0.00
Interest Expenses	-80.0	-149.5	-164.7	-164.7	-164.7
Net Financial Items	80.0	149.5	164.7	164.7	164.7
EBT	248.0	162.2	259.4	303.5	349.6
Income Tax Expenses	-33.0	-22.6	-44.1	-51.6	-59.4
Net Income	215.0	139.6	215.3	251.9	290.2

Balance sheet

Assets

Non-current assets

SEKm	2023	2024e	2025e	2026e	2027e
Property, Plant and Equipment (Net)	714.0	893.1	1,045.0	1,210.0	1,375.5
Goodwill	387.0	529.0	529.0	529.0	529.0
Intangible Assets	77.0	131.6	108.5	88.1	71.5
Right-of-Use Assets	186.0	230.0	230.0	230.0	230.0
Other Non-Current Assets	23.0	33.0	33.0	33.0	33.0
Total Non-Current Assets	1,387.0	1,816.7	1,945.5	2,090.1	2,239.1

Current assets

SEKm	2023	2024e	2025e	2026e	2027e
Inventories	936.0	1,233.9	1,232.0	1,305.9	1,384.3
Accounts Receivable	175.0	257.1	252.0	267.1	283.1
Other Current Assets	91.0	154.2	168.0	178.1	188.8
Cash Equivalents	340.0	496.0	640.3	667.6	718.0
Total Current Assets	1,542.0	2,141.1	2,292.3	2,418.7	2,574.2
Total Assets	2,929.0	3,957.8	4,237.8	4,508.8	4,813.3

Equity and Liabilities

Equity

SEKm	2023	2024e	2025e	2026e	2027e
Non Controlling Interest	0.00	0.00	0.00	0.00	0.00
Shareholder's Equity	1,345.0	1,527.2	1,707.6	1,905.7	2,132.9

Non-current liabilities

SEKm	2023	2024e	2025e	2026e	2027e
Long Term Debt	326.0	509.0	509.0	509.0	509.0
Long Term Lease Liabilities	114.0	147.0	147.0	147.0	147.0
Other Long Term Liabilities	159.0	198.0	198.0	198.0	198.0
Total Non-Current Liabilities	599.0	854.0	854.0	854.0	854.0

Current liabilities

SEKm	2023	2024e	2025e	2026e	2027e
Short Term Debt	196.0	406.0	406.0	406.0	406.0
Short Term Lease Liabilities	53.0	55.0	55.0	55.0	55.0
Accounts Payable	450.0	668.4	728.0	771.7	818.0
Other Current Liabilities	286.0	447.3	487.2	516.4	547.4
Total Current Liabilities	985.0	1,576.6	1,676.2	1,749.1	1,826.4
Total Liabilities and Equity	2,929.0	3,957.8	4,237.8	4,508.8	4,813.3

Cash flow

SEKm	2023	2024e	2025e	2026e	2027e
Operating Cash Flow	277.0	594.4	489.3	413.1	461.1
Investing Cash Flow	-296.0	-573.9	-239.2	-261.2	-276.9
Financing Cash Flow	217.0	126.5	-105.7	-124.7	-133.8

Rating 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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Disclaimer

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