Hanza: Wide and Robust Customer Base Paying Off

Hanza **Research Update** 2024-10-30 06:45 **Updated** 2024-10-30 06:46

Redeye raises its Base Case slightly following a Q3 report showing a relatively strong performance in a soft market. While the outlook is more cautious, the margins are gradually heading north and a continued inflow of MIG deals will drive growth in 2025.


Fredrik Nilsson


Fredrik Reuterhäll

Solid Performance in Soft Market

Sales was 8% short of our expectations and amounted to SEK1,107m (955). The organic growth was -4% y/y. While slightly below our expectations, considering the soft momentum in the sector recently – including several profit warnings – we believe that -4% organic growth is quite a solid number, nevertheless. According to management, Hanza's broad and strong customer base – with a significant share of relatively stable sectors like defence, mining, agriculture, and energy – has limited the downturn. In addition, Hanza highlights the importance of avoiding certain cyclical sectors such as automotive and consumer discretionary. Adjusted EBITA was SEK74m (89), corresponding to an EBITA margin of 6.7% (9.3). Our forecast was SEK76m and 6.4%.

Additional MIG Deals to Drive Growth in 2025

As seen in Q2, Hanza also sees strong new sales in Q3, following a greater need for cost-efficient manufacturing in the softer economic environment. The deal flow includes a deal with a German company worth over EUR10m per year at full capacity, where the production will take place in the Central Europe cluster. Also, Mitel – a Canadian Telecommunications company – signed a MIG deal with Hanza during the quarter that is expected to generate SEK60m annually. The deal came into place thanks to Orbit One and is a backshoring deal, where Mitel moves production closer to the end customer.

New Base Case SEK75 (73)

We raise our Base Case slightly to SEK 75 (73) following slightly cut short-and-mid-term forecasts and an impressive performance of Hanza considering the market environment. We keep our positive view and see substantial upside potential if the 2025 targets are reached. After trading at a 25-30% discount on EV/EBIT in our Q2 Update, Hanza is now trading on par with the peer median. Following the recent strong relative performance in Hanza's operations, we believe a faded discount is reasonable. Given that Hanza continues to outperform, we believe there is a case for the company to trade at a premium to the peer median.

Key financials

SEKm	2023	2024e	2025e	2026e	2027e
Revenues	4,154.0	4,961.3	5,240.8	5,659.1	5,997.9
Revenue Growth	16.4%	19.4%	5.6%	8.0%	6.0%
EBITDA	464.7	458.4	591.7	653.9	705.4
EBIT	328.0	262.4	397.8	454.8	496.1
EBIT Margin	7.9%	5.4%	7.6%	8.1%	8.3%
Net Income	215.0	121.9	197.4	244.7	278.9
EV/Revenue	0.9	0.7	0.6	0.6	0.5
EV/EBIT	11.2	13.2	8.4	7.2	6.5

REDEYE

REDEYE QUALITY RATING

People	Business	Financials
4	3	3

FAIR VALUE RANGE

Price 69.3

Bear 25.0 | Base 75.0 | Bull 101

TIMELINESS

6

KEY STATS

Market Cap	3.0 BSEK
Entprs. Value (EV)	3.4 BSEK
Net Debt (2024e)	448.8 MSEK
30 Day Avg Vol	89 K
Shares Outstanding	43.7M
Price / Earnings	24.8x
PEG	N/A
Dividend Yield	1.0%

Data from 2024-10-30 06:47

IMPORTANT INFORMATION

Redeye, Mäster Samuelsgatan 42, 10tr, Box 7141, 103 87 Stockholm. Tel. +46 8-545 013 30
E-post: info@redeye.se

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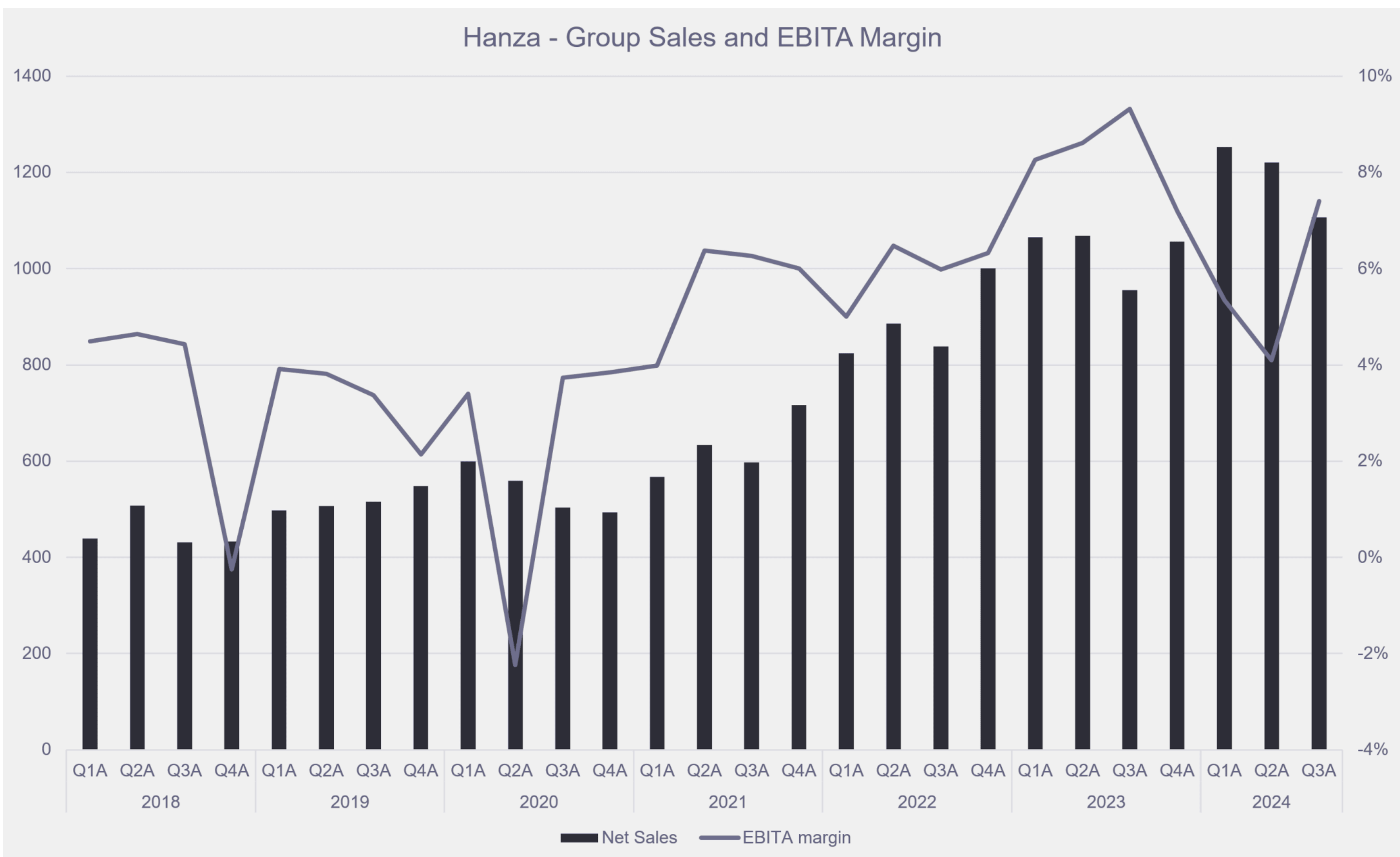
Review of Q3 2024

Estmates vs. Actuals						
Sales	**Q3E 2024**	**Q3A 2024**	**Diff**		**Q3A 2023**	**Q2A 2024**
Net sales	1200	1107	-8%		955	1221
Y/Y Growth (%)	26%	16%			14%	14%
Main Markets	718	626	-13%		547	723
Y/Y Growth (%)	-1%	14%			22%	20%
EBITA (MM)	54	56	4%		68	34
EBITA margin	7.5%	8.9%			12.4%	5%
Other Markets	482	478	-1%		405	495
Y/Y Growth (%)	-3%	18%			4%	8%
EBITA (OM)	24	21	-13%		23	18
EBITA margin	5.0%	4.4%			5.7%	3.6%
Earning						
EBITA	76	74	-3%		89	50
EBITA Margin (%)	*6.4%*	*6.7%*			*9.3%*	*4.1%*
EBIT	70	68	-2%		85	43
EBIT Margin (%)	*5.8%*	*6.1%*			*8.9%*	*3.5%*
Diluted EPS	0.53	0.91	72%		1.22	0.14

No Signs of a Weak Market

Sales was 8% short of our expectations and amounted to SEK1,107m (955). The organic growth was -4% y/y. While slightly below our expectations, considering the soft momentum in the sector recently – including several profit warnings – we believe that -4% organic growth is quite a solid number, nevertheless. According to management, Hanza's broad and strong customer base – with a significant share of relatively stable sectors like defence, mining, agriculture, and energy – has limited the downturn. In addition, Hanza highlights the importance of avoiding certain cyclical sectors such as automotive and consumer discretionary.

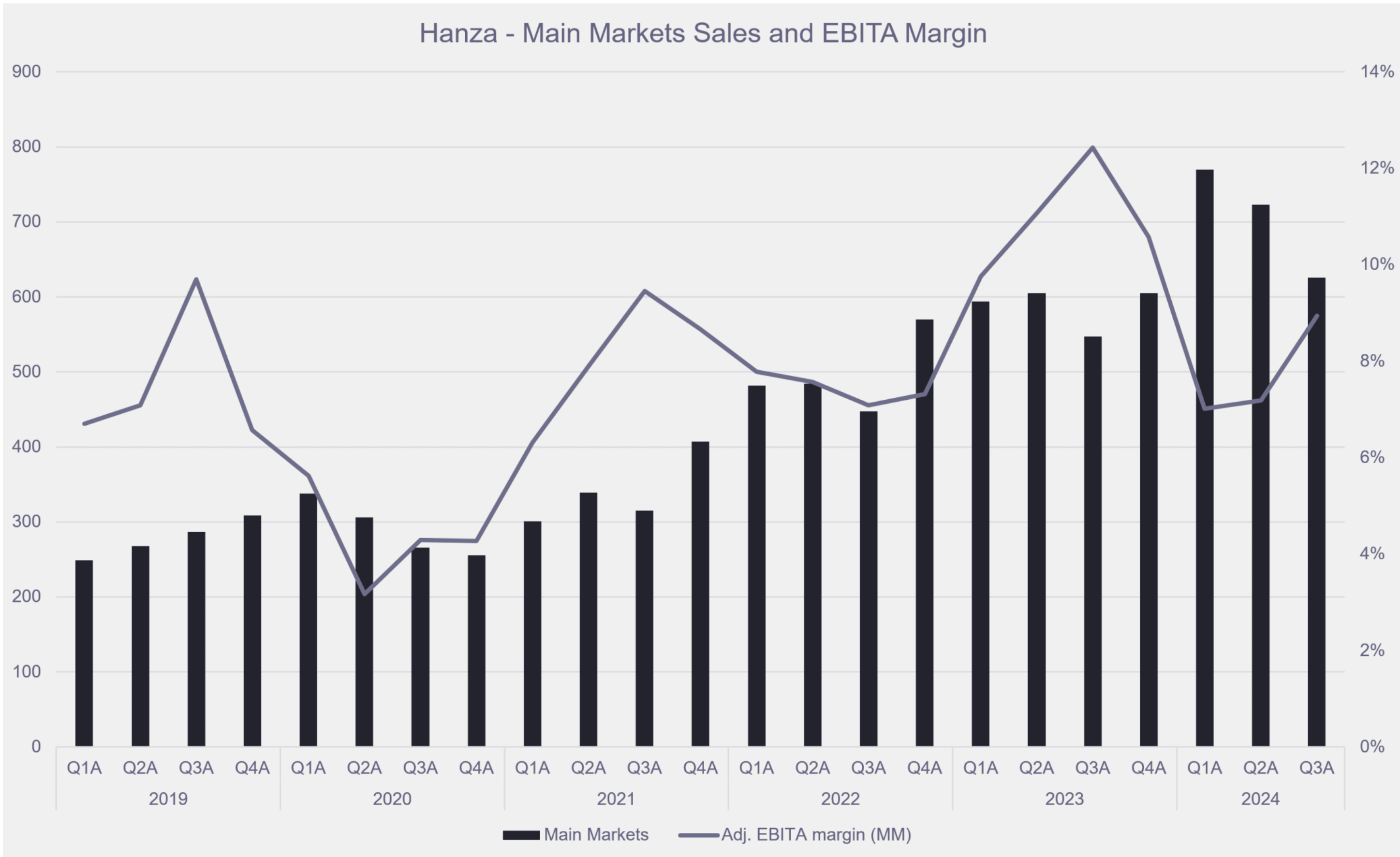
Adjusted EBITA was SEK74m (89), corresponding to an EBITA margin of 6.7% (9.3). Our forecast was SEK76m and 6.4%. Thus, the outcome roughly matched our expectations, and considering the weak sentiment in the sector seen recently, we believe that an EBITA that matches our expectations is a strong sign.



Source: Hanza

Main Markets

Main Markets missed our sales forecasts by 13%, while EBITA was 4% higher than estimated. Organic growth was -8%. The adjusted EBITA margin was 8.9% (12.4), slightly increasing from 7.2% in Q2. Excluding Orbit One, the EBITA margin was 9.8%, up from (8.2% in Q2). Thus, the q/q margin improvement was driven both by Orbit One and the "old" Hanza. Following the integration in Q1 and the consolidation of factories in Q2, Orbit One is now heading towards the 8% margin target (our calculations suggest ~7% in EBITA margin in this quarter). Also, management seems confident in Orbit One reaching 8% in the near future and is satisfied with the integration – a statement that we agree with considering the market environment, which, at least at the beginning of 2024, was hurting Orbit One to a greater extent than "old" Hanza.

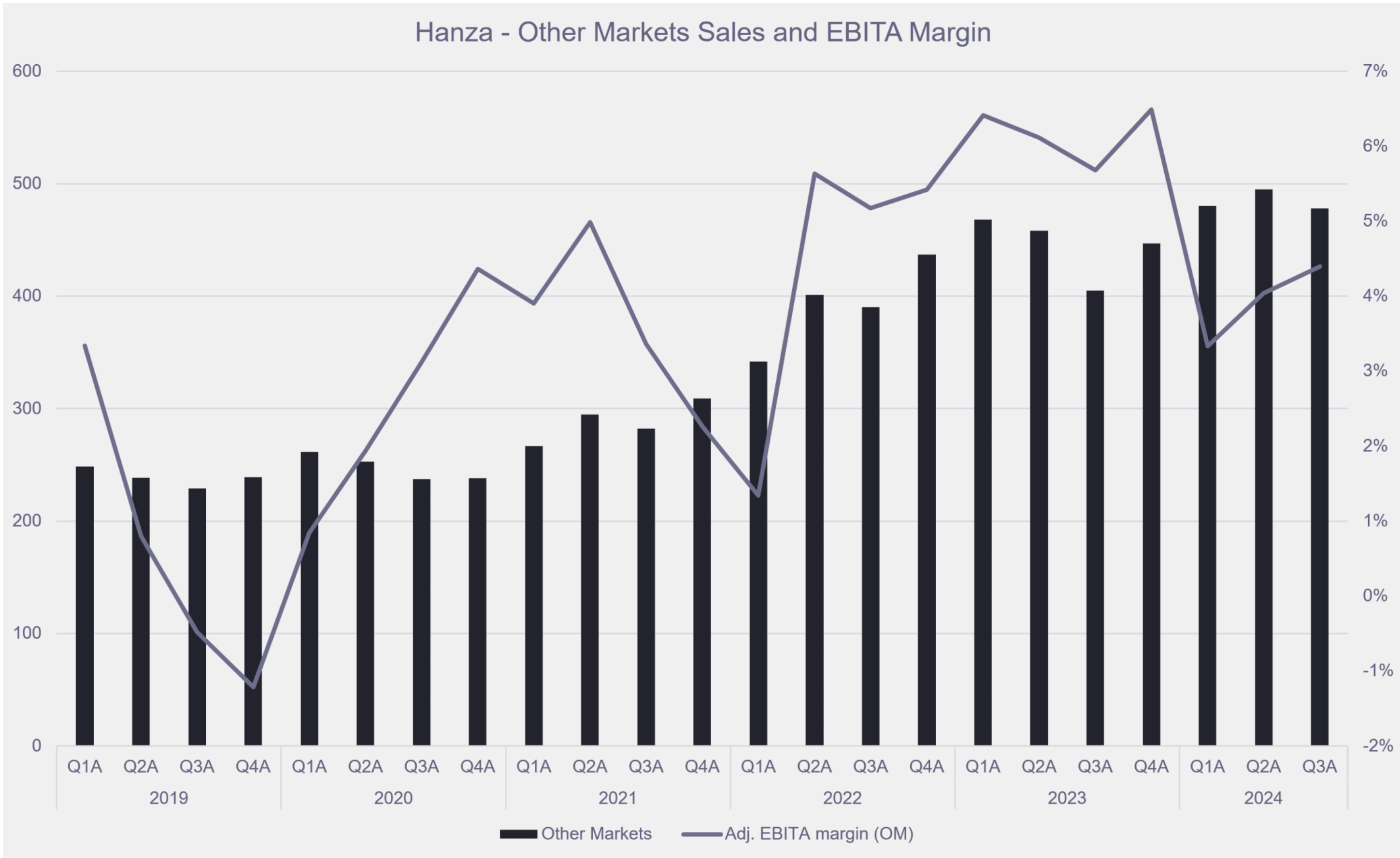


Source: Hanza

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

Other Markets largely matched our sales forecasts, while the EBITA margin was somewhat softer. Organic growth was 3% y/y. The adjusted EBITA margin was 4.4% (5.7), an increase from 4.0% in Q2. Excluding Orbit One, the EBITA margin was 4.6%, down from 5.2% in Q2. Thus, the q/q margin improvement was driven by Orbit One, implying that the integration has already started to impact other markets positively. Despite the relatively strong 3% organic growth, the margin improvement was lower than in Main Markets. That is explained by the Hanza 2025 program, which mainly targeted Other markets, Poland in particular, and MIG deal initiations, which negatively affected margins in the short term.



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.

Further MIG Deals

As seen in Q2, Hanza also sees strong new sales in Q3, following a greater need for cost-efficient manufacturing in the softer economic environment. The deal flow includes a deal with a German company worth over EUR10m per year at full capacity, where the production will take place in the Central Europe cluster. Also, Mitel – a Canadian Telecommunications company – signed a MIG deal with Hanza during the quarter that is expected to generate SEK60m annually. The deal came into place thanks to Orbit One and is a backshoring deal, where Mitel moves production closer to the end customer.

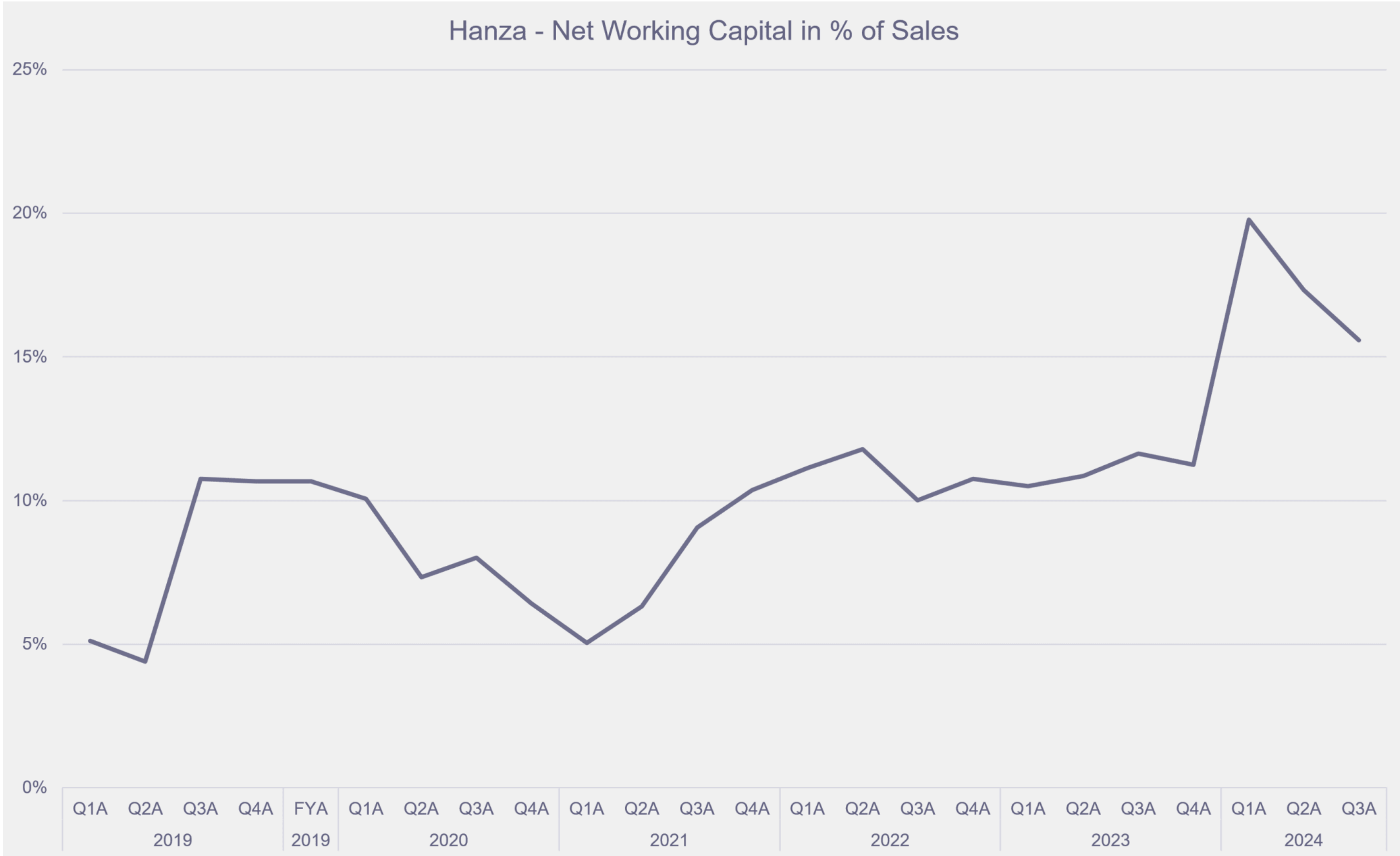
Interestingly, management noted in recent quarters that softer macroeconomic conditions could trigger product companies to evaluate their production chains. Looking at Q2 and Q3, it is apparent that some of those revaluations have resulted in product companies turning to Hanza. Note that there is typically a six to twelve-month lead time from the deal to production for MIG deals.

More Cautious Outlook

The expectations of a macroeconomic rebound in late 2024 seem increasingly unlikely– according to management, peers and other businesses with exposure to economic cycles. Thus, management no longer expects a volume rebound from current customers by the end of 2024. However, management sees signs of an improvement in 2025, although it plans for unchanged market conditions – which seems reasonable in our view. Also, the strong inflow of new deals will help Hanza grow in 2025 in the case of a continuation of the soft market.

Improved NWC - Reducing Inventory in Orbit One

Although the net working capital (NWC) remained somewhat higher than the level seen in Hanza historically, Hanza has reduced the NWC during the last two quarters. While one should expect variation from quarter to quarter, we are encouraged to see NWC heading the right way. As mentioned in our last Update, Hanza sees potential to gradually improve the NWC in Orbit One to align with Hanza's historical levels.



Source: Hanza

Financial Forecasts

We lower our forecasts for 2024 by 3% on sales and raise our EBITA estimate by 2%. We lower our sales expectations for Q4 on the back of the somewhat softer outlook. The underlying adjusted EBITA is lowered somewhat for the same reason, while the headline EBITA is raised following the positive net one-offs in the quarter.

Regarding 2025, we cut our sales and EBITA forecasts by about 5%. We expect SEK5.2bn in sales (with no future M&A) and 8.1% in EBITA margin. This margin aligns with Hanza's >8% target but somewhat lower sales than the SEK6.5bn target. However, our forecasts do not include any future M&A. While new factories and deals could take Hanza to SEK6.5bn in sales 2025, considering the lead times on both deals and, especially factories, we believe M&A is necessary to reach the target.

Management seems confident in reaching SEK6.5bn and an 8% EBITA margin in 2025. However, management is more confident in reaching the 8% EBITA margin than the SEK6.5bn sales target. The current operations can reach 8% while management more or less confirms that an acquisition is necessary to reach the sales target.

Estimate Revisions						
Sales	**FYE 2024**	**Old**	**Change**	**FYE 2025**	**Old**	**Change**
Net sales	4886	5027	-3%	5229	5523	-5%
Y/Y Growth (%)	18%	21%		7%	10%	
Main Markets	2883	3023	-5%	3054	3325	-8%
Y/Y Growth (%)	23%	29%		6%	10%	
EBITA (MM)	183	193	-6%	282	291	-3%
EBITA margin	6%	6%		9%	9%	
Other Markets	1995	1998	0%	2175	2198	-1%
Y/Y Growth (%)	12%	12%		9%	10%	
EBITA (OM)	71	87	-18%	146	155	-6%
EBITA margin	4%	4%		7%	7%	
Earning						
EBITA	296	291	2%	421	440	-4%
EBITA Margin (%)	*6.1%*	*5.8%*		*8.1%*	*8.0%*	
EBIT	262	265	-1%	398	417	-5%
EBIT Margin (%)	*5.4%*	*5.3%*		*7.6%*	*7.6%*	
Diluted EPS	2.78	2.38	17%	4.50	4.75	-5%

Source: Hanza & Redeye Research

Forecasts								
Sales	**FYA 2023**	**Q1A 2024**	**Q2A 2024**	**Q3A 2024**	**Q4E 2024**	**FYE 2024**	**FYE 2025**	**FYE 2026**
Net sales	4144	1253	1221	1107	1305	4886	5229	5647
Y/Y Growth (%)	17%	18%	14%	16%	24%	18%	7%	8%
Main Markets	2351	770	723	626	764	2883	3054	3299
Y/Y Growth (%)	19%	30%	20%	14%	26%	23%	6%	8%
EBITA (MM)	256	39	34	41	69	183	282	310
EBITA margin	11%	5%	5%	7%	9%	6%	9%	9%
Other Markets	1778	480	495	478	542	1995	2175	2349
Y/Y Growth (%)	13%	3%	8%	18%	21%	12%	9%	8%
EBITA (OM)	110	12	18	11	30	71	146	171
EBITA margin	6%	3%	4%	2%	6%	4%	7%	7%
Earning								
EBITA	345	67	50	82	97	296	421	476
EBITA Margin (%)	*8.3%*	*5.3%*	*4.1%*	*7.4%*	*7.4%*	*6.1%*	*8.1%*	*8.4%*
EBIT	328	61	43	68	90	262	398	455
EBIT Margin (%)	*7.9%*	*4.9%*	*3.5%*	*6.1%*	*6.9%*	*5.4%*	*7.6%*	*8.1%*
Diluted EPS	4.98	0.78	0.14	0.91	0.96	2.78	4.50	5.58

Source: Hanza & Redeye Research

Valuation

We raise our Base Case slightly to SEK 75 (73) following slightly cut short-and-mid-term forecasts and an impressive performance of Hanza considering the market environment. 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	**25**	**75**	**101**
Sales CAGR			
2024 - 2031	4%	6%	6%
2031 - 2041	1%	3%	4%
Avg EBIT margin			
2024 - 2031	7%	8%	9%
2031 - 2041	5%	9%	9%
Terminal EBIT Margin	6%	8%	9%
Terminal growth	2%	2%	2%
WACC	10%	10%	10%

Source: Redeye Research

Peer Valuation

After trading at a 25-30% discount on EV/EBIT in our Q2 Update, Hanza is now trading on par with the peer median. Following the strong relative performance in Hanza's operations recently, we believe a faded discount is reasonable. Given that Hanza continues to outperform we believe there is a case for the company trading at a premium to the peer median.

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	3 695	2 782	1.2	1.0	0.8	11.0	8.4	7.0	5%	18%	9%	11%	12%	12%
Kitron	7 475	8 266	0.9	0.8	0.7	10.9	8.9	7.6	-9%	12%	8%	8%	9%	9%
Nolato	16 728	9 941	1.7	1.6	1.4	17.8	15.5	13.6	4%	7%	7%	9%	10%	11%
Scanfil	6 116	10 226	0.6	0.6	0.5	8.9	8.0	7.3	-5%	5%	5%	7%	7%	7%
Inission	1 289	2 348	0.5	0.5	0.4	7.7	6.7	5.7	7%	5%	5%	7%	7%	8%
NCAB	12 692	4 068	3.1	2.7	2.5	23.0	19.4	17.2	0%	11%	7%	14%	14%	15%
Hanza	3 416	4 886	0.7	0.6	0.6	13.0	8.2	7.1	18%	7%	8%	5%	8%	8%
Average	**7 344**	**6 074**	**1.3**	**1.1**	**1.0**	**13.2**	**10.7**	**9.4**	**3%**	**9%**	**7%**	**8.8%**	**9.5%**	**9.9%**
Median	**6 116**	**4 886**	**0.9**	**0.8**	**0.7**	**11.0**	**8.4**	**7.3**	**4%**	**7%**	**7%**	**8.3%**	**8.8%**	**9.1%**

Source: Redeye, Company reports, FactSet

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 75

Our DCF model shows a fair value of SEK 75, 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	4,961.3	5,240.8	5,659.1	5,997.9
Cost of Revenue	2,334.0	2,856.3	3,241.8	3,501.2	3,711.2
Operating Expenses	1,345.3	1,571.6	1,395.3	1,492.0	1,569.2
EBITDA	464.7	458.4	591.7	653.9	705.4
Depreciation	65.6	86.4	86.7	94.6	108.8
Amortizations	17.0	33.6	23.4	20.7	16.8
EBIT	328.0	262.4	397.8	454.8	496.1
Shares in Associates	0.0	0.0	0.0	0.0	0.0
Interest Expenses	-80.0	-128.0	-160.0	-160.0	-160.0
Net Financial Items	80.0	128.0	160.0	160.0	160.0
EBT	248.0	134.4	237.8	294.8	336.1
Income Tax Expenses	-33.0	-12.6	-40.4	-50.1	-57.1
Net Income	215.0	121.9	197.4	244.7	278.9

Balance sheet

Assets

Non-current assets

SEKm	2023	2024e	2025e	2026e	2027e
Property, Plant and Equipment (Net)	714.0	891.0	1,028.3	1,182.2	1,336.8
Goodwill	387.0	524.0	524.0	524.0	524.0
Intangible Assets	77.0	133.4	110.1	89.4	72.6
Right-of-Use Assets	186.0	272.0	272.0	272.0	272.0
Other Non-Current Assets	23.0	41.0	41.0	41.0	41.0
Total Non-Current Assets	1,387.0	1,861.5	1,975.3	2,108.5	2,246.3

Current assets

SEKm	2023	2024e	2025e	2026e	2027e
Inventories	936.0	1,172.7	1,150.3	1,242.4	1,316.9
Accounts Receivable	175.0	244.3	235.3	254.1	269.4
Other Current Assets	91.0	146.6	156.9	169.4	179.6
Cash Equivalents	340.0	440.1	588.5	617.8	671.1
Total Current Assets	1,542.0	2,003.7	2,131.0	2,283.7	2,436.9
Total Assets	2,929.0	3,865.2	4,106.3	4,392.2	4,683.3

Equity and Liabilities

Equity

SEKm	2023	2024e	2025e	2026e	2027e
Non Controlling Interest	0.0	0.0	0.0	0.0	0.0
Shareholder's Equity	1,345.0	1,473.9	1,640.7	1,835.8	2,053.3

Non-current liabilities

SEKm	2023	2024e	2025e	2026e	2027e
Long Term Debt	326.0	513.0	513.0	513.0	513.0
Long Term Lease Liabilities	114.0	175.0	175.0	175.0	175.0
Other Non-Current Lease Liabilities	159.0	203.0	203.0	203.0	203.0
Total Non-Current Liabilities	599.0	891.0	891.0	891.0	891.0

Current liabilities

SEKm	2023	2024e	2025e	2026e	2027e
Short Term Debt	196.0	376.0	376.0	376.0	376.0
Short Term Lease Liabilities	53.0	64.0	64.0	64.0	64.0
Accounts Payable	450.0	635.2	679.7	734.1	778.2
Other Current Liabilities	286.0	425.1	454.9	491.3	520.8
Total Current Liabilities	985.0	1,500.3	1,574.6	1,665.4	1,738.9
Total Liabilities and Equity	2,929.0	3,865.2	4,106.3	4,392.2	4,683.3

Cash flow

SEKm	2023	2024e	2025e	2026e	2027e
Operating Cash Flow	277.0	588.8	486.7	411.1	461.8
Investing Cash Flow	-296.0	-562.7	-223.9	-248.5	-263.4
Financing Cash Flow	217.0	135.1	-114.4	-133.3	-145.2

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.

The team

MANAGEMENT

Björn Fahlén
bjorn.fahlen@redeye.se

Tomas Otterbeck
tomas.otterbeck@redeye.se

EDITORIAL

Jesper Von Koch
jesper.vonkoch@redeye.se

Joel Karlsson
joel.karlsson@redeye.se

TECHNOLOGY TEAM

Anton Hoof
anton.hoof@redeye.se

Fredrik Nilsson
fredrik.nilsson@redeye.se

Fredrik Reuterhäll
fredrik.reuterhall@redeye.se

Henrik Alveskog
henrik.alveskog@redeye.se

Hjalmar Ahlberg
hjalmar.ahlberg@redeye.se

Jacob Benon
jacob.benon@redeye.se

Jessica Grunewald
jessica.grunewald@redeye.se

Martin Wahlström
martin.wahlstrom@redeye.se

Mattias Ehrenborg
mattias.ehrenborg@redeye.se

Niklas Sävås
niklas.savas@redeye.se

Oskar Vilhelmsson
oskar.vilhelmsson@redeye.se

Rasmus Jacobsson
rasmus.jacobsson@redeye.se

LIFE SCIENCE TEAM

Christian Binder
christian.binder@redeye.se

Filip Einarsson
filip.einarsson@redeye.se

Filip Lindkvist
filip.lindkvist@redeye.se

Fredrik Thor
fredrik.thor@redeye.se

Gustaf Meyer
gustaf.meyer@redeye.se

Johan Unnerus
johan.unnerus@redeye.se

John Westborg
john.westborg@redeye.se

Kevin Sule
kevin.sule@redeye.se

Mats Hyttinge
mats.hyttinge@redeye.se

Oscar Bergman
oscar.bergman@redeye.se

Richard Ramanius
richard.ramanius@redeye.se

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