

Hexatronic

Sector: Capital Goods

Stunning Growth

Redeye raises its Base Case and forecasts following a Q1 report beating our estimates significantly. Sales in the strategic growth markets accelerate faster than we thought, and the scalability was proven solid. We expect the strong operational momentum to continue.

Sales and EBITA Beating Our Forecasts by 33% and 52%

Sales and EBITA were in line with the preliminary figures released April 13, showing a sales growth of 119% (73% organic) and a record high EBITA margin of 13.3%. Both sales and EBITA crushed our forecasts, being 33% and 52% above. Cost increases that have not been passed on to customers yet negatively impacted margins of 1-2%, making the 13.3% even more impressive.

Still Much Left to Build

Despite Hexatronic's significant acceleration of sales growth, the FTTH/B penetration in the strategic growth markets remains at low levels. In September 2021, the FTTH/B penetration in the US was 20%. Although the UK and Germany data date to September 2020, their rates were a mere ~5%. Also, according to management, the market activity in the strategic growth markets is not yet on par with the Swedish market peak in 2017.

New Base Case SEK 400 – New Bull Case SEK 570

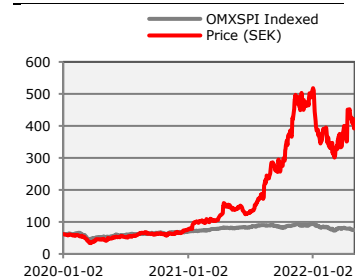
We raise our sales and EBITA forecasts by 15% and 25% for 2022E and 2023E, following the strong momentum in the strategic growth markets and the positive outlook. We increase our Base Case to SEK 400 (330) and our Bull Case to SEK 575 (500) and considering Hexatronic's solid operational momentum, which we expect will continue, we would not be surprised to see a share price in line with our Bull Case.

Key Financials (SEKm)	2020	2021	2022E	2023E	2024E
Net sales	2081	3492	5618	6849	8260
Revenue growth	13%	68%	61%	22%	21%
EBITDA	263	459	857	1094	1329
EBIT	167	325	672	902	1118
EBIT Margin (%)	8%	9%	12%	13%	14%
Net Income	117	222	488	678	850
EV/Revenue	1.5	6.0	2.8	2.2	1.8
EV/EBITDA	12.1	45.7	18.2	14.1	11.4
EV/EBIT	19.1	64.7	23.2	17.1	13.6

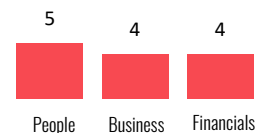
FAIR VALUE RANGE

BEAR	BASE	BULL
250	400	575

HTRO VERSUS OMXS30



REDEYE RATING



KEY STATS

Ticker	HTRO
Market	Large Cap
Share Price (SEK)	405
Market Cap (SEKm)	16452
Net Debt (SEKm)	795
Free Float (%)	84
Avg. daily volume ('000)	115 910

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Exceptional Q1 – In Line with Preliminary Figures

	Q1 E 2022	Q1 A 2022	Diff	Q1 A 2021	Q4 A 2021
Sales	1 043.0	1 388.5	33.1%	634.8	1 169.5
Y/Y Growth (%)	64.3%	118.7%		34.2%	129.6%
Gross Profit	448.0	578.2	29.1%	292.3	491.3
Gross Profit Margin (%)	43.0%	41.6%		46.0%	42.0%
EBITA	121.0	184.3	52.3%	63.5	122.8
EBITDA Margin (%)	11.6%	13.3%		10.0%	10.5%
EBIT	110.0	170.9	55.4%	56.6	108.7
EBIT Margin (%)	10.5%	12.3%		8.9%	9.3%
EPS	2.00	2.98	49.0%	1.03	1.81

Source: Hexatronic & Redeye Research

Sales beat our forecast by an exceptional 33%, following very high growth mainly in the US and the UK. Sales growth was 119% y/y, and the organic growth was impressive 73%. Both the organic growth and the contribution from acquisitions beat our estimates. Considering that shortages of skilled workers have been an issue holding back fiber expansion in many countries, we believe Hexatronic's strong sales growth indicates the company is gaining market share.

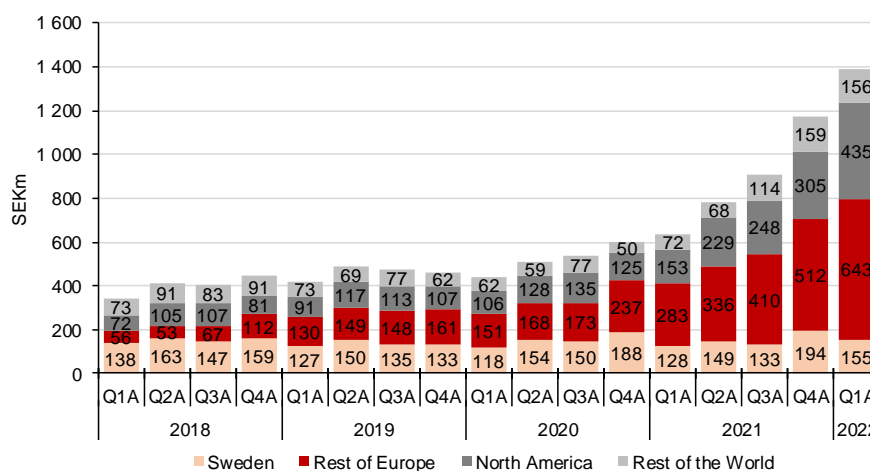
EBITA was SEK 184m (64), beating our forecast of SEK 121m by 52%. The EBITA margin reached a record high level of 13.3% (10.0) because of high utilization in most factories. However, Hexatronic has not managed to fully offset increasing material costs by price increases at this point. According to management, the increased material costs had a negative effect of about 1-2%-points on the gross margin. As costs have continued to increase during Q1 following the Russian invasion of Ukraine, we will likely see a negative effect in Q2 as well. Thus, while we are impressed by the 13.3% margin in the quarter, given that Hexatronic can pass on most price increases, which we find likely, there is potential for EBITA margins of about 14-15%.

The order book remains solid, and management's outlook seems very positive. The demand is strong in all three strategic growth markets, and management seems especially excited about the US, which is interesting considering the above-average margins in the US market. The Biden infrastructure deal includes USD 65bn targeting broadband, and some of its other parts of are relevant for Blue Diamond (duct). Also, activity levels in the strategic growth markets are still not on par with the peak in the Swedish market.

In the report, Hexatronic mentioned increasing its investment in the new duct factory in South Carolina. While the facility is two months late relative to the plan, it is expected to start producing by Q4 2022. To keep up with the increasing demand, Hexatronic will invest an additional SEK 150m in the factory (the initial investment was USD 18m).

As for last quarter, demand seems to remain solid in all strategic growth markets, and Sweden holds up well, increasing sales 22% y/y following improving demand in FTTH and transport network. However, we expect roughly flat sales in Sweden for the FY 2022. Despite increased costs for freight and materials, Hexatronic managed to raise its EBITA margin significantly y/y. Thus, we are impressed by the performance, and we have obviously underestimated the business for yet another quarter.

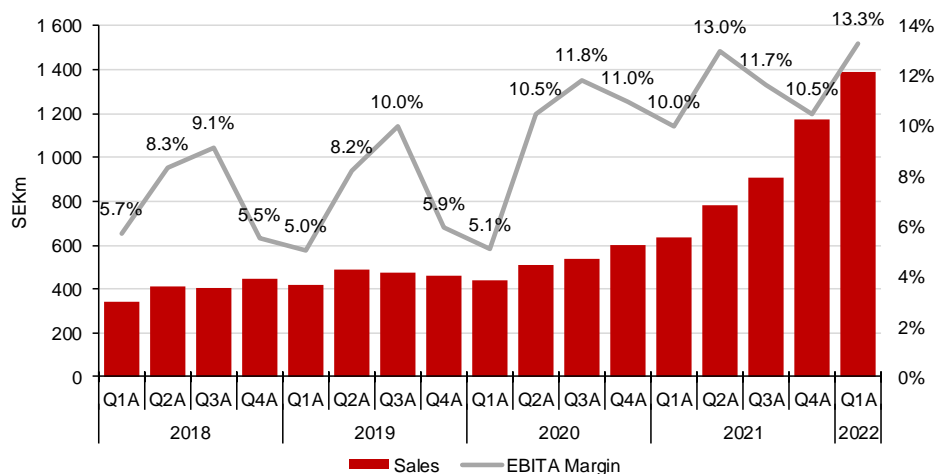
Hexatronic – Sales by Region



Source: Redeye Research, Hexatronic

As seen in recent quarters, following strong organic growth and M&A, the Rest of Europe and North America continued to grow in importance. During Q1 2022, 78% of Hexatronic’s sales were generated in North America and the Rest of Europe. Thus, the investments made in new markets following the Swedish market peak in 2017 have started to pay off significantly in 2021 and continues to do so in 2022. Considering the strong momentum in the US, the UK and Germany, we expect the share to increase further.

Hexatronic – Sales and EBITA margin



Source: Redeye Research, Hexatronic

Note that the underlying margin has continued to improve during Q3 and Q4 2021, while the headline number was negatively affected by incentive program-related one-offs.

As highlighted in the graph above and as mentioned earlier, Hexatronic has seen solid scalability following its accelerating sales growth. Considering the 1-2% point decline in gross margins related to costs increases that have not been passed on to customers yet, the underlying improvement is even better. However, most factories are currently running close to 100% capacity, which could dampen the short-term margin expansion potential.

Financial Forecasts

Following the much stronger Q1 report than we expected, both in terms of sales and margins, combined with a solid outlook, we make significant increases to our forecasts. We raise our sales forecasts for 2022E and 2023E by ~15% and increase our EBITA forecasts by 25%. Considering that Hexatronic reached 13.3% despite seeing a negative effect from rapid cost increases on the gross margin, our previous forecast of ~12.5% in EBITA margin seems too defensive. Also, while the utilization is close to 100% in many factories, the higher sales should result in some scalability, and the new duct facility in South Carolina is expected to open in Q4 2022.

Our sales growth assumption for 2022 of 61% might seem high, but it is basically Q1 times four plus some additional q/q growth adjusted for seasonal patterns. Even if it implies a very high growth rate, we believe it is reasonable considering the pace set in Q1.

Regarding EBITA margins we forecast 13.1% and 14.0% for 2022E and 2023E. We expect the improvement to be driven mainly by passed-on cost increases. Considering management sees a negative effect of 1-2% from the cost increase, our assumptions imply the lower bound. Also, we expect the investment in South Carolina to have a short-term negative effect on margins over the next few quarters. Although, the long-term effects of another duct plant in the US are most likely positive for margins.

The estimate revisions are slightly higher than what we indicated in our Note about the preliminary figures.

	FYE 2022	Old	Change	FYE 2023	Old	Change
Sales	5 618	4 891	14.9%	6 849	5 967	14.8%
Y/Y Growth (%)	60.9%			21.9%		
Gross Profit	2 363	2 177	8.6%	2 945	2 673	10.2%
Gross Profit Margin (%)	42.1%	44.5%		43.0%	44.8%	
OPEX	(1 530)	(1 492)	2.6%	(1 883)	(1 814)	3.8%
Y/Y Growth (%)	42.4%	38.8%		23.1%	21.6%	
EBITA	737	601	22.6%	958	756	26.7%
EBITA Margin (%)	13.1%	12.3%		14.0%	12.7%	
EBIT	684	553	23.7%	902	715	26.1%
EBIT Margin (%)	12.2%	11.3%		13.2%	12.0%	
EPS	12.30	10.60	16.0%	16.70	13.80	21.0%

Source: Hexatronic & Redeye Research

We expect operational momentum to continue over the next years. For 2023 and 2024, we estimate organic growth rates of about 20%, driven by the strategic growth markets, the UK, the US, and Germany.

We believe margins will continue to improve over the next years. While the utilization rates are high in many factories, we believe Hexatronic can obtain some scale advantages when expanding its current production facilities. Also, an increasing share of revenues from the USA should support margins going forward.

	FYA 2021	Q1A 2022	Q2E 2022	Q3E 2022	Q4E 2022	FYE 2022	FYE 2023	FYE 2024
Sales	3 492	1 389	1 421	1 363	1 446	5 618	6 849	8 260
Y/Y Growth (%)	67.8%	118.7%	81.7%	50.5%	23.7%	60.9%	21.9%	20.6%
Sweden	603	155	156	143	194	649	662	675
Y/Y Growth (%)	(1.2%)	21.7%	5.0%	8.0%	0.0%	7.6%	2.0%	2.0%
Rest of Europe	1 541	643	680	661	666	2 649	3 298	4 057
Y/Y Growth (%)	111.5%	127.4%	102.2%	61.4%	30.0%	72.0%	24.5%	23.0%
North America	935	435	421	391	397	1 644	2 064	2 539
Y/Y Growth (%)	89.4%	184.5%	84.1%	57.6%	30.0%	75.8%	25.5%	23.0%
Rest of the World	413	156	163	167	190	676	824	989
Y/Y Growth (%)	66.2%	116.9%	140.1%	45.8%	20.0%	63.8%	22.0%	20.0%
Gross Profit	1 534	578	595	575	615	2 363	2 945	3 552
Gross Profit Margin (%)	43.9%	41.6%	41.9%	42.2%	42.5%	42.1%	43.0%	43.0%
OPEX	(1 075)	(373)	(388)	(372)	(398)	(1 530)	(1 883)	(2 255)
Y/Y Growth (%)	59.4%	25.0%	22.8%	23.1%	21.5%	42.4%	23.1%	19.7%
EBITA	393	184	182	178	192	737	958	1 174
EBITA Margin (%)	11.3%	13.3%	12.8%	13.1%	13.3%	13.1%	14.0%	14.2%
EBIT	355	171	169	165	179	684	902	1 118
EBIT Margin (%)	10.2%	12.3%	11.9%	12.1%	12.3%	12.2%	13.2%	13.5%
EPS	6.52	2.98	3.08	3.00	3.26	12.30	16.70	20.93

Source: Hexatronic & Redeye Research

Investment Case

Excellent position in exciting segment

Hexatronic has a strong and complete product offering in the attractive FTTH segment, with an excellent geographic market mix. High quality, unique yet cost-efficient solutions and a focus on systems sales, distinguish the company. It has managed to build a strong platform in its chosen growth markets, the US, UK, and Germany, through a series of successful acquisitions, and appears very well positioned to capitalise on the expected acceleration of growth.

A real quality name in Redeye's universe

Applying Redeye's company rating model, we rate Hexatronic as a true quality name. It scores very well in all key areas, such as business fundamentals, financials, and people. It has a strong position and brand in the market, it is profitable and cash generative with a strong outlook and is also backed by a strong balance sheet. We feel the company is very well run, mixing favourable organic growth prospects with acquired growth for promising compounding effects. In addition, its ESG credentials are outstanding, in our view

Core markets poised for structural growth

We believe the key, large, international markets, the US, UK, and Germany, are in an early stage of a prolonged and strong growth period. Activity levels are currently high and increasing, and we expect demand to continue to strengthen going forward.

Strong momentum likely to further accelerate

Hexatronic enjoyed growing momentum in 2020, topped by a very strong final quarter – the order backlog is now extremely strong. We believe these trends have continued into the early part of 2021 and predict a strong demand environment for multiple years. Indeed, we may be observing an inflection point – should the corona crisis begin to fade, a further boost is, in fact, likely as Hexatronic has faced significant challenges due to the imposed restrictions.

Counter Thesis

Possible price pressure

Hexatronic operates in fiercely competitive markets, and some of its customers are large players. Cost and price are always a delicate dimension, and there is always the risk that some of the margin improvements the company achieves simply will filter through to its customers.

Chinese imports

There is also the risk of ultra-cheap imports from China disturbing the European market especially. There is, however, a pending anti-dumping case which may lead to tariffs being implemented, lending protection.

What about the very long term?

Hexatronic finds itself in the interesting situation of looking at a huge wave of demand approaching, but also not knowing what may come afterwards. When FTTH is fully deployed, there will not be much business left in that field. Management is fully aware of this, and efforts are being made to start exploring natural prospects that could be added to the concern in the very long term. *What does Hexatronic do in 2035?*

Valuation

Bear Case 250 SEK

- Average sales growth of ~14% 2023-2030
- Average EBITA margin of ~12% 2023-2030
- Average sales growth of ~-7% 2031-2034
- Terminal growth rate of 2%
- Terminal EBITA margin of ~6%

Base Case 400 SEK

- Average sales growth of ~17% 2023-2030
- Average EBITA margin of ~14% 2023-2030
- Average sales growth of ~-5% 2031-2034
- Terminal growth rate of 2%
- Terminal EBITA margin of ~9%

Bull Case 575 SEK

- Average sales growth of ~21% 2023-2030
- Average EBITA margin of ~17% 2023-2030
- Average sales growth of ~4% 2031-2034
- Terminal growth rate of 2%
- Terminal EBITA margin of ~12%

We raise our Base Case to SEK 400 (330).

Our new Bull Case is SEK 575 (500). While the Bull Case assumes slightly higher growth and margins 2023-2030, the main difference is in the 2030-terminal period. Unlike our Base Case, where we expect the strategic growth markets to have negative sales growth from 2030 and onwards (like in Sweden post-2017), our Bull Case assumes flat sales and minor margin declines.

In our Bull Case, we expect Hexatronic to increase its sales from non-FTTH sources until 2030 fast enough to limit the expected downturn in FTTH. While Hexatronic has exposure to harsh environment, core networks, 5G, farming, and data centers, the bulk of revenues are generated from FTTH. However, Hexatronic has a solid M&A track record, and several recent acquisitions, such as DCS and Weterings have added exposure to non-FTTH segments. Also, there are likely at least ten years left until the FTTH-boom is over in the strategic growth markets. Thus, Hexatronic has plenty of time to add additional sources of revenue until then, and M&A will likely play a major role.

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

Hexatronic has a strong management team of entrepreneurial people with plenty of skin in the game. CEO has significant experience from the telecom industry. Staff at other key positions, that joined the group through last year's acquisitions, are also intact. The company has delivered so far on their financial goals.

Business: 4

Due to the competitive situation, product differentiation appears to be difficult, thus the price will always be an issue. Hexatronic is a small player compared to some of the dominant multinational companies. Surely that means growth opportunities but also challenges.

Financials: 4

In our view, Hexatronic is very financially stable and receives a good score in most subcategories. Overall we view Hexatronic's profitability levels as compelling and improving. We see some risks for new rights issues given the strong focus on acquisitions, still if the acquisition is done at good prices and creates value this will not be an issue.

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 (2022-05-04)

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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