

Hexatronic

Sector: Capital Goods

Investments Paying Off

Redeye raises its Base Case and forecasts following a Q2 report beating our estimates significantly and a strong outlook. While sales in the strategic growth markets accelerated faster than we thought, the quarter's highlight was the record-high EBITA margin.

Strong Sales and Outlook

Sales beat our forecasts by 17%, following stronger than expected organic and acquired growth. Organic growth was 60%, driven mainly by the US, the UK, and Sweden, boosted by a large submarine cable order. While management sees a risk for fiber (which Hexatronic makes fiber cables out of) shortage dampening growth in 2023, the outlook is positive and strengthened by a large FTTH system deal in the US.

Stunning Margins

While Hexatronic has had several quarters of excellent organic growth, the EBITA margin took a giant leap this quarter, hitting a record high of 16.7%. High utilization in most factories, a favorable sales mix, and robust growth in the high-margin US, all contributed to the high number. Although we do not assume as high as 16.7% going forward, the quarter highlights the potential in Hexatronic's business as previous investments in the strategic growth markets are paying off big.

New Base Case SEK 95 (90)

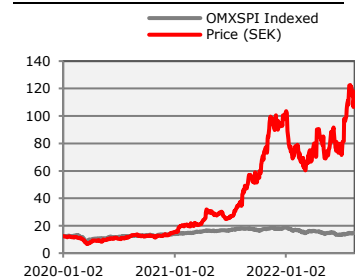
We raise our sales and EBITA forecasts by about 13% and 30% for 2022E and 2023E, in line with our preliminary revisions following Hexatronic's preliminary figures released July 11. We raise our Base Case to SEK 95 (90) due to slightly higher margin assumptions for the long term. We leave our Bear Case unchanged at SEK 60 and raise our Bull Case to SEK 142 (125), as the quarter's high margins make us more favorable to the margin potential in an optimistic scenario.

Key Financials (SEKm)	2020	2021	2022E	2023E	2024E
Net sales	2081	3492	6318	7741	9357
Revenue growth	13%	68%	81%	23%	21%
EBITDA	278	492	1087	1348	1641
EBIT	209	397	949	1208	1482
EBIT Margin (%)	10%	11%	15%	16%	16%
Net Income	131	255	654	870	1087
EV/Revenue	1.5	6.0	3.8	3.0	2.5
EV/EBITDA	15.2	52.9	25.2	19.5	15.7
EV/EBIT	17.5	58.7	26.7	20.5	16.3

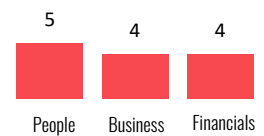
FAIR VALUE RANGE

BEAR	BASE	BULL
60	95	142

HTRO VERSUS OMXS30



REDEYE RATING



KEY STATS

Ticker	HTRO
Market	Large Cap
Share Price (SEK)	113.6
Market Cap (SEKm)	23 080
Net Debt (SEKm)	807
Free Float (%)	83
Avg. daily volume ('000)	100 930

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Exceptional Quarter Again – In Line with Preliminary Figures

	Q2E 2022	Q2A 2022	Diff	Q2A 2021	Q1A 2022
Sales	1 420.8	1 662	17.0%	782.0	1 388.5
Y/Y Growth (%)	81.7%	112.5%		68.8%	159.8%
Sweden	156.2	244.1	56.2%	148.8	155.2
Y/Y Growth (%)	5.0%	64.0%		-2.7%	17.2%
Rest of Europe	680.1	747.5	9.9%	336.4	642.5
Y/Y Growth (%)	102.2%	122.2%		109.3%	272.5%
North America	421.2	524.2	24.4%	228.8	435.3
Y/Y Growth (%)	84.1%	129.1%		114.5%	222.0%
Rest of the World	163.2	145.9	(10.6%)	68.0	155.5
Y/Y Growth (%)	140.1%	114.6%		9.1%	102.2%
Gross Profit	595.3	705.9	18.6%	357.4	578.2
Gross Profit Margin (%)	41.9%	42.5%		45.7%	41.6%
OPEX	(387.9)	(408.6)	5.3%	(250.2)	(372.6)
Y/Y Growth (%)	55.0%	63.3%		45.0%	137.9%
EBITA	182.4	278.0	52.4%	101.6	184.3
EBITDA Margin (%)	12.8%	16.7%		13.0%	13.3%

Source: Hexatronic & Redeye Research

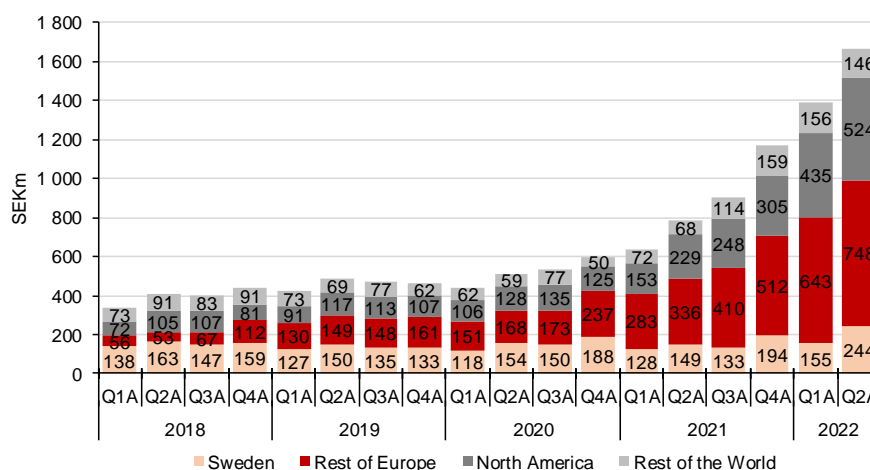
Sales beat our forecast by 17%, following high growth mainly in the US, the UK, and Sweden, thanks to a large submarine cable order. Sales growth was 113% y/y, and the organic growth was impressive 60%. Both the organic growth and the contribution from acquisitions beat our estimates. Although price increases had a positive effect on growth, we believe higher volumes drove the bulk.

While sales, as mentioned, beat our forecasts by 17%, considering Hexatronic's strong track record and the rapid increase in activity in the strategic growth market, we believe it is a strong but not exceptional beat. However, we are impressed by the substantial EBITA margin increase, and EBITA beat our forecast by 52%. The EBITA margin hit a record high level of 16.7%, far above the company's >12% target. The strong margin resulted from low OPEX relative to sales, which fell to 24.6% of sales (32) as the gross margin declined to 42.5% (45.7). The changing cost mix results from higher material costs (not fully compensated for yet), high utilization at factories, and acquisitions with lower gross margins and OPEX compared to the group average. We believe gross margins will remain at this level throughout 2022 with a gradual improvement during 2023, as some material prices have continued to increase.

The high demand in every market resulted in solid scalability, lifting margins. Also, strong sales in the US, with above-average margins and a favorable sales mix, had a positive. While we do not expect 16.7% for the upcoming quarters, we have most likely been too defensive in our margin assumptions before this report. Apparently, the investments taken in the strategic growth markets (the US, the UK, and Germany) since ~2017-2018, were more potent than we thought.

As for last quarter, demand seems to remain solid in all strategic growth markets, with the US in particular beating our forecasts by 24%. Both the duct and FTTH system businesses had a strong Q2, and just after the end of the quarter, Hexatronic won a FTTH system deal worth at least USD 40m over three years - another sign the FTTH system offering is gaining traction in the USA. Sweden, where we do not expect any material growth, grew by 64% y/y in Q2, mainly thanks to a large submarine cable order. This highlights Hexatronic's opportunities outside of the FTTH market.

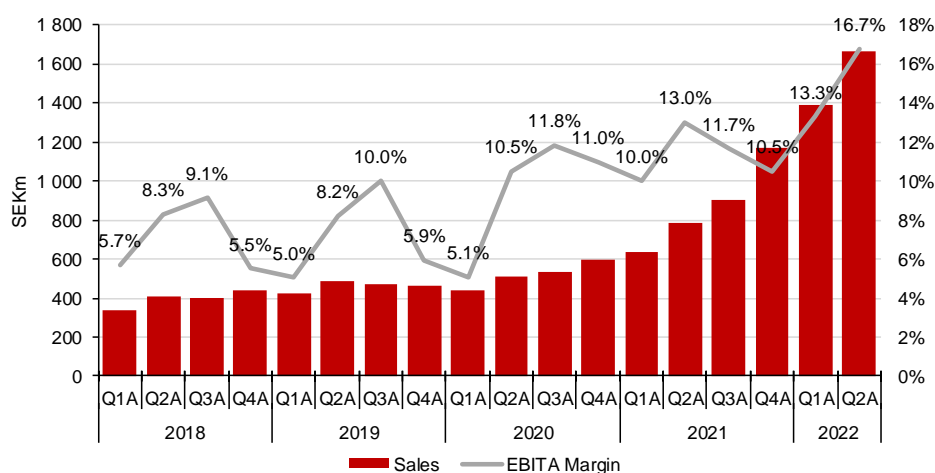
Hexatronic -- Sales by Region



Source: Redeye Research, Hexatronic

The EBITA margin reached a new record high of 16.7% and the solid trend with steadily increasing margins continued.

Hexatronic -- Sales and EBITA margin



Source: Redeye Research, Hexatronic

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

Financial Forecasts

We leave our forecasts largely in line with [our revisions](#) following the preliminary figures published on July 11. That means a ~13% increase in sales and gross margins for 2022 and 2023. We believe the current run rate and management's positive outlook combined with fiber penetration expansion forecasts support upward revisions, although potential fiber shortages are a risk. We assume Hexatronic's investments in additional production capabilities will be enough to support robust growth in 2023 as well, although with a slower growth rate compared to 2022.

The biggest raise regards margins; we raise 2022 and 2023 to 15-16% on the EBITA level. Lower than in Q2 but way above the R12m figure of about 14%. While the product mix was favorable in Q2 and as new investments will drive OPEX near-term, we believe increasing levels on an R12m basis is reasonable, as scalability on new sales should be high as well.

	FYE 2022	Old	Change	FYE 2023	Old	Change
Sales	6 318	5 618	12.5%	7 741	6 849	13.0%
Y/Y Growth (%)	81.0%	60.9%		22.5%	21.9%	
Gross Profit	2 673	2 363	13.1%	3 328	2 945	13.0%
Gross Profit Margin (%)	42.3%	42.1%		43.0%	43.0%	
OPEX	(1 631)	(1 530)	6.6%	(2 013)	(1 883)	6.9%
Y/Y Growth (%)	51.7%	42.4%		23.4%	23.1%	
EBITA	948	737	28.7%	1 208	958	26.1%
EBITA Margin (%)	15.0%	13.1%		15.6%	14.0%	
EBIT	894	684	30.8%	1 148	898	27.9%
EBIT Margin (%)	14.2%	12.2%		14.8%	13.1%	
EPS	3.21	2.46	30.6%	4.28	3.32	28.9%

Source: Hexatronic & Redeye Research

We expect operational momentum to continue over the next years. For 2023, 2024, and 2025, 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 (relative R12m), and the Q2 report strongly indicates such levels are possible. 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	Q1 A 2022	Q2A 2022	Q3E 2022	Q4E 2022	FYE 2022	FYE 2023	FYE 2024	FYE 2025
Sales	3 492	1 389	1 662	1 572	1 696	6 318	7 741	9 357	11 104
Y/Y Growth (%)	67.8%	118.7%	112.5%	73.7%	45.0%	81.0%	22.5%	20.9%	18.7%
Sweden	603	155	244	143	194	737	673	687	700
Y/Y Growth (%)	(1.2%)	21.7%	64.0%	8.0%	0.0%	22.2%	(8.6%)	2.0%	2.0%
Rest of Europe	1 541	643	748	764	794	2 947	3 717	4 572	5 486
Y/Y Growth (%)	111.5%	127.4%	122.2%	86.4%	55.0%	91.3%	26.1%	23.0%	20.0%
North America	935	435	524	516	534	2 009	2 587	3 183	3 819
Y/Y Growth (%)	89.4%	184.5%	129.1%	107.6%	75.0%	114.8%	28.8%	23.0%	20.0%
Rest of the World	413	156	146	150	174	625	763	916	1 099
Y/Y Growth (%)	66.2%	116.9%	114.6%	30.8%	10.0%	51.6%	22.0%	20.0%	20.0%
Gross Profit	1 534	578	706	667	722	2 673	3 328	4 023	4 775
Gross Profit Margin (%)	43.9%	41.6%	42.5%	42.4%	42.6%	42.3%	43.0%	43.0%	43.0%
OPEX	(1 075)	(373)	(409)	(409)	(441)	(1 631)	(2 013)	(2 414)	(2 843)
Y/Y Growth (%)	59.4%	28.9%	23.2%	22.6%	19.7%	51.7%	23.4%	19.9%	17.8%
EBITA	393	184	278	231	254	948	1 208	1 482	1 785
EBITA Margin (%)	11.3%	13.3%	16.7%	14.7%	15.0%	15.0%	15.6%	15.8%	16.1%
EBIT	355	171	264	218	241	894	1 148	1 422	1 725
EBIT Margin (%)	10.2%	12.3%	15.9%	13.9%	14.2%	14.2%	14.8%	15.2%	15.5%
EPS	1.30	0.60	0.93	0.80	0.89	3.21	4.28	5.35	6.51

Source: Hexatronic & Redeye Research

Also, following the solid growth in Sweden, highlighting Hexatronic's opportunities outside of FTTH, and the strong margin in the quarter, we have raised our very-long term assumptions slightly; see valuation segment for details.

Investment Case

Case

Pole position in the boom for digital highways

Considering Hexatronic's solid position in large immature markets like the US, the UK, and Germany (~40x the Swedish market), we believe the company can sustain revenue growth of ~20 percent until 2025. To stay competitive, these countries need to improve their FTTH coverage and—regardless of whether they invest in fixed FTTH or 5G—fiber is the foundation. Following the Covid-19 pandemic, investments have picked up significantly as the need for high-quality digital infrastructure has proven evident. Ongoing sales growth and improving margins are the main catalysts.

Evidence

Proven record in several major markets with easily deployed high-quality system solutions

Following large investments and acquisitions in the US, the UK, and Germany, sales in these markets have surged and now represent ~75 percent of group sales. Yet, these markets are only now beginning their fiber rollouts. Hexatronic has gained market share thanks to its high-quality and easily deployed system solutions, especially among small and medium-sized customers with limited in-house know-how. This vigorous growth has been accompanied by rising margins thanks to higher utilization rates in Hexatronic's factories.

Challenges I

Boom-and-bust FTTH cycle pushes risks to the very long term

Hexatronic's sales in Sweden have declined by about 30 percent from their peak in 2017, yet about 50 percent of sales relate to FTTH. While Hexatronic has other sources of sales, such as transportation networks and submarine cables, FTTH is of great importance. Although the US, the UK, and German FTTH markets will likely remain robust until 2030, at least, we believe finding new revenue streams will be crucial for Hexatronic in the very long term. New markets and related verticals (like DCS) are feasible options.

Challenges II

Possible price pressure

Hexatronic operates in fiercely competitive markets, and some of its customers are large players. Cost and price are always a delicate balance, and there is always the risk that some of its achieved margin improvements simply filter through to customers. However, Hexatronic has an edge thanks to its high-quality easily deployed system solutions, especially in the current environment, where shortages of technicians are slowing the rollouts.

Counter-Thesis

- **Failure to mitigate long-term FTTH decline**
- **Competitors mimicking the easily deployed system solutions**

Company Description

Background

Hexatronic is a technology group listed on Large Cap Stockholm. The group comprises ~50 companies with around ~1,300 employees and its headquarters are in Gothenburg. Hexatronic develops and manufactures most of its products at its cabling factory in Hudiksvall and its several duct factories in the US and on continental Europe, while complementing with some third-party components. In addition to its products, Hexatronic offers field support and training services to ensure a successful rollout for its customers.

While its production is scalable if the factories do not reach 100 percent utilization, Hexatronic's know-how is scalable and is the key to its offering. Most of its revenues are not recurring; the fiber and duct are produced and then laid down in the ground, lasting ~40 years. However, most fiber rollout projects typically run for several years, bringing recurring orders from customers.

Value Proposition

Hexatronic provides a wide range of passive fiber infrastructure products and solutions mainly to telecom companies and network owners. However, its core offering is a complete fiber system solution that is easier to deploy than the competition. Hexatronic's offering is especially attractive to small and medium-sized customers, which often lack in-house fiber know-how.

Fiber networks are digital highways and a must for reliable high-speed internet. While the need for reliable high-speed internet has been strong for many reasons for years, the Covid-19 pandemic highlighted its importance for competitiveness, increasing the political will to invest in fiber.

Fiber is the only alternative to get high-speed internet. 5G and fixed wireless are both dependent on fiber for their back-ends. Considering 5G's short range, fiber is a necessary complement rather than a substitute.

Competitive Advantages

We do not believe Hexatronic has any obvious moats, as its products are themselves largely indistinguishable from the competition. We see Hexatronic's convenient deployment and system know-how as competitive advantages that come close to a process moat. While Hexatronic is unique in its process in the important US market, some competitors in the European market do have a similar offering. As the market is currently suffering from a lack of technicians, we believe having an easily deployed solution is a substantial competitive advantage at present.

Business Strategy

In the wake of the FTTH/B market peak in Sweden in 2017, Hexatronic expanded into the so-called "strategic growth markets" of the US, the UK, and Germany. These three are significantly larger markets than Sweden, with substantially lower FTTH/B penetration rates. Hexatronic's products are not the cheapest on the market; instead, it competes with fast and easily deployed full-service system solutions, making its offering especially attractive to smaller network owners, which often lack in-house know-how.

This full-service offering also includes training for technicians, a scarce resource that often slows down fiber rollouts. Hexatronic thus focuses on superior functionality and best relationships rather than the lowest price, where the competition from bigger players is tough.

To decrease its dependence on FTTH/B, Hexatronic has acquired several fiber-related businesses focusing on other areas. One example is DCS, a US company providing connectivity for data centers. Hexatronic can then utilize DCS's production facilities and know-how to serve new, yet related, markets.

SWOT

Strengths

- Easily deployed full-service system solutions
- Established position in several major markets
- Solid M&A record

Weaknesses

- Significant exposure to markets with boom-and-bust characteristics
- Sales growth requires higher capex
- Commodity-like products

Opportunities

- Strong position in several fast-growing markets with low fiber penetration
- Further acquisitions to enter new markets or to broaden the offering

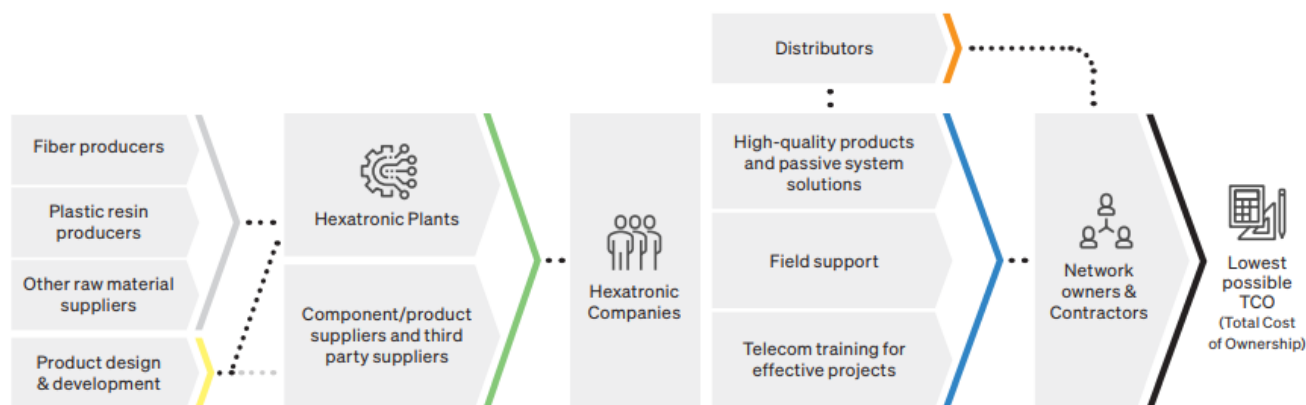
Threats

- Competitors taking easily deployed system solutions into the US
- Unable to pass on increasing material costs to customers

Business Overview

Hexatronic develops and manufactures most of its products at its cabling factory in Hudiksvall and its several duct factories in the US and on continental Europe, while complementing with some third-party components. In addition to its products, Hexatronic offers field support and training services to ensure a successful rollout for its customers. Hexatronic's main competitive advantage is its easily deployed system solution, while most competitors focus on products rather than full solutions. Hexatronic's system solution is especially attractive for smaller players, which typically lack in-house know-how.

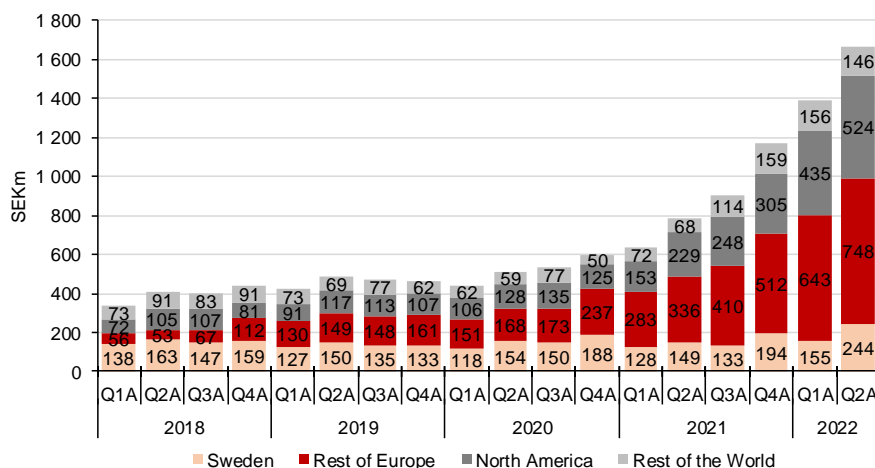
Hexatronic - Offering



Source: Hexatronic

A few years ago, the Swedish market accounted for a majority of Hexatronic’s sales. Following a decline in this market and a surge in sales in North America and Rest of Europe (largely the US, the UK, and Germany) thanks to investments and acquisitions, these regions now represent ~75 percent of sales.

Hexatronic – Sales by Region



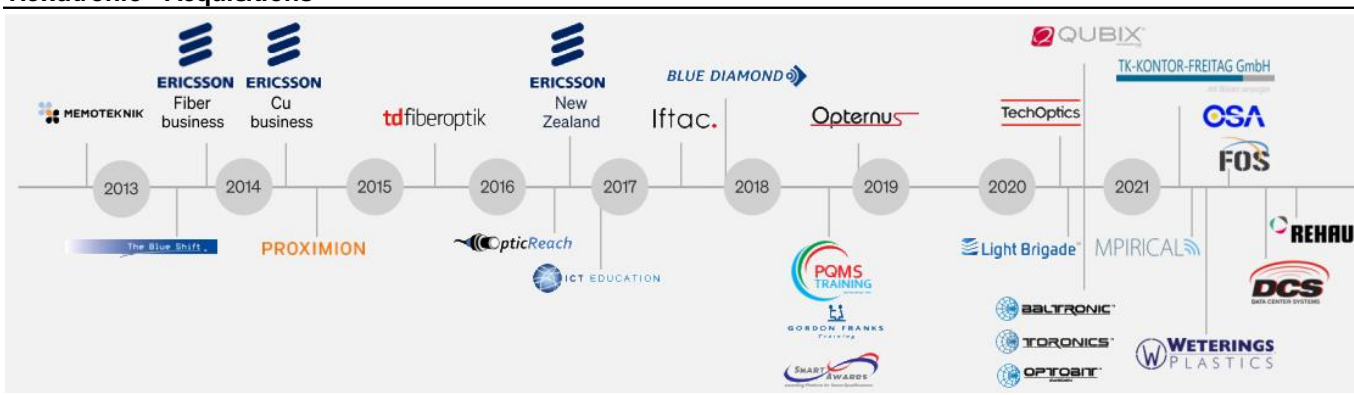
Source: Redeye Research, Hexatronic

In addition to fiber infrastructure, Hexatronic also manufactures and sells duct targeting the general infrastructure and agricultural markets following acquisitions; many duct producers serve both the fiber and other markets.

Strong M&A Track Record

Hexatronic and its management have a strong M&A record. Since acquiring Ericsson’s fiber cable factory in Hudiksvall in 2013 (today, at the core of its operations), Hexatronic has made over 20 acquisitions, of which most have strengthened its position in strategic growth markets. The most significant, such as Ericsson’s fiber business and US duct manufacturer Blue Diamond, have been highly successful, and now form the core of today’s Hexatronic.

Hexatronic - Acquisitions



Source: Hexatronic

Hexatronic Acquisitions				
Year	Acquisition	Payment	Employees	Net Sales at purchase
2012	Memoteknik	N/A	N/A	SEK 31m
2013	The Blue Shift	N/A	N/A	SEK 31.5m
	Ericsson Fiber Business	SEK 55m	85	SEK 350m
2014	Ericsson Cu Business	N/A	15	N/A
	Proximion	SEK 55m	20	SEK 30-35m
2015	Tele & Datanät Fiberoptik i Örebro AB	SEK 80m	50	SEK 125m
	OpticReach	SEK 10m	11	SEK 20m
2016	Ericsson New Zealand	SEK 30m	19	SEK 60m
	ICT Education	SEK 15m	4	SEK 20m
	lftac	SEK 9m	10	SEK 20m
2017	Blue Diamond	USD 24.5m	85	USD 29m
2018	PQMS Training, Gordon Franks & Smart Awards	GBP 2m	N/A	GBP 4.2m
	Opternus	EUR 10m	44	EUR 15m
2020	TechOptics	N/A	N/A	N/A
	Light Brigade	N/A	N/A	N/A
	Baltronics Group OU	N/A	N/A	N/A
	Toronics Inc	N/A	N/A	N/A
	Optobit	N/A	N/A	N/A
	Qubix	EUR 14.4m (90%)	N/A	N/A
2021	TK Kontor Freitag	N/A (75%)	N/A	N/A
	Mpirical	N/A	N/A	N/A
	Weterings	EUR 5.6m	N/A	EUR 15m
	OSA & FOS	AUD 47.4m	N/A	AUD 45m
	DCS	USD 17,2-19,9m	>100	N/A
	Rehau	EUR 40.5m	N/A	EUR 30m

Source: Hexatronic & Redeye Research

Management, Board, and Owners

Management

Board of Directors				
Name	Position	Since	Capital (%)	Note
Anders Persson	Chairman	2014	0.13%	Board Chairman of Coloreel AB and Board member of Ferroamp Elektronik AB. MSc in Engineering Physics from Chalmers University of Technology, Gothenburg.
Erik Selin	Member	2014	2.2%	Board Chairman of K-Fast Holding AB, Brinova Fastigheter AB and Collector Bank AB. Board Member and President of Fastighets AB Balder. Board Member of Ernström & C.o AB and Hedin Bil.
Charlotta Sund	Member	2022	<0.01%	CEO Tekniska Verken in Linköping AB. Board Member of Enea Aktiebolag. Board Member of Tekniska Verken Group. MSc in Industrial Economics.
Helena Holmgren	Member	2020	<0.01%	Board Member of Profoto AB. MBA, Lund University and MBA, University of Ottawa.
Jaakko Kivinen	Member	2018	6.3%	Advisor to Accendo Capital. MSc in Economics, Helsinki School of Economics and MBA, University of South Carolina.
Per Wassén	Member	2021	<0.01%	Board Member of GU Venture AB, Board Member of Impact Coatings AB and Chairman of ES Energy Save Holding AB. MSc in Engineering Physics, Chalmers University of Technology, and MSc in Economics, School of Business, Economics and Law at the University of Gothenburg.

Board

Management				
Name	Position	Since	Capital (%)	Note
Henrik Larsson Lyon	CEO, Hexatronic Group AB	2014	2.09%	Previously Manager & Sales at Nexans. BSc in Business Administration.
Pemilla Lindén	CFO, Hexatronic Group AB	2021	<0.01%	Previously CFO at Handicare Group and several positions at Mölnlycke. BSc in Business Administration.
Lise-Lott Schönbeck	DMO, Hexatronic Group AB	2020	<0.01%	Previously, Product Manager at Vitrolife and Director Marketing & Product Management at Biolin Scientific AB. MSc in Engineering Physics and Chemistry.
Anna Bailey	Supply Chain Director, Hexatronic Group AB	2014	0.02%	Previously, Supply Chain Manager at Nexans and PMC Hydraulics AB. MSc in Industrial Economics.
Martin Åberg	Deputy CEO, Hexatronic Group AB	2014	2.2%	Previously CFO, CEO and currently Chairman at Proximion AB. MSc in Engineering Physics, MSc in Business, also a Chartered Financial Analyst, IFL, Stockholm School of Economics.
Håkan Bäckström	CEO, Hexatronic Cables & Interconnect Systems	2017	0.25%	Previously Head of Ericsson Supply Site and several other positions at Ericsson. MSc in Mechanical Engineering, focus on industrial economics, also Managing Industrial Operations (IMOP).
Christian Priess	Head of Central Europe, Hexatronic Group AB	2019	-	Currently Chairman Of The Board at Gloden Goup Ltd. CEO - Business Development at Hexatronic Denmark and Germany. MSc International Business, IMD MBA.
Tomas Jendel	CTO, Hexatronic Group AB	2020	<0.01%	Previously Senior Solution Architect among other positions at Ericsson. MSc and Lic. Eng. in Vehicle Engineering.
Magnus Angermund	Head of Northern Europe, Hexatronic Group AB	2021	0.08%	Previously Sales and Marketing at EcoDataCenter. Earlier at Hexatronic as Marketing Manager during 2016-2020. High School Electrical/Telecom Engineering, IHM, IFL Executive Management Program.

Hexatronic: Shareholders

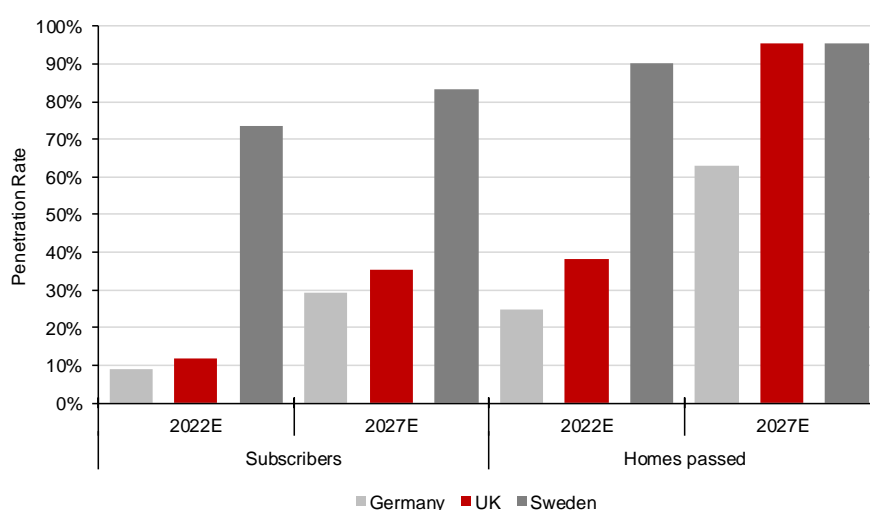
Owners	Capital	Votes
AMF Pension & Fonder	7.03%	7.11%
Handelsbanken Fonder	6.70%	6.78%
Jonas Nordlund	6.28%	6.38%
Accendo Capital	6.25%	6.35%
Swedbank Robur Fonder	5.76%	5.84%
Chirp AB	4.34%	4.41%
Vanguard	3.12%	3.17%
Henrik Larsson Lyon	2.06%	2.09%
JP Morgan Asset Management	1.70%	1.72%
Hexatronic Group AB	1.58%	0.43%
Futur Pension	1.45%	1.48%
Avanza Pension	1.41%	1.43%
Swedbank Försäkring	1.35%	1.37%
Göran Nordlund	1.34%	1.36%
BlackRock	1.17%	1.19%
Others	48.48%	48.89%

Source: Redeye Research & Holdings (2022-08-15)

Market Overview

Hexatronic's three most important markets—the US, the UK and Germany, the so-called strategic growth markets—all have significantly lower FTTH/B penetration rates than Sweden. While the read over from penetration rates to sales is not 1-to-1, the magnitude of the potential in these markets remains clear. First, these countries together have 40x the number of households versus Sweden. Second, their FTTH/B subscription penetration rates (2022E) span from 20 percent in the US to ~10 percent in the UK and Germany, compared to Sweden's +70% percent, suggesting vast markets to compete for. Considering the rapid growth seen since 2021, we believe Hexatronic has a sound position in these markets. As discussed in the Financials and Estimate section of this report, we believe the potential in these markets and Hexatronic's position in them will provide ~17 percent CAGR sales growth for 2022-2027.

FTTH/B Penetration in Key European Markets



Source: Redeye Research, FTTH Council Europe asbl

The US

Hexatronic has three types of operations in the US: Blue Diamond (blue on the map below), its system offering (orange); and the recently acquired DCS (gray).

Presence in the US

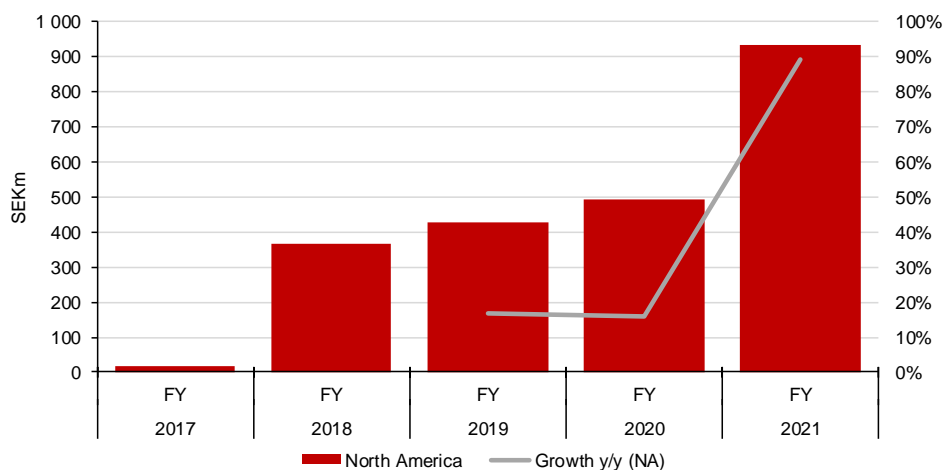


Source: Hexatronic

According to management, Blue Diamond has been one of Hexatronic's best acquisitions so far, with organic growth exceeding the expected 5-6 percent. Management expects President Biden's infrastructure deal to have a positive impact on the subsidiary. In addition to FTTH investments, a duct is laid beside a road when it is built. Interestingly, there are no duct factories up for sale, which is why Hexatronic decided to invest USD ~33m in a new production facility in South Carolina.

While Blue Diamond has been Hexatronic's US growth driver historically, Hexatronic's system offering (complete FTTH) has gained traction recently, the USD 50m deal with Ting being an example of this. Although Hexatronic's market share is low in the US, the lack of Chinese imports and competitors mimicking Hexatronic's system offering makes it a particularly appealing solution. According to management, these factors will, among others, make the US the company's most profitable market. Continued robust growth in this market will thus likely result in higher margins. Also, while Hexatronic's US market share is low, this is the company's largest market. At 27x the households of Sweden and likely higher revenues per household, the US's potential is vast.

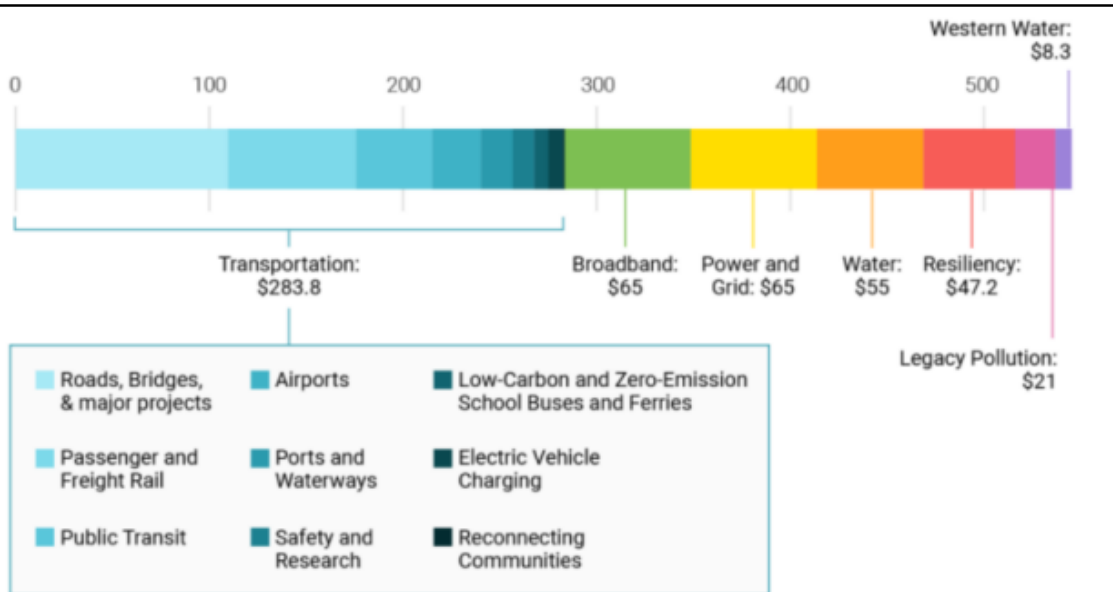
Hexatronic – North America



Source: Redeye Research, Hexatronic

President Biden’s infrastructure Bill

The Biden Infrastructure Bill



Source: Hexatronic, Fiber Broadband Association/RVA December 2021

President Biden’s infrastructure deal includes USD 65bn targeting broadband, while other parts are relevant for Hexatronic’s duct offering (Blue Diamond). We believe the deal highlights the political ambitions to improve infrastructure, including digital infrastructure, and it supports both our view and management’s on the potential in the US market.

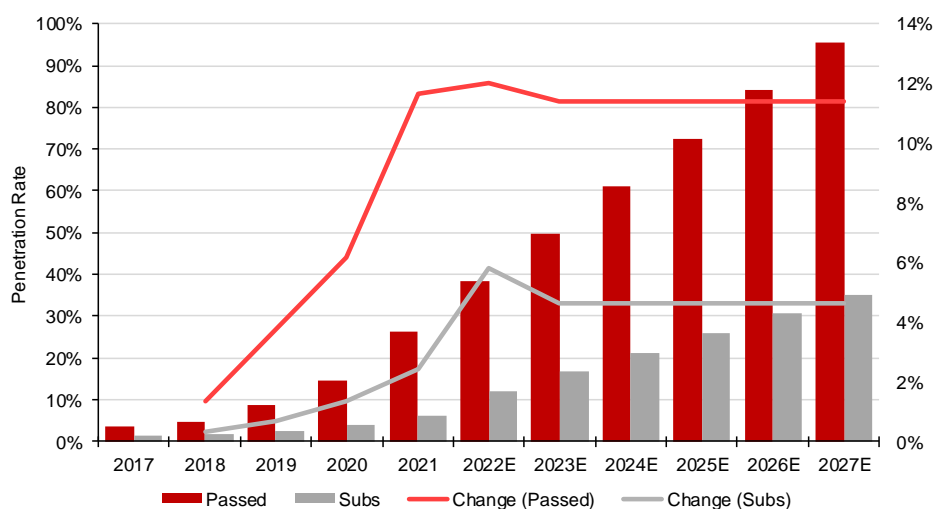
The UK

The UK has about 6x the households of Sweden. As the UK is building a somewhat less robust fiber network, though, revenues per household and margins are likely lower than the group average. Nevertheless, this market remains significant, and City Fibre, a major customer, has so far connected about 1m out of its target of 8m connections. While this market is smaller than the US, Hexatronic's market share is higher in the UK. Notably, in February 2022, Hexatronic extended a deal with City Fibre that is now worth GBP 100m over the next three years.

The UK government targets that 85 percent of the households should have access to a gigabit connection in 2025. Considering that only six percent had fiber subscriptions in September 2021, this is an ambitious goal. According to management, it will likely take at least ten years before the UK reaches its 2025 target. We believe management's view is reasonable for several reasons. First, it has a deep understanding of the market and understands the shortage of technicians. Second, despite large investments, Sweden missed its 2020 target by quite a substantial margin.

FTTH Council Europe estimates the UK will reach 38 percent homes passed and 12 percent subscriber penetration in September 2022, corresponding to respective increases of 12 percentage points and five percentage points relative to September 2021. For 2027, it expects 96 percent homes passed and 35 percent subscriber penetration. We have extrapolated the data between 2022 and 2027 in the graph below and our conclusion is that homes passed penetration will increase in line with the level seen in 2021 and 2022, roughly 12 percentage points annually, until 2027. Using the same method, however, the annual increase in subscription penetration would be around five percentage points per year until 2027, in line with 2022, but roughly twice the 2021 figure.

FTTH/B Penetration in UK



Source: Redeye Research, FTTH Council Europe asbl

Judging by the data for homes passed, the UK market has likely plateaued. However, the subscriber data suggests a significant growth acceleration in the coming years. Hexatronic's offering is relevant to both homes passed and subscriptions (not the subscriptions themselves but last mile fiber and connectivity). Management follows the numbers of subscriptions most closely and believes this is the most relevant measure.

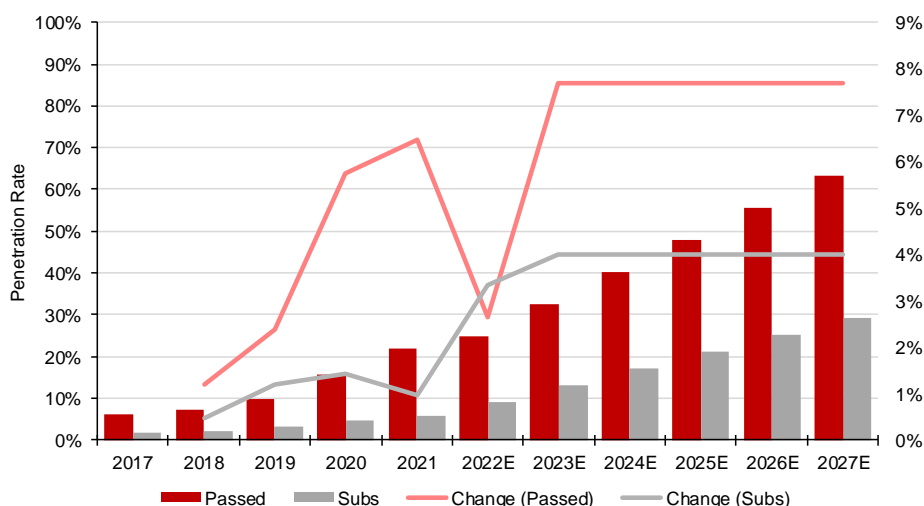
Also, Hexatronic's offering has a strong position in the last mile. In our forecasts, which we return to in the Financials and Estimates section of this report, we assume a 20/80 relevance for homes passed and subscribers.

Moreover, dense urban areas, where every meter of fiber has a significant impact on the number of homes passed, are likely to be built out first. Thus, the fiber products needed for every percentage point of homes passed penetration would most likely be lower at the beginning of the expansion phase.

Germany

The German market is still not as active as the UK, but it is starting to take off. Hexatronic recently announced two large orders with a total value in the region of EUR 21m. The market has about 9x the households of Sweden, but the revenues per household are roughly equal to Sweden. The German market has a high share of small and medium-sized players, including many city networks. This matches Hexatronic well as its system offering suits smaller players, which often lack in-house fiber expertise.

FTTH/B Penetration in Germany

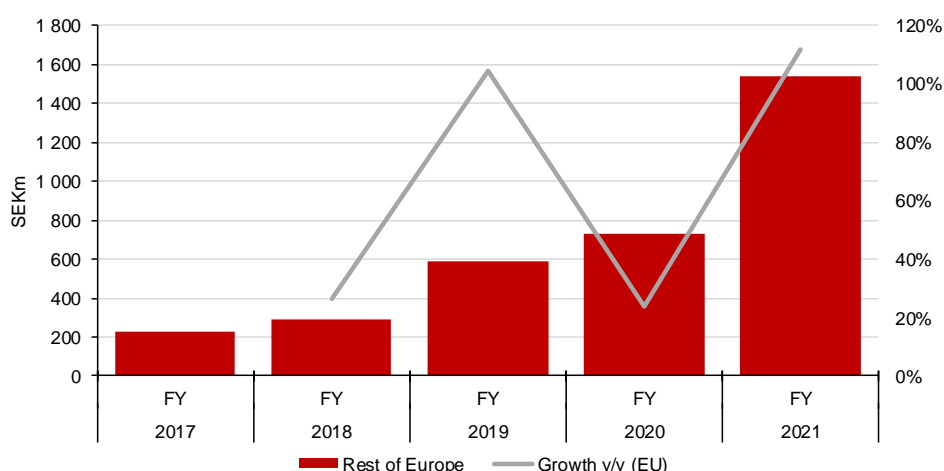


Source: Redeye Research, FTTH Council Europe asbl

FTTH Council Europe estimates Germany will reach 25 percent homes passed and nine percent subscriber penetration in September 2022, corresponding to increases of a mere three percentage points each relative to September 2021. For 2027, it expects 63 percent homes passed and 29 percent subscriber penetration. We have extrapolated the data between 2022 and 2027 in the graph below, and our conclusion is that homes passed penetration will increase in line with the level in 2021 and 2022, roughly eight percentage points annually, until 2027. Using the same method, the annual increase in subscription penetration would be four percentage points until 2027.

The German market has thus still not reached a plateau, according to these forecasts. We believe Germany will overtake the UK as the key growth driver for Hexatronic’s Rest of Europe segment in the coming years.

Hexatronic – Rest of Europe

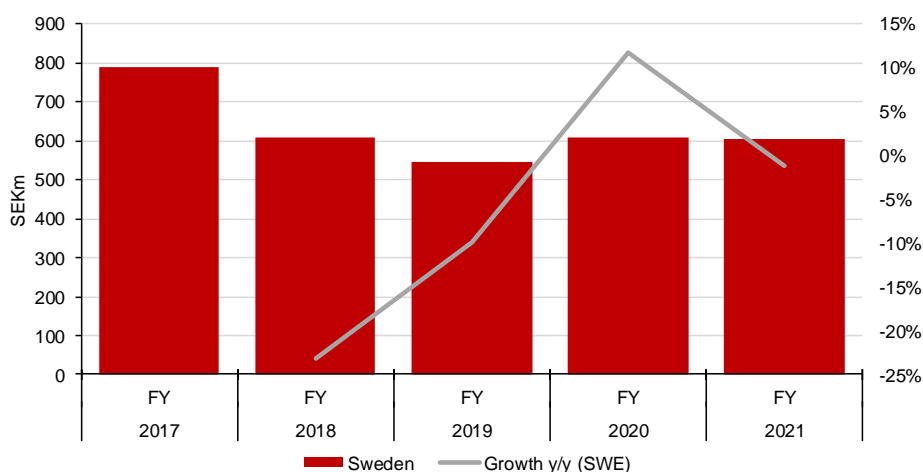


Source: Redeye Research, Hexatronic

Sweden

Since the FTTH peak in 2017, Hexatronic’s sales in Sweden have declined by about 30 percent, although FTTH still accounts for ~50 percent of sales. While the Swedish market is of limited importance to sales and earnings growth, it is an interesting case study of post-FTTH boom market conditions, with implications for our long-term view of Hexatronic’s strategic growth markets.

Hexatronic – Sweden



Source: Redeye Research, Hexatronic

Considering that 50 percent of the company’s sales still relate to FTTH, the post-boom tail seems to be substantial, which we find positive. On the other hand, FTTH will, at some point, reach maturity, and given a lifespan of 40-50 years, the need for replacement will be limited for the foreseeable future, resulting in diminishing demand for Hexatronic’s solutions. While reaching such a scenario in the strategic growth markets is some way ahead, we believe Hexatronic will need to expand into new markets or related verticals to maintain its sales. However, the company has a sound track record of M&A and entering new markets, as well as plenty of time.

Valuation

Bear Case 60 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 95 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 ~11%

Bull Case 142 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 ~14%

We raise our Base Case to SEK 95 (90), due to a slightly raised assumption for terminal EBITA margin, following the strong level seen in Q2. One could argue that a single quarter should not impact our terminal forecasts. However, we still expect a significant decline relative to current levels.

Our new Bull Case is SEK 142 (125). 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 (2022-08-15)

Rating	People	Business	Financials
5	32	15	4
3-4	157	139	48
0-2	5	40	142
total	194	194	194

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Fredrik Nilsson owns shares in the company : No

Jacob Svensson owns shares in the company : No

Redeye performs/have performed services for the Company and receives/have received compensation from the Company in connection with this.