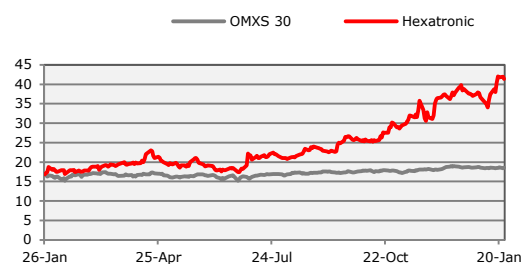


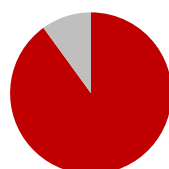
**Summary**
**Hexatronic (HTRO.ST)**
**Enhanced market outlook**

- Hexatronic continues their victory march. The report for the first quarter of 2016/17 beat our estimates on all accounts. Despite currency headwinds and producing to their current limit the company showed strong profitability. When the forex situation normalizes, and the production investments are finalized, we see increasing margins.
- Both the European Commission and the Swedish Government have recently updated and increased their goals for internet connectivity. In total, EU estimates an investment need of EUR 500bn in broadband infrastructure to reach their goals. In our view, the market outlook for Hexatronic is thus further strengthened.
- We raise our long-term growth assumptions, which generates a new estimated Fair Value of 53 (40) SEK per share. Our Bear- and Bull-case are also heightened. Hexatronic still trades at almost half the valuation multiples of its international peers.

List: 1,475 MSEK  
 Market Cap: 1,475 MSEK  
 Industry: Telecommunication Equipment  
 CEO: Henrik Larsson-Lyon  
 Chairman: Anders Persson

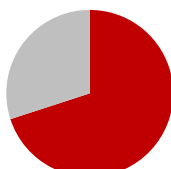

**Redeye Rating (0 – 10 points)**

Management



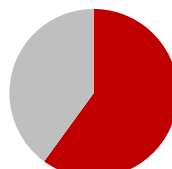
9.0 points

Ownership



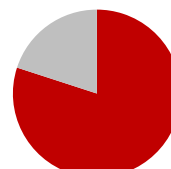
7.0 points

Profit outlook



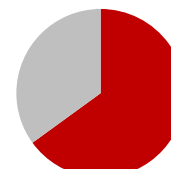
6.0 points

Profitability



8.0 points

Financial strength



6.5 points

**Key Financials**

	14/15	15/16	*16/17E	2018E	2019E
Revenue, MSEK	627	891	1,610	1,461	1,753
Growth	26%	42%	81%	-9%	20%
EBITDA	64	81	186	187	235
EBITDA margin	10%	9%	12%	13%	13%
EBIT	50	63	153	148	193
EBIT margin	8%	7%	10%	10%	11%
Pre-tax earnings	49	55	124	134	186
Net earnings	37	42	97	104	146
Net margin	6%	5%	6%	7%	8%
Dividend/Share	0.00	0.00	0.29	0.00	0.00
EPS adj.	1.12	1.25	2.59	2.78	3.88
P/E adj.	9.8	17.9	15.7	14.7	10.5
EV/S	0.5	0.8	1.0	1.0	0.8
EV/EBITDA	5.3	9.2	8.3	7.6	5.9

**Share information**

Share price (SEK)	40.8
Number of shares (m)	36.1
Market Cap (MSEK)	1,475
Net debt (MSEK)	-5
Free float (%)	50 %
Daily turnover ('000)	50

**Analysts:**

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 henrik.alveskog@redeye.se

**\*16/17 is extended  
 with 3 months**

**Important information:** All information regarding limitation of liability and potential conflicts of interest can be found at the end of the report.

## Redeye Rating: Background and definitions

The aim of a Redeye Rating is to help investors identify high-quality companies with attractive valuation.

### Company Qualities

The aim of Company Qualities is to provide a well-structured and clear profile of a company's qualities (or operating risk) – its chances of surviving and its potential for achieving long-term stable profit growth.

We categorize a company's qualities on a ten-point scale based on five valuation keys; 1 – Management, 2 – Ownership, 3 – Profit Outlook, 4 – Profitability and 5 – Financial Strength.

Each valuation key is assessed based a number of quantitative and qualitative key factors that are weighted differently according to how important they are deemed to be. Each key factor is allocated a number of points based on its rating. The assessment of each valuation key is based on the total number of points for these individual factors. The rating scale ranges from 0 to +10 points.

The overall rating for each valuation key is indicated by the size of the bar shown in the chart. The relative size of the bars therefore reflects the rating distribution between the different valuation keys.

### Management

Our Management rating represents an assessment of the ability of the board of directors and management to manage the company in the best interests of the shareholders. A good board and management can make a mediocre business concept profitable, while a poor board and management can even lead a strong company into crisis. The factors used to assess a company's management are: 1 – Execution, 2 – Capital allocation, 3 – Communication, 4 – Experience, 5 – Leadership and 6 – Integrity.

### Ownership

Our Ownership rating represents an assessment of the ownership exercised for longer-term value creation. Owner commitment and expertise are key to a company's stability and the board's ability to take action. Companies with a dispersed ownership structure without a clear controlling shareholder have historically performed worse than the market index over time. The factors used to assess Ownership are: 1 – Ownership structure, 2 – Owner commitment, 3 – Institutional ownership, 4 – Abuse of power, 5 – Reputation, and 6 – Financial sustainability.

### Profit Outlook

Our Profit Outlook rating represents an assessment of a company's potential to achieve long-term stable profit growth. Over the long-term, the share price roughly mirrors the company's earnings trend. A company that does not grow may be a good short-term investment, but is usually unwise in the long term. The factors used to assess Profit Outlook are: 1 – Business model, 2 – Sale potential, 3 – Market growth, 4 – Market position, and 5 – Competitiveness.

### Profitability

Our Profitability rating represents an assessment of how effective a company has historically utilised its capital to generate profit. Companies cannot survive if they are not profitable. The assessment of how profitable a company has been is based on a number of key ratios and criteria over a period of up to the past five years: 1 – Return on total assets (ROA), 2 – Return on equity (ROE), 3 – Net profit margin, 4 – Free cash flow, and 5 – Operating profit margin or EBIT.

### Financial Strength

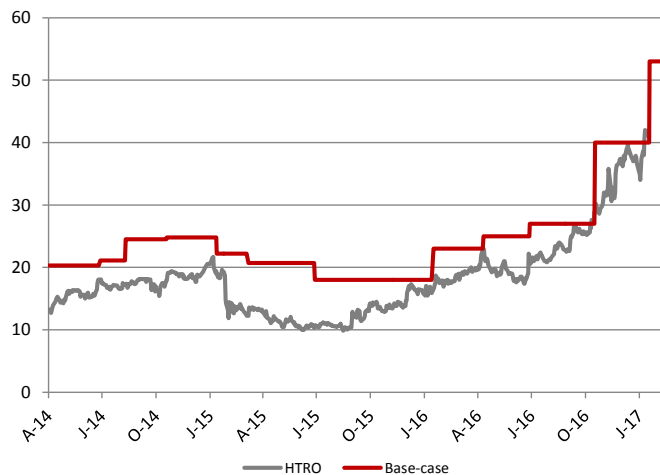
Our Financial Strength rating represents an assessment of a company's ability to pay in the short and long term. The core of a company's financial strength is its balance sheet and cash flow. Even the greatest potential is of no benefit unless the balance sheet can cope with funding growth. The assessment of a company's financial strength is based on a number of key ratios and criteria: 1 – Times-interest-coverage ratio, 2 – Debt-to-equity ratio, 3 – Quick ratio, 4 – Current ratio, 5 – Sales turnover, 6 – Capital needs, 7 – Cyclicity, and 8 – Forthcoming binary events.

## Strong market warrants forecast hike

In this report we focus on interesting market data that shows the favorable market for fiber equipment the next decade and more, which in our view warrants a positive estimate revision. We also discuss the latest [quarterly report](#), a gross margin that will [increase](#), the changes in the [board of directors](#) and the new acquisitions within the business area [Education](#). The increase in our assumed growth also leads to higher margins due to operational [leverage](#). The market continues to be strong and our market forecast is enhanced mainly due to the following:

- New even more aggressive broadband related goals from the Swedish government. Read [here](#).
- Increased connectivity goals from the European Commission. Investment need in broadband infrastructure of roughly EUR 500bn the coming decade. Read [here](#).

### Historical Base-case and share performance



Source: Redeye Research & Bloomberg

We raise our valuation, in Base-case, to 53 SEK per share. Compared to international peers Hexatronic continues to be conservatively valued given the strong prospects.

Peer valuation, international fiber optical companies								
Company	Curr.	EV	EV/S 17E	EV/S 18E	EV/EBIT 17E	EV/EBIT 18E	Sales CAGR 15-18E	EBIT % 18E
Fiberhome Telecom Tech CO-A	CNY	30 241	1.5x	1.2x	28.2x	23.0x	22%	5%
Clearfield INC	USD	237	2.7x	2.4x	29.3x	25.5x	17%	10%
O-net Communications Group	HKD	2 971	1.4x	1.1x	15.3x	11.2x	32%	10%
Huber & Suhner AG-REG	CHF	1 118	1.4x	1.4x	20.1x	18.4x	5%	7%
<b>Average</b>			<b>1.7x</b>	<b>1.5x</b>	<b>23.2x</b>	<b>19.5x</b>	<b>19%</b>	<b>8%</b>
<b>Median</b>			<b>1.4x</b>	<b>1.3x</b>	<b>24.1x</b>	<b>20.7x</b>	<b>20%</b>	<b>9%</b>
<b>Hexatronic Group at Base-case</b>	SEK	<b>1595 2 075</b>	<b>1.0x 1.2x</b>	<b>1.0x 1.4x</b>	<b>9.6x 12.5x</b>	<b>10.3x 13.4x</b>	<b>27%</b>	<b>10%</b>

Source: Bloomberg & Redeye Research

## Outstanding performance

The company outperformed, yet again, our estimates on all counts for the first quarter of the split financial year of 2016/17.

*Strong organic development during the period*

Estimate vs. Outcome				
MSEK	15/16 Q4	16/17 Q1E	16/17 Q4A	Diff
<b>Net sale</b>	<b>224</b>	<b>294</b>	<b>336</b>	<b>15%</b>
other income	1.3	1.4	0.3	
COGS	-126	-169	-192	14%
<b>Gross Profit</b>	<b>99</b>	<b>126</b>	<b>144</b>	<b>14%</b>
SG&A	-78	-95	-105	10%
<b>EBITDA</b>	<b>22</b>	<b>31</b>	<b>39</b>	<b>27%</b>
Net sale Growth %		31%	50%	
Gross Profit margin %	44%	43%	43%	
EBITDA margin %	9.6%	10.5%	11.6%	

Source: Hexatronic Group & Redeye Research

*Order backlog increased with 43% compared to last year*

Hexatronic reported a 50% rise in net sales, compared to our forecast of 31%. Roughly 29% of the growth was organic and 21% from the acquisitions of OpticReach, Hexatronic New Zealand, and ICT Education. At the end of the quarter, the order backlog stood 43% higher compared to the same time last year, which clearly indicates that we will see a continued strong growth in the quarters to come.

*Hexatronic is conducting growth investments to handle the demand*

The EBITDA margin was strong at 11.6% in contrast to our expected level of 10.5%. However, we argue that the actual underlying profitability is even higher due to;

- Hexatronic currently has to make direct purchases of cable duct and other finished products externally because of the high growth and demand in order to meet client orders; this dampens the gross profit margin and subsequent EBITDA. To adjust, Hexatronic is conducting growth investments in production (employees and machinery) which will drive down COGS in the coming quarters as the production is optimized and become more efficient.
- The weakening of SEK has also affected the gross profit and EBITDA margin negatively, as a relatively large part of purchases of raw material and goods are made in EUR and USD, and sales are primarily in SEK as of now.

*We should probably see underlying gross profit margins in the region of 45-48%*

## Improved margins ahead

Despite the points above the reported gross profit margin was well in-line with our estimate at 43%. Hexatronic also states they are making some price increases, which will start having a gradual effect from the beginning of 2017. As Warren Buffett said: *“The single most important decision in evaluating a business is pricing power.”* Given the price increases, less purchase of finished products and normalized currency conditions we

should probably see underlying gross profit margins in the region of 45-48%. We will look into this in the upcoming quarters.

*We believe we are starting to see improved leverage of the earlier conducted production investments*

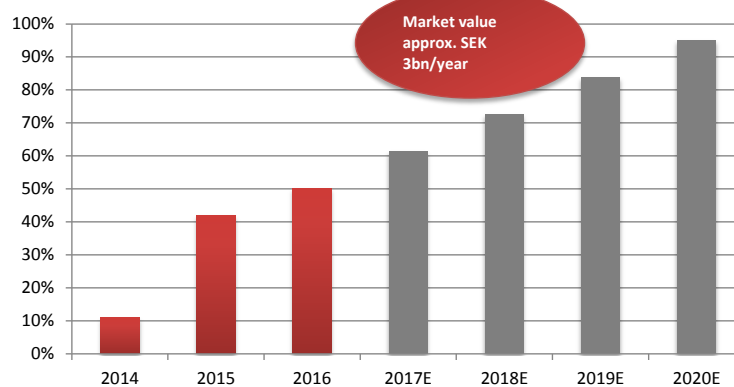
SG&A (mostly personnel and external costs) was lower, both in absolute numbers and in relation to sales, than expected. We believe we are starting to see improved leverage of the earlier conducted production investments, including both plant and personnel. We had expected this but not to the same degree we saw in the report. We also want to highlight financial expenses increased significantly due to the revaluation of liabilities in EUR and USD, due to the weakened SEK. This is a non-recurring and non-operational effect, and is of no concern to us. However it unfairly lowers the net profit and EPS, so adjustments must be made to see through this.

## Update on the market outlook

### New fiber related government goals

In December the Swedish government updated their broadband-related goals. The new goals state that 95%, up from 90%, of the households in 2020 should have access to at least 100 Mbit / s internet. A new goal is also 98% should have access to at least 1 Gbit / s in the home and at work by 2025. Today 50% of the households in Sweden have access to at least 100 Mbit / s. The penetration rate is steadily rising. Still, this means that for the government goals to be met, roughly 2.5 million household’s needs to be connected during the coming four years. An installation of fiber to the home cost somewhere between SEK 20-30k, the cost of material (that Hexatronic can supply) is approximately 20% of the installation. So as a rough approximation we know that the market for Hexatronic per installation is about SEK 4.3k. This means that the market value of fiber equipment, for the government goals to be finalized, are about SEK 3bn per year. The goals also mean that people will have the possibility of having 100 Mbit / s internet, however, some will not connect their homes at first chance but wait for whatever reason. This will create an aftermarket of “late adopters” that will be huge and be sustained for many years after 2020. They will likely pay a higher price and be forced to use Hexatronic air blown fiber equipment that already is the standard in the existing system.

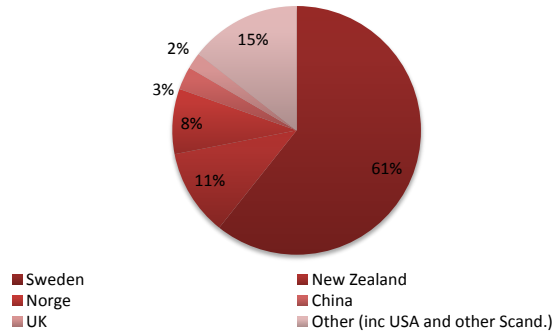
#### Current 100 Mbit/s penetration and government goal (Sweden)



Source: European Commission & Redeye Research

We want to highlight that these SEK 3bn are for Sweden alone. The significant opportunity for Hexatronic lies in less mature markets in the rest of the world. In the graph below are the geographical sales split during 2015/17.

**Geographic net sales distribution 2015/16**



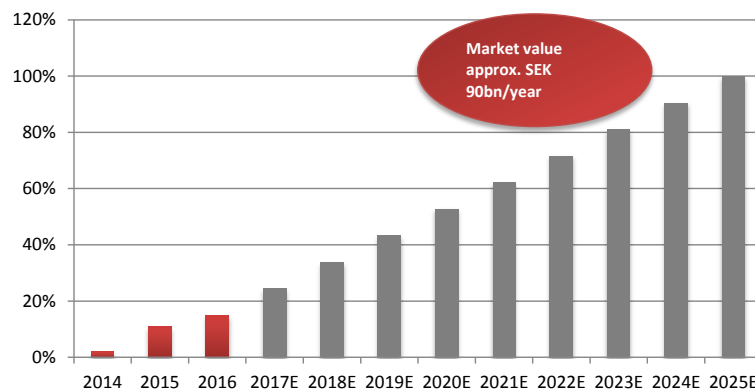
Source: Hexatronic Group

**European Union updates their broadband goals**

In September the European Commission presented their internet connectivity goals. The European Union now has an objective that all households in Europe, both rural and urban should have access to a connectivity offering of 100 Mbit / s broadband, which can be upgraded to Gbps. For Hexatronic the last sentence is important as this means the households needs fiber connections. To reach these goals the Commission estimates that investments of EUR 500bn are necessary over the next decade; of these investments roughly 20% is related to fiber optic material. Today about 15% of the households have 100 Mbit / s connectivity access. In Europe, there are about 222 million households with an average population growth of 1% per year, which means that roughly 211 million will be connected during the coming ten years. The approximated market value of the EU fiber material market will be SEK 90bn per year on average the coming decade, in other words; the opportunity for Hexatronic in Europe is massive.

*The opportunity for Hexatronic in Europe is massive*

**Current 100 Mbit/s penetration and Comission goal (EU)**

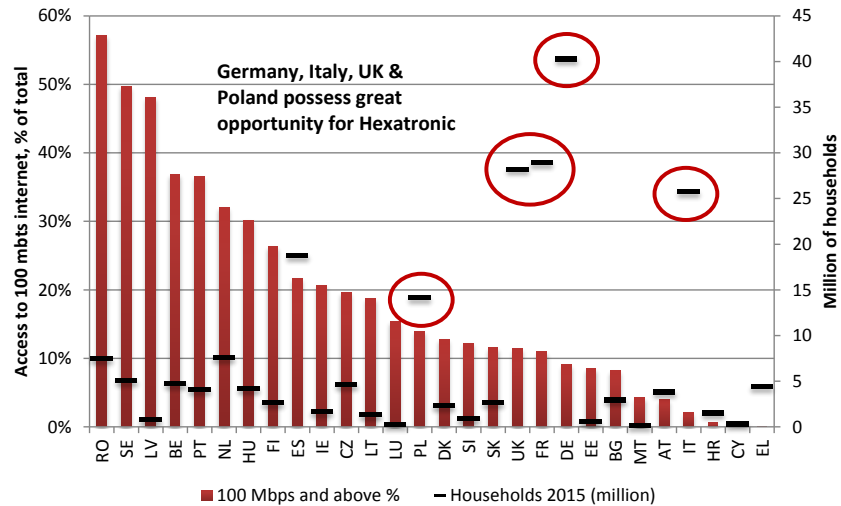


Source: European Commission & Redeye Research

The greatest opportunities lie in the countries with the least developed broadband infrastructure and largest populations. We find Germany, UK, Poland and Italy as highly attractive markets for Hexatronic.

**100 mbts penetration and million of households per country**

*Germany, UK, Poland and Italy as highly attractive markets for Hexatronic*



Source: European Commission, Eurostat & Redeye Research

*In the USA there are about 125 million households, and only about 10 million are fiber broadband subscribers*

We should also not forget that possibilities outside of Europe will also be splendid. New Zealand will experience rapid growth the coming five years as the country works towards the goal of 99% accessibility to broadband of 50 Mbit / s. In the USA there are about 125 million households, and only about 10 million are fiber broadband subscribers. According to our approximation, the investment need in the USA, to make high-speed broadband accessible for all could possibly reach USD 200-300bn the coming 10 to 15 years.

*That the company outgrows the market in Sweden by about 2x is a distinct indication of a very attractive offering*

We believe there will be a tremendous opportunity for Hexatronic to expand to new markets, countries, and regions the coming decade. We haven't even started to discuss the effects of 5G networks that needs fiber or the massive investments in Asia and MENA regions. We expect Hexatronic to continue to make growth investments to be able to capitalize on these growth opportunities. That the company outgrows the market in Sweden by about 2x is a distinct indication of a very attractive offering, which should lead to a high success rate abroad.

## Key events during the period

### Two acquisitions within Education

During the quarter Hexatronic conducted two smaller acquisitions within the new business area Education. The acquired companies are ICT Education and Iftac AB have a combined net sales of roughly SEK 40m last year.

*One key ingredient of the international expansion for Hexatronic is educating installers in new market regions*

We find the acquisition and the new segment as interesting. The new operating unit indicates that Hexatronic sees further acquisition potential within this space, as the market for fiber focused professional education is highly fragmented. As the market for fiber infrastructure is growing strong, the demand for expert education will also. We also believe that Education, in combination with Homes past, will be highly important to develop the aftermarket for the fiber infrastructure. We also want to add that one key ingredient of the international expansion for Hexatronic is educating installers in new market regions about their modern installing techniques and products. Something ICT, Iftac and future acquired companies, can service.

### ICT Education

ICT Education; is a company focused educating and training professionals within fiber and copper-techniques. In conjunction with the acquisition, consolidated during Q1 2016/17, Hexatronic also creates a new business area with a focus on Education.

Hexatronic has agreed to acquire the shares in ICT for SEK 15m, with an additional purchase consideration of SEK 9m, based on the growth of earnings during the coming two years. In step one, Hexatronic will pay SEK 10m in cash and SEK 5m with newly issued shares to the seller IKT Networks.

During the split financial year of 2015/16 (ended in April), ICT had net sales of SEK 21.5m with and EBIT of SEK 7.9m. The margins are very high, but we want to add that the company only had four employees during the year. We believe the sustainable long-term margin levels to be around 30%, which of course is still strong.



<b>ICT Education</b>			
<b>Period</b>	<b>13/14</b>	<b>14/15</b>	<b>15/16</b>
<b>Net sales</b>	<b>2.0</b>	<b>14.0</b>	<b>21.5</b>
COGS	-1.1	-7.5	-9.0
<b>Gross profit</b>	<b>0.9</b>	<b>6.5</b>	<b>12.5</b>
OPEX	0.0	-1.3	-4.4
<b>EBITDA</b>	<b>0.9</b>	<b>5.2</b>	<b>8.1</b>
D&A	0.0	0.0	-0.2
<b>EBIT</b>	<b>0.9</b>	<b>5.2</b>	<b>7.9</b>
Net sales growth		599%	54%
Gross profit margin	47%	46%	58%
EBITDA margin	45%	37%	37%
EBIT margin	45%	37%	37%

Source: Bolagsverket

Depending on the additional purchase amount Hexatronic is paying roughly 2-3x last year's EBITDA, an attractive price in our view.

<b>Acquisitions multiples (on 15/16 numbers)</b>			
<b>EV</b>	<b>EV/S</b>	<b>EV/EBITDA</b>	<b>EV/EBIT</b>
15	0.7x	1.9x	1.9x
24*	1.1x	3.0x	3.1x

Source: Hexatronic &amp; Redeye Research

\*With additional purchase consideration

*The current CEO, Karin Nygård-Skalman will continue as the chief executive*

### **Iftac AB**

Iftac, like ICT, has its headquarters in Hudiksvall. The company conducts training and certification in IT and Telecom and has about ten employees. The current CEO, Karin Nygård-Skalman will continue as the chief executive. During the split financial year of 2014/15, Iftac had sales of SEK 19.6m and an EBITDA of SEK 5.3m. This was the first year for the company as a corporation and the financial period was also extended for two months. The company is expected to experience strong growth coming years. Iftac expected to be consolidated as of 2 January 2017.

<b>Iftac AB</b>	
<b>Period</b>	<b>2014-10 to 2015-12</b>
<b>Net sales</b>	<b>19.6</b>
COGS	0.0
<b>Gross profit</b>	<b>19.6</b>
OPEX	-14.3
<b>EBITDA</b>	<b>5.3</b>
D&A	0.0
<b>EBIT</b>	<b>5.3</b>
Net sales growth	
Gross profit margin	
EBITDA margin	27%
EBIT margin	27%

Source: Bolagsverket

The fixed purchase price amounts to SEK 8.9 million paid in cash. Moreover, an additional consideration could amount to 7.8 million based

on the next two financial years EBITDA. The acquisition was financed with the use of the acquisition credit from Nordea.

Acquisitions multiples (on 14/15 numbers)			
EV	EV/S	EV/EBITDA	EV/EBIT
8.9	0.5x	1.7x	1.7x
16.7	0.9x	3.2x	3.2x

Source: Hexatronic & Redeye Research

\*With additional purchase consideration

Based on the numbers for 2014/15 Hexatronic is paying 0.5x net sales and 1.7x EBITDA. These multiples are lower than for ICT, but as we discussed earlier 2014/15 was an extended year for Iftac, so the multiples for annual numbers would be higher.

### Changes in the board and more institutional owners enter

At the AGM Anders Persson, board member, was elected as the new Chairman as he succeeds Göran Nordlund that declined reelection. Anders Persson has been a board member of Hexatronic since 2014 and has a strong track-record with a number of active board positions in public companies. Anders is also the Chairman of Paynova, and board member of Invisio and TargetEveryOne. At the AGM Mark Shay, representing the new majority shareholder Accendo Capital, and Malin Frenning was elected as new board members. It is evident that the institutional investor has discovered the company as 4 funds is now among the top 15 shareholders.

*We must take one sentence and thank Göran for his diligent work and contribution over the years*

Göran Nordlund has been with the company for many years and remains as one of the largest shareholders of Hexatronic. Just like Gert Nordin stepping down we see this as a natural step for the company as Hexatronic enters a new stage as a larger corporation with many independent subsidiaries. In the initial phase of the “new” Hexatronic, Göran played a crucial part in the acquisition of Ericsson’s fiber factory in Hudiksvall, which is now the backbone of Hexatronic. We must take one sentence and thank Göran for his diligent work and contribution over the years.

### Extended financial year

2016/17 will be an extended financial year for Hexatronic and will stretch between September 2016 and December 2017. When the split financial year has ended, Hexatronic will change their reporting to fiscal years instead. This means that Q2 will be prolonged with one month and will be a tertial instead, and that Q3 (actually Q2 in fiscal standards) will be between April and June. The new reporting structure will affect our forecast but not the underlying yearly business volume.

## Estimate changes and the coming quarter

### Full year revisions

As outlined in this analysis report we have updated both our assumed growth rates and margin levels. We believe there is a significant opportunity for Hexatronic to grow in international markets the coming decade and that the company has the power to do so. We have confidence in that the international expansion will create better capacity utilization, and in combination with increased gross profit margins and operational leverage we should see increasing margins the coming years. As discussed earlier, 16/17E is also affected by the extended financial year as it stretches for 15 months instead of 12.

*We have adjusted our estimates upwards*

<b>Forecast adjustments</b>			
<b>MSEK</b>	<b>16/17E</b>	<b>2018E</b>	<b>2019E</b>
<b>Revenues</b>			
Old	<b>1 097</b>	<b>1 330</b>	<b>1 569</b>
New	<b>1 610</b>	<b>1 460</b>	<b>1 753</b>
% change	<b>46.8%</b>	<b>9.8%</b>	<b>11.7%</b>
<b>EBITDA</b>			
Old	<b>117</b>	<b>153</b>	<b>161</b>
New	<b>186</b>	<b>187</b>	<b>235</b>
% change	<b>59%</b>	<b>22%</b>	<b>46%</b>
<b>EBITDA-margin</b>			
Old	<b>10.7%</b>	<b>11.5%</b>	<b>10.3%</b>
New	<b>11.5%</b>	<b>12.8%</b>	<b>13.4%</b>

Source Redeye Research

Long-term, we see strong growth prospects for Hexatronic with the aforementioned market trend and future needs of investment in fiber infrastructure.

### Q2 estimates – Hard to predict but will be strong

As the next report is extended by one month the estimate is harder than usual to predict. Still, we believe the strong sales momentum to continue as the order backlog at the beginning of December was strong. The acquisitions of ICT, Iftac and, New Zealand, will also boost the growth levels.

<b>Next quarter estimates</b>		
<b>MSEK</b>	<b>15/16 Q2</b>	<b>Dec'16-Mar'17 Tertian</b>
<b>Revenues</b>	<b>173</b>	<b>322</b>
<b>EBITDA</b>	<b>2</b>	<b>19</b>
<b>EBIT</b>	<b>-2</b>	<b>11</b>
Revenue Growth	33%	n.m.
EBITDA margin	1.3%	5.8%
EBIT margin	-1.3%	3.4%

Source: Redeye Research

We expect revenues in the region of SEK 322m. As the period is extended and we now have more revenue abroad we expect to see higher margins than the “usual” Q2 for Hexatronic. Still the winter takes its toll. We anticipate an EBITDA in the region of SEK 19m corresponding to and margin of 5.8%

## Valuation

*Our fair value is raised to 53 SEK per share in our Base-case*

Our estimated Fair Value, in Base-case, per share is adjusted upwards to **53** (40) SEK per share, due to an increase in growth and margin assumptions. We also make some minor adjustments to our Rating given the changes in the board and ownership structure. In our valuation, we are accounting for a dilution effect from the outstanding stock options. To summarize: We believe that Hexatronic will experience significant growth for many years to come driven by the structural growth of the market for fiber infrastructure. We expect that the company will expand to new growth regions, and therefore increase their sustainable margin level. We estimate a CAGR of sales in the region of 17% between the years 2015/16-25 and an average EBITDA-margin of 13% during the period. Our valuation implies and EV/EBITDA exit multiple of 7x, which we find as a conservative assumption to make.

Hexatronic Group: Base-case			
Assumptions	2016-25	DCF-value	
CAGR Sales	17%	WACC	10.0%
EBITDA margin (avg)	13%	Net present value FCF	272
ROIC (avg)	28%	Net present value of Termina	1 716
<b>Terminal</b>		EV	1 988
Terminal growth FCF	4.0%	Net debt	1
Terminal EBITDA margin	14%	Value assos. Companies	0
Exit EV/EBITDA multiple	7x	Value minorities	0
		<b>DCF-value</b>	<b>1 989</b>
		<b>Estimated Fair value</b>	<b>53</b>
		Today's share price	42.0
		<b>Potential/Risk</b>	<b>26%</b>

Source: Redeye Research

Our estimated Fair Value implies a potential/margin of safety of 25% from today's share price levels. We see a period of strong growth in the coming years and increasingly attractive long-term prospects due to the international expansion.

### Valuation discrepancy to international peers for no reason

Our Base-case fair value implies an EV/EBIT 2018E (as 2016/07 will be an extended year 2018 is better to use in comparison) multiple of about 13.4x. Compared to international peers this is still conservative. The peer group consisting of fiber optical equipment companies trade at a median of EV/EBIT18E of 20.7x. Hexatronic should have a small cap discount but not as large as today's valuation levels. We believe a much higher multiple is motivated given the company's attractive growth prospects.

Peer valuation, international fiber optical companies								
Company	Curr.	EV	EV/S 17E	EV/S 18E	EV/EBIT 17E	EV/EBIT 18E	Sales CAGR 15-18E	EBIT % 18E
Fiberhome Telecom Tech CO-A	CNY	30 241	1.5x	1.2x	28.2x	23.0x	22%	5%
Clearfield INC	USD	237	2.7x	2.4x	29.3x	25.5x	17%	10%
O-net Communications Group	HKD	2 971	1.4x	1.1x	15.3x	11.2x	32%	10%
Huber & Suhner AG-REG	CHF	1 118	1.4x	1.4x	20.1x	18.4x	5%	7%
<b>Average</b>			<b>1.7x</b>	<b>1.5x</b>	<b>23.2x</b>	<b>19.5x</b>	<b>19%</b>	<b>8%</b>
<b>Median</b>			<b>1.4x</b>	<b>1.3x</b>	<b>24.1x</b>	<b>20.7x</b>	<b>20%</b>	<b>9%</b>
<b>Hexatronic Group at Base-case</b>	SEK	<b>1589</b> <b>1 988</b>	<b>1.0x</b> <b>1.2x</b>	<b>1.1x</b> <b>1.4x</b>	<b>10.4x</b> <b>13.0x</b>	<b>10.7x</b> <b>13.4x</b>	<b>25%</b>	<b>10%</b>

Source: Bloomberg & Redeye Research

## The investment case of Hexatronic

As we have discussed before, Hexatronic is present in a growing industry, fiber optical communication equipment. The growth in the industry is affected by the fact that we today consume more and more data due to the usage of smartphones, streaming services like Netflix, IP-TV and clouding software/solutions. The increased data usage directly affects the need for investment in the fiber optical infrastructure in almost all the regions in the world.

*Strong structural market growth drives the case*

We find it likely that Hexatronic will be able to capitalize on the aforementioned market trends, as the company is one of the most dominant players in the Nordic region with a competitive product offering. As acquisition is a part of Hexatronic's growth strategy. We find it likely that Hexatronic wants to acquire companies outside of Nordic, primarily for their international customer base. A stronger international presence will be a key to nurse future growth when the large investments in the Nordic region start to mature.

The main acquisition conducted by the company was when Hexatronic acquired Ericsson's fiber optical cable factory in Hudiksvall (Sweden), which is the largest subsidiary of the group. The acquired customers were primarily other units in the Ericsson group. One of the key challenges, since the large acquisition, for the company, have been to reverse the sales force focus to customers outside the Ericsson group while also maintaining previous customers they have acquired through the acquisition. During 2014/15 Hexatronic invested in both sales and marketing and we find it likely that the company will reap the benefits from these investments in the coming years. Hexatronic offers products throughout the whole fiber infrastructure and sells these with a system based approach, compared to their competitors that mostly sell one based product solutions. We find that this system based selling is a competitive advantage and will likely enhance the growth and profitability prospects of the company. Almost all of Hexatronic's products are now certified by Skanova (compared to the time of the acquisition), which is Sweden's largest wholesaler of network capacity and a subsidiary to TeliaSonera. The Skanova certification opens up a large part of the market that Hexatronic previously haven't been able to focus on; we see this as an untapped growth opportunity.

*Certification by Skanova opens up a large market*

Despite being presented in a growth industry with good prospect for future growth, having healthy margins, good return on capital and with a competent management team the valuation of Hexatronic indicates low expectations of future value creation. The primary reasons we see for the low embedded expectations is;

- **Short historical financial history** – We find it likely that most investors have a hard time to track and understand the financial history of the company. Hexatronic has completed a number of

acquisitions during a quite short time-frame making it hard for investors, with limited time on their hands, to estimate sustainable profitability levels. We see this as an opportunity for a more savvy investor that digs through the numbers. In our view, current sustainable profitability levels are satisfying but also likely increasing due to top-line growth.

- **Small/nano-cap** – Hexatronic is still a small company. This, according to us, creates an opportunity as Hexatronic might be overlooked by the investment community, creating a more likely disparity between true fundamental value and market capitalization.
- **Limited market communications** – Hexatronic has had an internal focus to manage the acquisitions and to structure the group that has led to a low degree of communications with the market. The poor communications have affected the valuation of the company negatively, in our view, in some situations when increased communication would have been desirable. We believe that management has learned from this experience and that they will enhance their communication with the market going forward.

*An opportunity for the savvy investor*

All these effects increase the likelihood of mispricing, and opportunity for the savvy investor.

**Hexatronic: Fair value range**

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Hexatronic currently trades 25% of our Base-case. The share has had a strong run from the low level of around 10 SEK per share, but we find that today’s share price still implies a good enough margin of safety to our estimates.

**Bull-case assumptions**

In our Bull-case we assume that the company can live up to their goal of about 20% annual growth during the next couple of years and sustain a high growth rate. In this scenario we also model an increase their profitability due to scalability, and a successful international expansion. The large increase in international sales leads to a higher capacity utilization of Hexatronic’s production units.

**Bear-case assumptions**

In our Bear-case we assume a slower future demand for fiber due to financial distress in the market thus reducing the investments done by the telecom operators and new entrants gaining market share, like Nexans and Draka expanding their offerings. Lower growth, profitability and no acquisitions this give rise to a lower ROIC and lower terminal growth rates.

**Internal catalysts for value creation**

Hexatronic has stated that they see some cost synergies between them and TD Fibreroptik. If these synergies can be capitalized on this will most likely lead to an improved gross margin going onward, which will increase the cash flows and thus also the value of the company.

Hexatronic's system based offering could lead to a higher market share as the company competes with a better service than their competitors. This could result in a high revenue growth and thus a higher valuation.

*The system based offering could lead to higher market share*

The growth of infrastructure investment in fiber will be substantially over the coming years. Due to the large need of higher internet capacity, with the reason of changing consumer behaviour. The overall market growth will likely increase the revenue levels of Hexatronic and also the growth rates.

**External catalysts**

*Listing on Nasdaq Stockholm could lead to higher valuation levels*

Hexatronic, in its present shape, is a relatively new company. We find it likely that a future continued performance of the company will increase the investor awareness and thus enhance the valuation of the company.

## Summary Redeye Rating

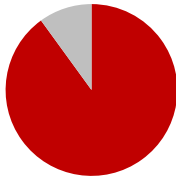
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The rating consists of five valuation keys, each constituting an overall assessment of several factors that are rated on a scale of 0 to 2 points. The maximum score for a valuation key is 10 points.

### Rating changes in the report

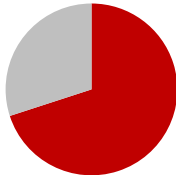
We have made some minor Rating adjustments due to board changes.

Management 9.0p



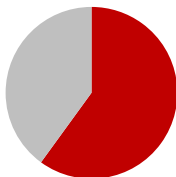
Hexatronic has a strong management team of entrepreneurial people with plenty of skin in the game. CEO have significant experience from the telecom industry. Staff at other key positions, that joined the group through last year's acquisitions, are also intact. The company has delivered so far on their financial goals but we would like to see further transparency on subsidiary/segment level as Hexatronics corporate structure becomes more and more complex.

Ownership 7.0p



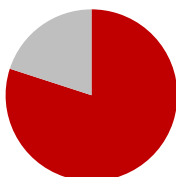
Hexatronic receives high scores in our ownership Rating. The CEO, Henrik Larsson-Lyon owns a significant stake in the company and Hexatronic has some of the most renowned institutional owners that focus on the small cap universe. The largest shareholder is the hedge-fund Accendo Capital, which is also an active member of the board. For the rating to increase even further more substantial holdings from other members of the board would be needed.

Profit outlook 6.0p



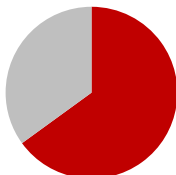
The rating for Growth Outlook is only average, in spite of good overall market prospects. The reason is mainly the competitive situation. Product differentiation appears to be difficult, thus price will always be an issue. Hexatronic is a small player compared to some of the dominant multinational companies. Surely that means growth opportunities but also challenges.

Profitability 8.0p



The last few years both the margins and return on capital has strengthened. We view Hexatronic's profitability levels as compelling and stable.

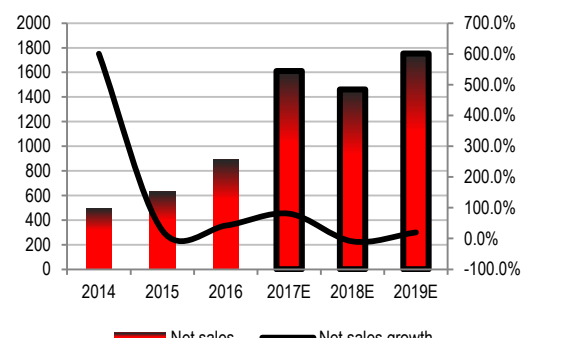
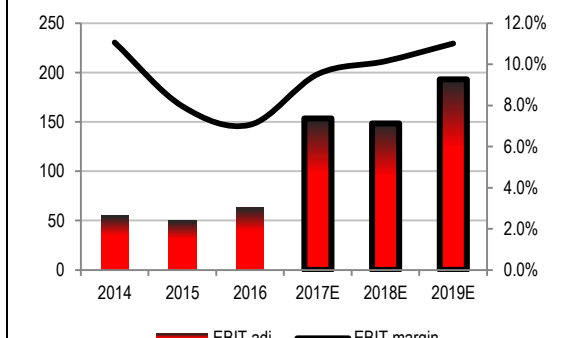
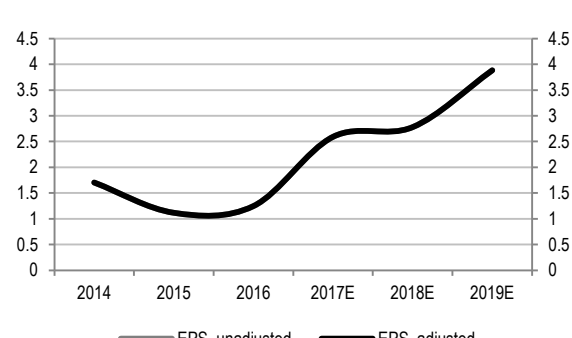
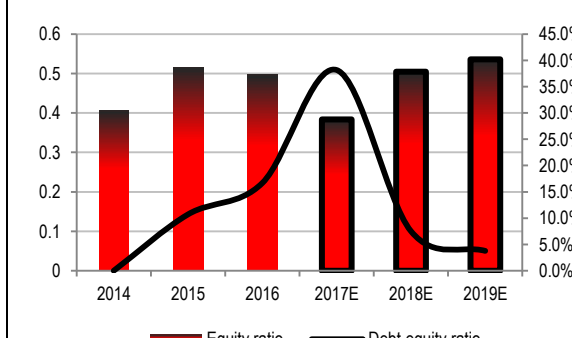
Financial strength 6.5p



In our view Hexatronic is very financial stable and scores high in most subcategories for Financial Strength. 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.



<b>Income statement</b>	<b>14/15</b>	<b>15/16</b>	<b>16/17E</b>	<b>2018E</b>	<b>2019E</b>
Net sales	627	891	1,610	1,461	1,753
Total operating costs	-564	-810	-1,425	-1,274	-1,518
<b>EBITDA</b>	<b>64</b>	<b>81</b>	<b>186</b>	<b>187</b>	<b>235</b>
Depreciation	-14	-18	-32	-37	-40
Amortization	0	0	0	-2	-2
Impairment charges	0	0	0	0	0
<b>EBIT</b>	<b>50</b>	<b>63</b>	<b>153</b>	<b>148</b>	<b>193</b>
Share in profits	0	0	0	0	0
Net financial items	-1	-8	-29	-15	-7
Exchange rate dif.	0	0	0	0	0
<b>Pre-tax profit</b>	<b>49</b>	<b>55</b>	<b>124</b>	<b>134</b>	<b>186</b>
Tax	-11	-13	-27	-29	-40
<b>Net earnings</b>	<b>37</b>	<b>42</b>	<b>97</b>	<b>104</b>	<b>146</b>
<b>Balance</b>	<b>14/15</b>	<b>15/16</b>	<b>16/17E</b>	<b>2018E</b>	<b>2019E</b>
<b>Assets</b>					
<i>Current assets</i>					
Cash in banks	46	51	81	85	124
Receivables	137	168	306	277	333
Inventories	164	198	370	336	421
Other current assets	8	15	26	24	29
<b>Current assets</b>	<b>356</b>	<b>431</b>	<b>783</b>	<b>722</b>	<b>906</b>
<i>Fixed assets</i>					
Tangible assets	43	81	161	161	193
Associated comp.	0	0	0	0	0
Investments	0	0	0	0	0
Goodwill	0	0	0	0	0
Cap. exp. for dev.	82	93	93	91	89
O intangible rights	0	0	0	0	0
O non-current assets	0	0	0	0	0
<b>Total fixed assets</b>	<b>126</b>	<b>174</b>	<b>254</b>	<b>252</b>	<b>282</b>
Deferred tax assets	0	0	0	0	0
<b>Total (assets)</b>	<b>482</b>	<b>605</b>	<b>1,038</b>	<b>974</b>	<b>1,189</b>
<b>Liabilities</b>					
<i>Current liabilities</i>					
Short-term debt	0	0	0	0	0
Accounts payable	73	102	242	219	263
O current liabilities	99	117	211	191	230
<b>Current liabilities</b>	<b>172</b>	<b>219</b>	<b>453</b>	<b>410</b>	<b>493</b>
Long-term debt	27	50	152	37	24
O long-term liabilities	0	0	0	0	0
Convertibles	0	0	0	0	0
<b>Total Liabilities</b>	<b>199</b>	<b>269</b>	<b>604</b>	<b>447</b>	<b>517</b>
Deferred tax liab	27	30	30	30	30
Provisions	7	5	5	5	5
Shareholders' equity	249	301	398	492	637
Minority interest (BS)	0	0	0	0	0
<b>Minority &amp; equity</b>	<b>249</b>	<b>301</b>	<b>398</b>	<b>492</b>	<b>637</b>
<b>Total liab &amp; SE</b>	<b>482</b>	<b>605</b>	<b>1,038</b>	<b>974</b>	<b>1,189</b>
<b>Free cash flow</b>	<b>14/15</b>	<b>15/16</b>	<b>16/17E</b>	<b>2018E</b>	<b>2019E</b>
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Depreciations total	-14	-18	-32	-38	-42
<b>EBIT</b>	<b>50</b>	<b>63</b>	<b>153</b>	<b>148</b>	<b>193</b>
Taxes on EBIT	-11	-15	-33	-33	-42
<b>NOPLAT</b>	<b>39</b>	<b>48</b>	<b>120</b>	<b>116</b>	<b>151</b>
Depreciation	14	18	32	38	42
<b>Gross cash flow</b>	<b>52</b>	<b>66</b>	<b>152</b>	<b>154</b>	<b>193</b>
Change in WC	-19	-23	-89	23	-63
Gross CAPEX	-126	-66	-113	-36	-72
<b>Free cash flow</b>	<b>-93</b>	<b>-23</b>	<b>-49</b>	<b>141</b>	<b>58</b>
<b>Capital structure</b>	<b>14/15</b>	<b>15/16</b>	<b>16/17E</b>	<b>2018E</b>	<b>2019E</b>
Equity ratio	52%	50%	38%	50%	54%
Debt/equity ratio	11%	17%	38%	8%	4%
Net debt	-19	-1	71	-48	-100
Capital employed	230	300	469	444	537
Capital turnover rate	1.3	1.5	1.6	1.5	1.5
<b>Growth</b>	<b>14/15</b>	<b>15/16</b>	<b>16/17E</b>	<b>2018E</b>	<b>2019E</b>
Sales growth	26%	42%	81%	-9%	20%
EPS growth (adj)	-35%	12%	108%	7%	40%
<b>DCF valuation</b>					
WACC (%)	10.0 %				
<b>Cash flow, MSEK</b>					
NPV FCF (2016-2018)					116
NPV FCF (2019-2025)					156
NPV FCF (2026-)					1716
Non-operating assets					51
Interest-bearing debt					-50
Fair value estimate MSEK					1988
Assumptions 2016-2022 (%)					
Average sales growth	12.1 %				
EBIT margin	10.7 %				
<b>Fair value e. per share, SEK</b>					<b>53.0</b>
Share price, SEK					40.8
<b>Profitability</b>	<b>14/15</b>	<b>15/16</b>	<b>16/17E</b>	<b>2018E</b>	<b>2019E</b>
ROE	21%	15%	28%	23%	26%
ROCE	26%	20%	34%	28%	33%
ROIC	48%	21%	40%	25%	34%
EBITDA margin	10%	9%	12%	13%	13%
EBIT margin	8%	7%	10%	10%	11%
Net margin	6%	5%	6%	7%	8%
<b>Data per share</b>	<b>14/15</b>	<b>15/16</b>	<b>16/17E</b>	<b>2018E</b>	<b>2019E</b>
EPS	1.12	1.25	2.59	2.78	3.88
EPS adj	1.12	1.25	2.59	2.78	3.88
Dividend	0.00	0.00	0.29	0.00	0.00
Net debt	-0.57	-0.03	1.90	-1.27	-2.67
Total shares	33.54	33.68	37.51	37.51	37.51
<b>Valuation</b>	<b>14/15</b>	<b>15/16</b>	<b>16/17E</b>	<b>2018E</b>	<b>2019E</b>
EV	336.7	750.1	1,545.9	1,427.0	1,374.5
P/E	9.8	17.9	15.7	14.7	10.5
P/E diluted	9.8	17.9	15.7	14.7	10.5
P/Sales	0.6	0.8	1.0	1.0	0.9
EV/Sales	0.5	0.8	1.0	1.0	0.8
EV/EBITDA	5.3	9.2	8.3	7.6	5.9
EV/EBIT	6.7	11.9	10.1	9.6	7.1
P/BV	1.4	2.5	3.7	3.0	2.3
<b>Share performance</b>		<b>Growth/year</b>		<b>14/16e</b>	
1 month	5.2 %	Net sales		60.2 %	
3 month	41.2 %	Operating profit adj		75.2 %	
12 month	142.9 %	EPS, just		52.4 %	
Since start of the year	10.3 %	Equity		26.5 %	
<b>Shareholder structure %</b>		<b>Capital</b>		<b>Votes</b>	
Accendo Capital		13.2 %		13.2 %	
Göran Nordlund, private & thr. Comp.		9.7 %		9.7 %	
Jonas Nordlund, private & thr. Comp		9.0 %		9.0 %	
Gert Nordin		8.0 %		8.0 %	
Martin Åberg och Erik Selin (Chirp AB)		4.9 %		4.9 %	
Placeringsfond småbolagsfond, Norden		3.7 %		3.7 %	
Jovitech Invest AB		3.5 %		3.5 %	
Försäkringsbolaget Avanza Pension		3.2 %		3.2 %	
Swedbank Robur Västfonden		2.8 %		2.8 %	
Henrik Larsson Lyon		2.3 %		2.3 %	
<b>Share information</b>					
Reuters code					
List					
Share price					40.8
Total shares, million					36.1
Market Cap, MSEK					1474.5
<b>Management &amp; board</b>					
CEO					Henrik Larsson-Lyon
CFO					Lennart Sparud
IR					
Chairman					Anders Persson
<b>Financial information</b>					
<b>Analysts</b>					<b>Redeye AB</b>
Kristoffer Lindstrom					Mäster Samuelsgatan 42, 10tr
kristoffer.lindstrom@redeye.se					111 57 Stockholm
Henrik Alveskog					
henrik.alveskog@redeye.se					

Revenue & Growth (%)	EBIT (adjusted) & Margin (%)																																										
 <p>Net sales (bars) and Net sales growth (line) from 2014 to 2019E. Net sales are shown in SEK million on the left axis (0-2000), and growth is on the right axis (-100.0% to 700.0%).</p> <table border="1"> <thead> <tr> <th>Year</th> <th>Net sales (SEK million)</th> <th>Net sales growth (%)</th> </tr> </thead> <tbody> <tr> <td>2014</td> <td>~500</td> <td>~600.0%</td> </tr> <tr> <td>2015</td> <td>~600</td> <td>~20.0%</td> </tr> <tr> <td>2016</td> <td>~900</td> <td>~50.0%</td> </tr> <tr> <td>2017E</td> <td>~1600</td> <td>~100.0%</td> </tr> <tr> <td>2018E</td> <td>~1450</td> <td>~20.0%</td> </tr> <tr> <td>2019E</td> <td>~1750</td> <td>~100.0%</td> </tr> </tbody> </table>	Year	Net sales (SEK million)	Net sales growth (%)	2014	~500	~600.0%	2015	~600	~20.0%	2016	~900	~50.0%	2017E	~1600	~100.0%	2018E	~1450	~20.0%	2019E	~1750	~100.0%	 <p>EBIT adj (bars) and EBIT margin (line) from 2014 to 2019E. EBIT adj is shown in SEK million on the left axis (0-250), and margin is on the right axis (0.0% to 12.0%).</p> <table border="1"> <thead> <tr> <th>Year</th> <th>EBIT adj (SEK million)</th> <th>EBIT margin (%)</th> </tr> </thead> <tbody> <tr> <td>2014</td> <td>~50</td> <td>~11.0%</td> </tr> <tr> <td>2015</td> <td>~50</td> <td>~7.0%</td> </tr> <tr> <td>2016</td> <td>~60</td> <td>~7.0%</td> </tr> <tr> <td>2017E</td> <td>~150</td> <td>~10.0%</td> </tr> <tr> <td>2018E</td> <td>~145</td> <td>~10.0%</td> </tr> <tr> <td>2019E</td> <td>~190</td> <td>~11.0%</td> </tr> </tbody> </table>	Year	EBIT adj (SEK million)	EBIT margin (%)	2014	~50	~11.0%	2015	~50	~7.0%	2016	~60	~7.0%	2017E	~150	~10.0%	2018E	~145	~10.0%	2019E	~190	~11.0%
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<p><b>Earnings per share</b></p>  <p>EPS, unadjusted (line) and EPS, adjusted (line) from 2014 to 2019E. Both are shown on the left axis (0-4.5).</p> <table border="1"> <thead> <tr> <th>Year</th> <th>EPS, unadjusted</th> <th>EPS, adjusted</th> </tr> </thead> <tbody> <tr> <td>2014</td> <td>~1.7</td> <td>~1.7</td> </tr> <tr> <td>2015</td> <td>~1.1</td> <td>~1.1</td> </tr> <tr> <td>2016</td> <td>~1.1</td> <td>~1.1</td> </tr> <tr> <td>2017E</td> <td>~2.7</td> <td>~2.7</td> </tr> <tr> <td>2018E</td> <td>~2.7</td> <td>~2.7</td> </tr> <tr> <td>2019E</td> <td>~3.9</td> <td>~3.9</td> </tr> </tbody> </table>	Year	EPS, unadjusted	EPS, adjusted	2014	~1.7	~1.7	2015	~1.1	~1.1	2016	~1.1	~1.1	2017E	~2.7	~2.7	2018E	~2.7	~2.7	2019E	~3.9	~3.9	<p><b>Equity &amp; debt-equity ratio (%)</b></p>  <p>Equity ratio (bars) and Debt-equity ratio (line) from 2014 to 2019E. Equity ratio is on the left axis (0-0.6), and debt-equity ratio is on the right axis (0.0% to 45.0%).</p> <table border="1"> <thead> <tr> <th>Year</th> <th>Equity ratio</th> <th>Debt-equity ratio (%)</th> </tr> </thead> <tbody> <tr> <td>2014</td> <td>~0.4</td> <td>~0.0%</td> </tr> <tr> <td>2015</td> <td>~0.5</td> <td>~10.0%</td> </tr> <tr> <td>2016</td> <td>~0.5</td> <td>~15.0%</td> </tr> <tr> <td>2017E</td> <td>~0.4</td> <td>~40.0%</td> </tr> <tr> <td>2018E</td> <td>~0.5</td> <td>~5.0%</td> </tr> <tr> <td>2019E</td> <td>~0.55</td> <td>~5.0%</td> </tr> </tbody> </table>	Year	Equity ratio	Debt-equity ratio (%)	2014	~0.4	~0.0%	2015	~0.5	~10.0%	2016	~0.5	~15.0%	2017E	~0.4	~40.0%	2018E	~0.5	~5.0%	2019E	~0.55	~5.0%
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<p><b>Conflict of interests</b></p> <p><b>Kristoffer. Lindström owns shares in the company Hexatronic: Yes</b></p> <p><b>Henrik. Alveskog owns shares in the company Hexatronic: No</b></p> <p>Redeye performs/have performed services for the Company and receives/have received compensation from the Company in connection with this.</p>	<p><b>Company description</b></p> <p>The Hexatronic group of companies are active in the optical fiber infrastructure market. They offer a complete line of products for passive and complementary active products for optical networks. Home market is Skandinavia and main costumers are large telecom operators such as Telia and Telenor. Partners like ABB and Ericsson give Hexatronic access to the world market.</p>																																										

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**Redeye Rating (2017-01-27)**

Rating	Management	Ownership	Profit outlook	Profitability	Financial Strength
7,5p - 10,0p	42	40	20	9	18
3,5p - 7,0p	72	65	95	35	46
0,0p - 3,0p	9	18	8	79	59
Company N	123	123	123	123	123

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