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An Equity Note

Brandon Beylo

brandon@macro-ops.com

What's Inside:

- Harvia PLC (HARVIA) Deep Dive

Companies Mentioned:

- Harvia PLC (HARVIA)
- Watsco (WSO)
- Constellation Software (CSU)

MO Equity Note: Harvia PLC (HARVIA) – A Compounder In The Making

The Lindy Effect reveals that the future life expectancy of any non-perishable item (or utility) is equally proportional to its current age.

Humans have used saunas for over 4,000 years. And despite our technocratic superiority, we *still* like sweating in tiny boxes.

According to Lindy, it's safe to assume that humans will *continue* to do so for at least another 4,000 years.

Betting on something humans have done and will continue to do for 4,000+ years is usually a good money-making strategy. How can we play this in public markets?

Enter Harvia.

Harvia (HARVIA) is the world's largest sauna and spa company. They sell heaters, ready-made saunas, sauna rooms, still-water hot tubs, generators, control units, and other spare parts and services.

The company is your classic roll-up acquirer, buying smaller sauna/spa companies in complementary verticals. In many ways, HARVIA reminds me of Watsco (WSO), an incredibly successful (and profitable) HVAC equipment roll-up. Luckasz Tomicki of LRT Capital wrote an excellent piece on WSO that you can read here.

Both HARVIA and WSO operate in highly fragmented industries. Both are market leaders. And both businesses have long runways for organic/inorganic growth.

WSO has returned ~14.5% per year over the last decade. HARVIA, on the other hand, has generated a 65% IRR since its IPO in 2018.

Here's the important part: we're in a sauna surge. Thanks to COVID, many consumers view saunas as another at-home essential, like working out, eating right, and sleeping.

The United States alone is a massive opportunity. Finland, for example, is a $20B sauna market with 2.5M saunas installed throughout the country. Which is wild because Finland has the same population as South Carolina.

On the other hand, the US sports only 1M saunas with ~$8B in industry revenue. That's massive whitespace for the taking.

HARVIA is growing revenue 50%+, generating 100%+ returns on capital employed (ROCE) and reducing debt. The company has all the ingredients to become a **serious compounde**r, one that trades with the likes of WSO and CSU (~20x+ EBITDA and 30x+ FCF).

Today, you can buy HARVIA for ~13x EBITDA and 22x FCF, which is a steal in our books.

Why does this opportunity exist?

The company invested heavily in 2021 to support increased manufacturing and capacity. Though these investments will pay dividends in the long-term, they optically distorted the company's short-term results by reducing cash conversion, margins, and free cash flow.

HARVIA's current share price provides an opportunity to buy this future compounder for <10x 2026E FCF.

We believe shares should be worth **over EUR 100/share** in five years, nearly 200% higher than the current stock price.

Here's the best part. This is the *first English-only* research report on the company.

Let's get after it.

A Crash Course on The Sauna Business

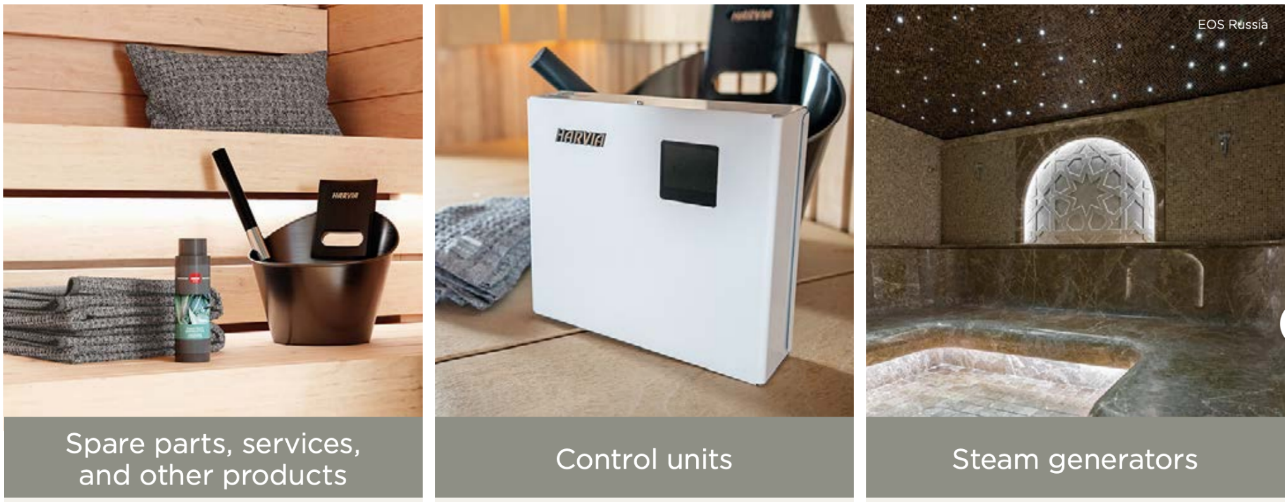
There are five main segments in the sauna/spa market:

- **Sauna Heaters**
- **Sauna rooms/Scandinavian tubs**
- **Control Units**
- **Steam Generators**
- **Other (Services, Infrared Radiators, and spa components)**

Let's explain how each above segment works together to create the sauna experience.

A sauna heater is that little box in the corner of every sauna that heats the room. Customers can buy wood-burning or electric heaters.

Rooms vary in size and design but are typically smaller, wooden structures. Then there are the control units. Think of those as the thermostat for the sauna (where you can set temperatures, etc.). Steam generators are self-explanatory and optional.



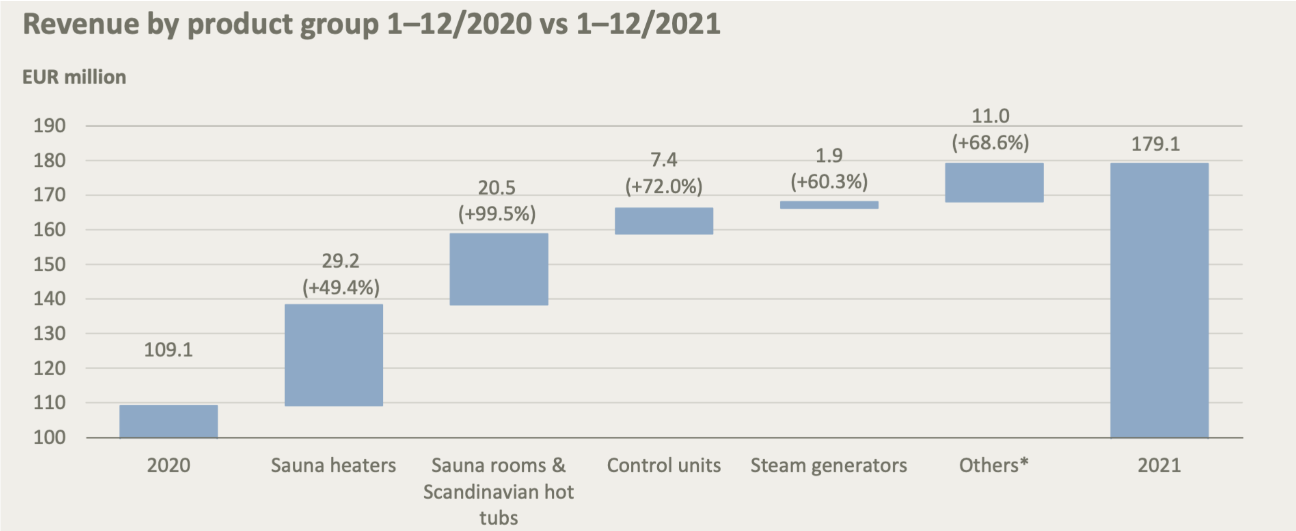
The important thing to remember here is that **each of the above five segments feeds off the other to create a profitable, recurring revenue business.**

Suppose HARVIA sells a sauna room to a hotel. Not only can HARVIA sell the room, but also the heaters, control units, spare generators, and any maintenance service along with the life of the sauna.

HARVIA deploys a land-and-expand model. They capture the customer with the room they need, then generate high-margin revenues with added services and required components.

Installed Units are the most important KPI in this game. Currently, there are 17M saunas installed worldwide. Each of those 17M saunas requires maintenance repair or generator/heater replacement.

More installed units mean more high-margin service and replacement part revenue. HARVIA makes most of its money selling heaters and rooms. For reference, out of the EUR 179M in revenue generated last year, EUR 49.5M came from heaters and rooms.



Replacement parts are a critical component of HARVIA's revenue. For example, the company estimates that ~80% of heater and equipment sales are *replacement* parts. Replacements also account for ~60% of sauna room sales.

It's hard to overstate how powerful this replacement model can be for shareholders. Look no further than TransDigm (TDG), which owns the aircraft replacement aftermarket industry.

TDG has consistently generated 50%+ gross margins and 30%+ EBIT margins from mainly selling aircraft replacement parts. TDG shareholders have also enjoyed a 22.5% IRR over the last 16 years. **It's a pretty good business.**

The Leader In A Highly Fragmented Industry

HARVIA operates in two *highly-fragmented* spaces: sauna/spa and heaters/components. The company is a global leader in both markets yet commands only 5% market share in sauna/spa and 20% market share in heaters/components.

Serial acquirers like HARVIA *love* highly fragmented markets. It means they can buy as many businesses as they want over the coming decades and generate above-average organic/inorganic revenue growth.

Of course, the most critical question to ask when assessing serial acquirers is, "why should a company sell to HARVIA?" There are a couple key reasons.

First, HARVIA boasts an unrivaled distribution system. Through its global distributor network, the company sells to specialist stores, retail stores, wholesalers, and DIY chains.

Second, acquired companies can increase sales through relationships with HARVIA's other acquired businesses. Remember, sauna rooms need control units, replacement heaters, etc.

HARVIA's recent acquisitions include *Almost Heaven Saunas, EOS, Kirami,* and *Sentiotech.* Let's use *Kirami* to highlight HARVIA's core acquisition strategy.

Kirami is a Finnish family-owned company and the largest manufacturer of still-water hot tubs globally.

The acquisition is a win-win for *Kirami* and HARVIA.

HARVIA adds exposure to a diversified hot tub revenue stream with a world-class manufacturer.

Kirami, on the other hand, leverages HARVIA's global distribution network and like-minded customer base to cross-sell products across the Atlantic (i.e., in the US) for the first time ever.

Not to mention the financial stability and dependency *Kirami* enjoys as part of the larger HARVIA.

Over time, HARVIA's competitive advantages grow exponentially with each new acquisition. More acquisitions mean **more cross-selling** for acquired companies and **more robust financial stability**, generating **a greater desire to operate under the HARVIA umbrella.**

HARVIA's Long-Term Growth Outlook

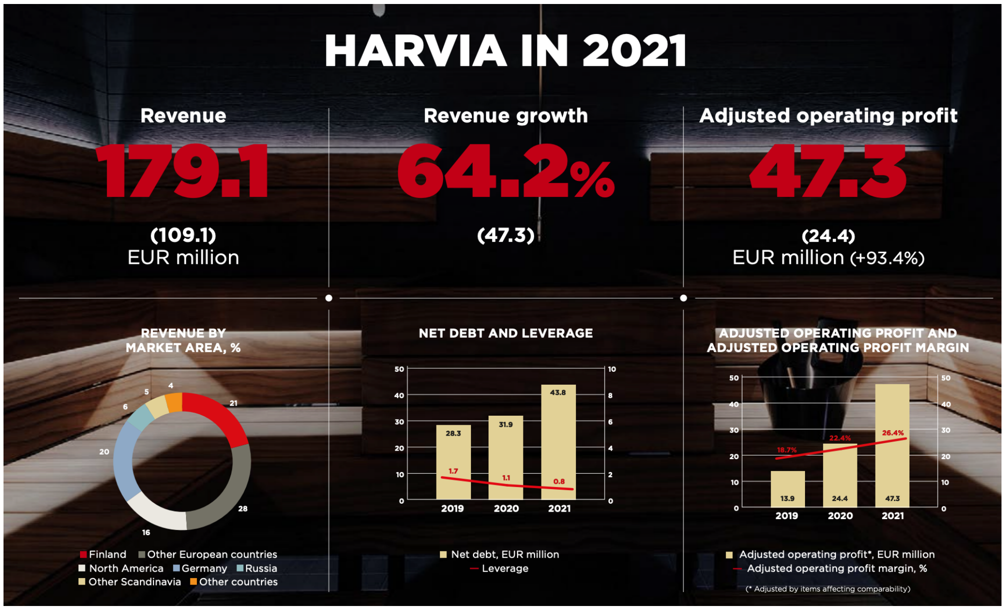
As mentioned earlier, humans will continue to use saunas for the next 4,000 years. This bodes well for HARVIA's replacement and services business. But what about new business? What about expanding their installed base?

Enter the United States.

The US is a massive, 300M+ person market with only 1M installed saunas (2018). Thanks to COVID, Americans are *finally* considering the immense health benefits of sauna exposure. HARVIA explains the American sauna surge in its 2021 Annual Report (emphasis mine):

> *"In the United States,* ***the sauna culture is still rather young and the sauna penetration is low.*** *On top of commercial sauna solutions at high-end hotels and gyms,* ***the sauna has become more popular in premium residential applications.***

Lately, the trend of active backyard living has increased throughout North America. Building a backyard paradise for relaxation and enjoyment together with family and friends has become very popular. In addition to the traditional barbecue and a hot tub or pool, ***outdoor saunas are showing up in more and more backyards.*** *Especially the traditional barrel sauna is becoming a vital ingredient of the backyard paradise concept."*



The sauna trend is here to stay and will become a *permanent* fixture in everyday life. Regular sauna bathing reduces the risk of

- Heart-related deaths
- Dementia
- Alzheimer's Disease
- High blood pressure
- Pulmonary disease
- Stroke

Armed with such health benefits, we expect that more people will choose saunas over hot tubs as both a status *and* health symbol to their peers.

What does this mean for HARVIA? Two things: **more installed bases** and **more replacement parts/maintenance sales.**

HARVIA expects long-term sauna/spa growth rates to fall around 5%. However, the company has historically *crushed* Its industry average.

For example, HARVIA has grown revenue at a blistering 43% CAGR since its IPO in 2018. Last year (2021), the company grew revenue by 64% with **43% organic growth.**

HARVIA can reasonably grow revenues at a 15-20% CAGR over the next decade between organic growth and acquisitions.

Great Business For A Great Price

HARVIA doesn't screen wildly cheap. It's trading at a modest 13x EBITDA and 22x FCF. HARVIA will likely **never** look cheap and should command a 25-30x FCF over the long term.

The company is the industry leader generating 100%+ ROCE in a highly fragmented market with the largest economy in the world *finally* increasing demand.

Suppose HARVIA generates a ~19% revenue CAGR over the next five years at ~27% EBITDA margins (in line with estimates).

Financial targets

	TARGET	2021
GROWTH	Average annual revenue growth of more than 5%	64.2% in total, with acquisitions 43.3% organic growth
PROFITABILITY	Adjusted operating profit margin exceeding 20% [1)]	26.4%
LEVERAGE	Net debt per adjusted EBITDA in the range of 1.5x–2.5x [2)]	0.8

By 2026, HARIVA would generate EUR 422M in revenue and EUR 118M in EBITDA. After subtracting taxes, capex, and adding back D&A, we're left with EUR 75M in free cash flow (<10x current EV).

In other words, you can buy this future compounder for a ~10% 2026 FCF yield.

HARVIA is a world-class company rolling up a highly fragmented space and doing so at 100%+ returns on capital. Businesses like that don't trade at market multiples.

In fact, we'd argue that investors should assign anywhere from a 20-25x FCF multiple for this business. Assuming a 25x multiple on 2026E FCF, **we get a EUR 1.875B company (EUR 100/share) or ~170% higher than the current market price. (EUR 38/share).**

Finally, insiders are aligned with shareholders. Management owns stock, and long-term incentive bonuses depend on revenue growth, EBIT margins, and total shareholder returns.

It's not often that Mr. Market offers a chance to buy a world-class compounder for <10x a few years out FCF.

Most investors will miss this opportunity because it's not a US company, doesn't trade on a US-based index, and IPO'd in 2018.

In fact, this is the ***first-ever*** English-based research report on the company.

That is the power of Macro Ops. We go where others don't to find businesses others can't. We'll buy a starter position Monday.

Portfolio Updates

Buys

- **STARTER LONG** in Twitter (TWTR)
- **STARTER LONG** in Telefonica Brasil (VIV)
- **STARTER LONG** in Desktop Metal (DM)
- **TACTICAL LONG** in Bitcoin (BTCUSD)

Sells

- **EXIT** Russell 2000 (RTYH2022) Short
- **EXIT** Navios Maritime (NMM) Long
- **EXIT** Tesla, Inc. (TSLA) Short