

# German industrials spotlight

## Abenomics is working!

- **Abenomics should lead to higher exports from Japan.**
- **German industrials' global market share under threat.**
- **Separately, we focus on two stocks exposed to China.**

Abenomics may actually be working! The Bank of Japan's closely watched Tankan survey, which measures sentiment among large manufacturers, was +4 in June. That is the highest reading since March 2011 (+6). Industrial production rose 2% in May vs April, the fourth consecutive monthly rise.

In the [last issue](#) we illustrated how German auto suppliers are exposed to a falling yen and rising Japanese exports. This time we expand the analysis to the rest of the industrials sector. Two sub-sectors that feature heavily in each country's stock-market indices are industrial machinery and chemicals. Industrial machinery constitutes 15% of MSCI Japan Industrials (versus 20% of MSCI Germany Industrials) while chemicals constitutes 15% of MSCI Japan Industrials (versus 21% of MSCI Germany Industrials). We can safely assume that businesses from each country compete head to head in these two global markets. An excellent example is forklift trucks where Toyota Material Handling competes globally with Jungheinrich. The threat is clear. Without the advantage of a weaker euro there must be a risk that German industrial exporters lose global market share to cheaper Asian competition. There will be pressure to lower costs in order to offset the inevitable downward pressure on output prices. How ironic that Clemens Fuest, president of the ZEW institute, sees a risk of "Japanese stagnation" in the eurozone under current ECB policies.

Separately, we look at two companies exposed to new build construction markets in China. In each case the share price has been falling on macro concerns, despite positive revisions to 2013 consensus earnings.

### Homag Group: Three-month EPS revisions +4.7%

Homag produces sophisticated woodworking machinery. Consensus forecasts were revised higher following the last two quarterly results. Homag is a direct play on the urbanisation of China, which may explain current nervousness around the stock. However, this is a research-driven business (R&D/sales = 6%, gross margins = 57%) with a global market share of 28% (company estimate) and growing. Valuation is reasonable. EV/EBITDA = 5.8x and P/B = 1.4x (both 12m trailing).

### Joyou: Three-month EPS revisions +1.2%

Joyou produces bathroom sanitary ware under its own brand and distributes international sanitary ware brands throughout PRC (including those of parent company Grohe). In Q113 Joyou reported revenue growth of 7%, in line with forecasts. Margins declined as expected due to product mix. Despite regulatory headwinds affecting the real estate sector in China, management gave an upbeat assessment of long-term future growth. The group has net cash and its valuation is low, on an EV/EBITDA of 3.7x and P/B of 0.7x (both 12-month trailing).

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#### MDAX Industrials Index



#### Ifo business expectations



#### Industrial Production SA



Source: Deutsche Bundesbank

**Exhibit 1: Overlooked and undervalued**

Stock name	Sub-sector	Market cap (€m)	Quality		Value		Rank
			Net gearing %	EBIT margin* %	P/BV	EV/EBITDA	
KOENIG & BAUER AG	Industrial machinery	227	-24	1.3	0.5	1.9	1
SALZGITTER AG	Steel	1,491	-3	0.0	0.4	3.4	2
STEICO SE	Building products	52	-4	5.1	0.6	3.0	3
OCEANICA GMBH & CIE KGAA	Marine	11	-63	63.8	0.8	1.0	4
EUROKAI KGAA	Marine ports & services	262	20	10.5	0.7	3.6	5
NORDWEST HANDEL AG	Trading companies & distributors	41	-49	0.6	0.8	1.9	6
<b>JOYOU AG</b>	<b>Building products</b>	<b>241</b>	<b>-7</b>	<b>16.8</b>	<b>0.7</b>	<b>3.7</b>	<b>7</b>
MUEHLHAN AG	Marine ports & services	30	25	0.1	0.6	4.4	8
AURUBIS AG	Diversified metals & mining	1,765	10	4.2	0.8	4.4	9
KSB AG	Industrial machinery	765	-15	7.0	1.0	3.6	10
GREIFFENBERGER AG	Industrial machinery	27	131	2.1	0.9	4.2	11
BREMER LAGERHAUS-GESELL AG	Marine ports & services	211	120	5.8	0.6	5.0	12
LEWAG HOLDING AG	Industrial machinery	26	15	4.6	0.9	4.5	13
TURBON AG	Office services & supplies	30	-3	8.1	1.1	3.4	14
NORDDEUTSCHE STEINGUT AG	Building products	25	68	4.4	0.8	4.9	15
RHEINMETALL AG	Industrial conglomerates	1,412	22	6.9	1.0	4.5	16
WESTAG & GETALIT AG	Building products	109	-8	5.4	0.9	5.1	17
DEUFOL SE	Air freight & logistics	31	67	2.9	0.3	6.5	18
IMPREGLO SE	Specialty chemicals	65	46	7.5	1.2	4.8	19
MARENAVE SCHIFFAHRTS AG	Marine	72	152	18.7	0.5	6.7	20

Source: Bloomberg. Notes: \*Three-year historical average. Data as at 8 July 2013.

**Exhibit 2: Rising revisions**

Stock name	Sub-sector	Market cap (€m)	Performance* %			EPS revisions %			Rank
			1m	3m	12m	1m	3m	12m	
BAYWA-BAYERISCHE WARENVERMIT	Trading companies & distributors	1,303	-1.2	4.8	31.3	7.1	6.1	42.9	1
SFC ENERGY AG-BR	Electrical components & equipment	34	-17.7	-15.6	-30.6	0.0	400.0	175.0	2
DUERR AG	Industrial machinery	1,672	-1.2	24.5	92.1	0.3	5.0	23.6	3
KUKA AG	Industrial machinery	1,149	-1.9	7.9	80.1	0.0	2.6	32.4	4
<b>HOMAG GROUP AG</b>	<b>Industrial machinery</b>	<b>214</b>	<b>-9.8</b>	<b>-0.8</b>	<b>16.2</b>	<b>0.0</b>	<b>4.7</b>	<b>19.7</b>	<b>5</b>
SCHALTBAU HOLDING AG	Industrial machinery	218	0.3	14.9	34.2	0.0	12.9	2.0	6
MBB INDUSTRIES	Industrial conglomerates	143	0.4	27.9	174.8	0.0	1.0	54.5	7
FRANCOTYP-POSTALIA HOLDING A	Office services & supplies	53	-0.6	45.3	44.8	0.0	23.7	-1.1	8
KRONES AG	Industrial machinery	1,739	1.2	2.0	31.2	0.4	1.5	0.3	9
JUNGHEINRICH - PRFD	Construction & farm machinery & heavy trucks	1,190	0.4	12.0	57.6	0.6	0.2	1.7	10
LOGWIN AG	Air freight & logistics	143	0.6	-6.2	16.6	0.0	0.0	33.3	11
<b>JOYOU AG</b>	<b>Building products</b>	<b>241</b>	<b>-14.3</b>	<b>-9.1</b>	<b>25.8</b>	<b>0.0</b>	<b>1.2</b>	<b>3.1</b>	<b>12</b>
FUCHS PETROLUB AG	Commodity chemicals	3,881	-9.0	-13.6	25.7	0.3	-0.4	3.3	13
NORMA GROUP	Industrial machinery	917	5.0	20.7	58.2	0.0	1.8	-3.7	14
GILDEMEISTER AG	Industrial machinery	1,041	0.4	14.2	24.6	0.3	1.6	-5.3	15
INDUS HOLDING AG	Industrial conglomerates	546	-2.6	4.6	23.6	1.1	1.1	-8.8	15
DYCKERHOFF AG - PRF	Construction materials	2,027	-0.4	13.7	68.2	0.0	0.0	0.0	17
UZIN UTZ AG	Specialty chemicals	106	-2.2	3.0	11.8	0.0			18
OHB AG	Aerospace & defence	296	6.0	6.6	31.7	0.5	-2.0	2.8	19
MASCH BERTHOLD HERMLE AG-VOR	Industrial machinery	710	0.0	7.7	72.6	0.0	-1.1	12.0	20

Source: Bloomberg. Notes: \*Total return. Data as at 8 July 2013.

## Appendix 1: Screening methodology

### Universe

We include all non-DAX30 stocks classified under GICS Level 1 Industrials or GICS Level 1 Materials, subject to a minimum market cap of €10m. This provides a universe of 140 stocks, some of which are excluded from the analysis due to lack of data.

### Exhibit 1: Overlooked and undervalued

Our first screen looks for financially sound companies trading on low multiple of assets (P/BV) and low multiple of core profits (EV/EBITDA). The universe of stocks is ranked first by P/BV and secondly by EV/EBITDA. An equal weighted composite rank is then computed.

This screen provides us with a list of top 20 'value' stocks that may have been neglected by investors.

This may be due to structural reasons such as low free float or poor liquidity. It may also indicate a business that is in serious operational or financial difficulty. Alternatively, a low rating may simply be a result of cyclical pressures. Empirical evidence suggests that stock-markets de-rate industrial stocks too aggressively when earnings are at or are close to cyclical troughs.

### Exhibit 2: Rising revisions

Generally speaking, stock-markets struggle to value companies with cyclical earnings streams.

Analysts struggle to model operating leverage, particularly in asset intensive companies such as those found in the Industrials sector. As a result, consensus earnings may be upgraded continually as business conditions improve. Empirical evidence suggests this alone can drive positive share price performance.

Our second screen looks for companies with positive earnings revisions. The stock universe is ranked by percentage change to 2013 consensus earnings over one-month, three-months, and 12-months respectively. An equal weighted composite rank is then computed.

This screen provides us with a list of top 20 'momentum' stocks which have the potential to both produce positive earnings surprises and attract a higher stock-market rating, particularly if valuation is supportive.

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