

# German industrials spotlight

## Sand in the gears

- Yen depreciation presents a challenge for the auto sector.
- Mid-cap revenues exposed to the big four German auto companies.
- Separately, we focus on two stocks trading on low valuations.

### Sand in the gears

The German auto industry is under threat from cheaper Asian imports. Despite the recent correction, the yen has weakened by 14% vs the euro year to date (to 31 May). This is principally due to the Bank of Japan's plans to double the monetary base and give Japanese auto manufacturers a significant price advantage over European peers. Furthermore, Japan's reflationary policies are likely to provoke reciprocal action from key trading partners such as China and South Korea. If a series of competitive devaluations develops, then the euro will automatically appreciate vs both the yen and the won. Under this scenario, Asian cars will offer increasing value to eurozone consumers and German manufacturers may begin losing market share in their home continent. These developments coincide with deepening concern about China's economic outlook. China is an increasingly important export market for German auto manufacturers and lower demand growth from this region would have a noticeable impact on revenues and profits.

The impact on mid-cap industrials should not be underestimated. The big four German auto manufacturers are key customers for companies in the auto components, chemicals, industrial machinery and steel sectors. Prime examples are Grammer (61% sales to auto industry) and SHW (100 % sales to auto industry).

Separately, we look at two stocks that appear in the top half of our value screen, have a high free float and are under-researched. Both stocks have the potential to rerate and could, in theory, be acquired.

### Dr. Hönle: Free float 85%; value rank 38/118

Dr. Hönle manufactures ultra-violet (UV) technology products. Applications range from printers to adhesive bonding. The balance sheet has net cash and operating margins average 12.6% over the past three years. Only three sell-side analysts have a recommendation on the stock (source: Bloomberg); however, the shareholder base includes stalwart names such as Loys (3%) and Allianz (2%) (source: Bloomberg).

### Centrotec: Free float 86%; value rank 39/118

Centrotec produces efficient climate and gas flue systems for buildings. It also has a medical technology subsidiary. Net gearing is 27% and operating margins have averaged 6.2% over three years. According to Bloomberg, only seven sell-side analysts officially cover the stock, which is below the sector average (eight). Key shareholders include Fidelity (6%), Allianz (3%) and Union Investment (2%) (source: Bloomberg).

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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	
UNITED POWER TEC	Electrical components & equipment	42	(35)	14.8	0.4	0.2	1
KOENIG & BAUER	Industrial machinery	262	(24)	1.3	0.6	2.6	2
YOUBISHENG GREEN	Paper packaging	48	(64)	23.4	0.7	0.2	3
STEICO SE	Building products	54	(4)	5.1	0.7	3.0	4
SALZGITTER AG	Steel	1,841	(3)	0.0	0.4	4.2	5
NORDWEST HANDEL	Trading companies & distributors	41	(51)	0.6	0.8	1.7	6
EUROKAI KGAA	Marine ports & services	281	20	10.5	0.7	3.8	7
NORDDEUTSCHE STE	Building products	23	68	4.4	0.7	4.6	8
JOYOU AG	Building products	292	(7)	16.8	0.8	4.6	9
BREMER LAGERHAUS	Marine ports & services	223	120	5.8	0.6	5.1	10
GREIFFENBERGER	Industrial machinery	28	131	2.1	0.9	4.3	11
KSB AG	Industrial machinery	794	(15)	7.0	1.0	3.7	12
RHEINMETALL AG	Industrial conglomerates	1,557	22	6.9	1.1	4.8	13
SIXT AG	Trucking	798	137	10.9	1.4	3.7	14
TELEGATE AG	Diversified support services	174	(83)	20.7	1.5	1.6	15
AURUBIS AG	Diversified metals & mining	2,142	10	4.2	1.0	5.3	16
DEUFOL SE	Air freight & logistics	34	67	2.9	0.4	6.6	17
WACKER CHEMIE AG	Specialty chemicals	3,010	38	12.3	1.3	4.7	18
MARENAVE SCHIFFA	Marine	68	152	18.7	0.5	6.6	19
TURBON AG	Office services & supplies	33	39	7.4	1.2	5.1	20

Source: Bloomberg. Notes: \*Three-year historical average. Data as at 29 May 2013.

**Exhibit 2: Rising revisions**

Stock name	Sub-sector	Market cap (€m)	Performance* %			EPS revisions %			Rank
			1m	3m	12m	1m	3m	12m	
SFC ENERGY AG-BR	Electrical components & equipment	44	17.4	5.4	4.6	400.0	250.0	175.0	1
HOMAG GROUP AG	Industrial machinery	238	7.0	17.3	53.8	1.7	9.8	9.5	2
LOGWIN AG	Air freight & logistics	149	(4.0)	1.9	10.6	0.0	100.0	33.3	3
KUKA AG	Industrial machinery	1,274	12.0	9.8	118.1	1.0	4.1	34.3	4
FRANCOTYP-POSTAL	Office services & supplies	48	19.2	12.1	25.2	12.6	5.4	3.2	5
DUERR AG	Industrial machinery	1,821	25.2	28.4	155.4	0.8	3.7	37.1	6
MBB INDUSTRIES	Industrial conglomerates	142	13.5	6.3	154.6	0.0	1.0	80.0	7
MTU AERO ENGINES	Aerospace & defence	4,089	11.4	12.1	35.2	0.3	3.1	5.7	8
JUNGHEINRICH-PFD	Construction & farm machinery & heavy trucks	1,275	19.6	11.8	65.9	1.2	1.1	2.1	9
JOYOU AG	Building products	292	11.9	29.1	58.2	0.3	1.2	3.1	10
KRONES AG	Industrial machinery	1,773	7.4	12.7	41.5	0.3	4.8	0.6	11
NORMA GROUP	Industrial machinery	892	5.6	7.1	54.9	1.4	2.8	(3.8)	12
SYMRISE AG	Specialty chemicals	3,783	3.1	12.1	41.2	0.5	0.2	2.8	13
R STAHL AG	Industrial machinery	237	5.0	31.1	49.6	(0.1)	9.6	12.3	14
NORDEX SE	Heavy electrical equipment	441	10.9	50.1	85.3	14.8	75.4	(23.8)	15
2G ENERGY AG	Heavy electrical equipment	180	4.0	6.9	24.1	3.7	7.3	(18.9)	15
DYCKERHOFF-PRF	Construction materials	2,034	15.8	11.7	68.1	0.0	0.0	0.0	17
BAYWA AG-VINK.	Trading companies & distributors	1,358	6.9	2.4	47.3	(0.8)	6.8	33.4	18
FUCHS PETROLUB	Commodity chemicals	4,449	3.5	10.4	55.9	0.0	(0.2)	3.0	19
UZIN UTZ AG	Specialty chemicals	109	12.3	13.8	17.4	0.0		(2.0)	20

Source: Bloomberg. Notes: \*Total return. Data as at 29 May 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 which 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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