EDISON

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

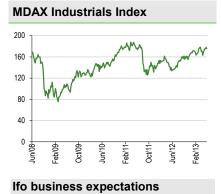
Centrotec produces efficient climate and gas flue systems for buildings. It also has a medical technology subsidiary. Net gearing is 27% and operating margins have averaged 6.2% over three years. According to Bloomberg, only seven sell-side analysts officially cover the stock, which is below the sector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

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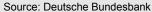




Exhibit 1: Overlooked and undervalued

| Stock name | Sub-sector | Market cap (€m) | Qua | 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 | ç |
| 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 |
| SIXTAG | 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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