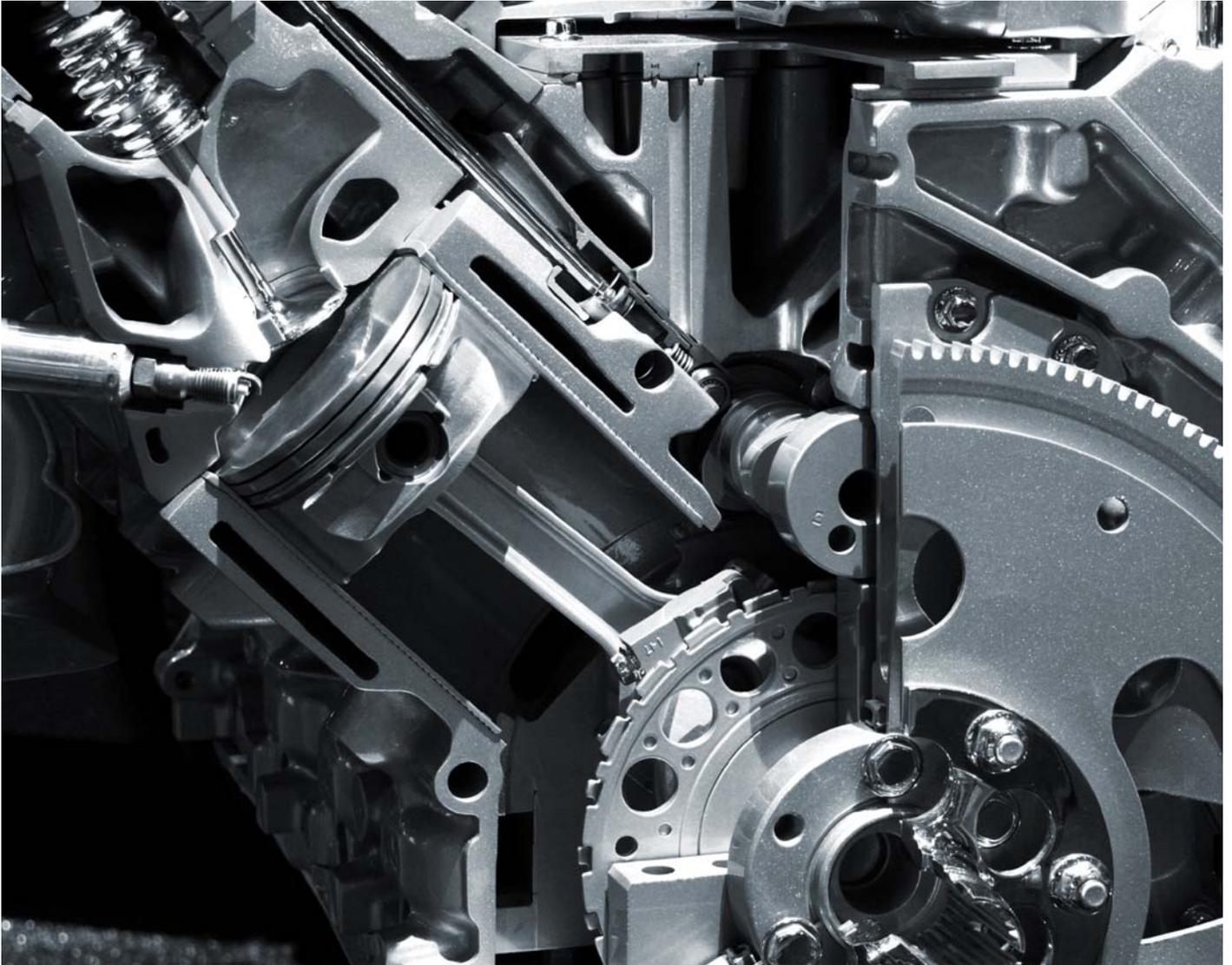




EDISON



German Mittelstand Conference

Strategy | Company profiles

October 2013

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Reena Dennhardt
Director of Edison Germany

Welcome to the Edison research guide for the OktoberINVESTfest. This book profiles the 10 German micro-caps presenting at the Invest in Bavaria forum and opens with a strategy overview from Edison's strategist, Alastair George, highlighting the discrepancy in equity valuations between the US and Europe.

German unemployment is at a 20-year low, and the budget deficit is a fraction of that of the US, Japan or the UK. The Mittelstand (defined as companies with less than €50m in revenue), accounts for 38% of German corporate revenue. Characterised by a high level of engineering sophistication and quality, this market has proved resilient to cheaper competition by maintaining a technical edge and a focus on exports.

Edison is Europe's leading investment intelligence firm, setting the standards for investor interaction with corporates. Our team of over 100 analysts and investment professionals work with leading companies, fund managers and investment banks worldwide to support their capital markets activity. We provide services to more than 400 retained corporate and investor clients from our offices in London, New York, Frankfurt, Sydney and Wellington and our research can be accessed free of charge from our website www.edisoninvestmentresearch.com/.

Reena Dennhardt
Director of Edison Germany



Wolfgang Huebschle
Executive Director

OktoberINVESTfest, the annual international investors and partnering forum held in New York City, is hosted by Invest in Bavaria in co-operation with Livingston Securities and our US and German partner organisations. The forum aims to foster innovation by enabling investors to learn about selected growth companies, while also providing these companies with access to capital to expand their businesses.

This year's programme features distinguished panelists and speakers, complemented by a mix of discussions and presentations. US and German investors and business leaders will share ideas on how to finance business expansion through various economic cycles. Simultaneously, companies will present their latest innovations, with a focus on the digital world.

As part of the OktoberINVESTfest, the German Mittelstand Conference offers institutional investors the opportunity to meet board members from leading German Mittelstand companies as they present their products and business models. The resulting new business opportunities will deepen transatlantic relations and encourage economic and scientific exchange.

The final highlight of the full-day event will be the Little OktoberINVESTfest, when participants can meet in an informal environment over Bavarian beer and cuisine.

We wish everybody a productive OktoberINVESTfest.

Wolfgang Huebschle
Executive Director
Bavarian US Offices for Economic Development, LLC

Global perspectives: Waiting for a clear shot

- **In recent years a number of easily visualised and widely discussed risks have failed to materialise.** These “asteroid impact” risks have included a total collapse of the developed world’s banking system, a break-up of the eurozone, major social instability, a hyper-inflationary episode or a slide into deflation.
- **None of these events, which were always low probability, have thus far occurred in the world’s larger economies.** In response, judging by developed market equity valuations, investors now fear little. This is not the same as having little to fear.
- **In our view, investors should now be taking a much closer look at the rather mundane but equally important investment risks of growth and valuation.** Economic growth in developed markets remains weak in a historical context. The cost of the global credit bubble in terms of lost output may not be reflected in asset prices, but is clearly visible in the GDP data.
- **Even more importantly, both the US and UK equity markets look extended on traditional valuation parameters.** The median dividend yield in these markets is back to 2007 levels. A key driver has been the amount of global monetary stimulus, which has driven a wedge between asset prices and underlying weak economic performance. Though September’s Fed meeting surprised markets by maintaining the current level of US QE, we continue to believe there is a strong likelihood of tapering by the end of this year.
- **What to do while waiting for a clear shot.** We highlight that following the recent sell-off, emerging market equities are now attractively valued based on dividend yields and price to 10-year average earnings. The delay to US QE tapering should also offer emerging market currencies some relief from recent capital outflows.

Analyst

Alastair George

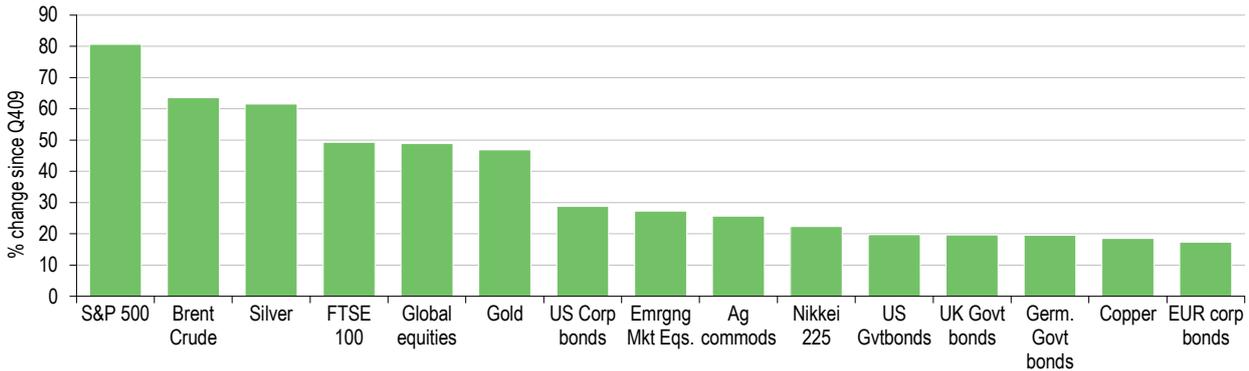
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Investors' "wall of worry" has been climbed

An unusually high level of investor caution following the market declines of 2008 paved the way for a bull market with both bonds and equities performing substantially in excess of normal expectations since then, Exhibit 1. Bonds were the direct beneficiaries of central bank purchases and real yields for a time were pushed into negative territory. Despite only disappointing growth in both emerging and developed markets, equity investors who have been prepared to ride the volatility have benefited from some of the strongest-ever gains over the last four years.

Exhibit 1: Bull market of Q209 – Q313

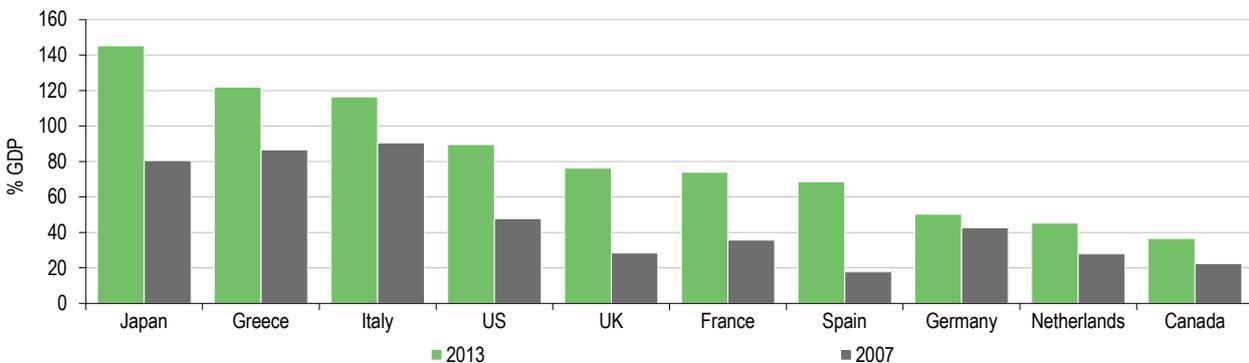


Source: Datastream. Note: Returns include dividends/coupons reinvested and shown in US\$.

This long period of exceptional returns is a strong disincentive to question the rationale for remaining invested. There has been no reward for selling since the turn of the decade – a period sufficiently long to have seen careers burnished and positions entrenched for those with bullish views. In short, the wall of worry has been climbed, leaving the optimists in charge.

The absence of questions may be contributing to the inherent contradictions observable across asset classes. Highly valued equity markets would normally imply confidence in robust growth in GDP and/or corporate profits such as in the 1960s or 1990s. Yet central bankers are keeping interest rates at ultra-low levels and depressing bond yields via QE to prevent a relapse in economic activity and a slide into deflation. Meanwhile, precious metals have also delivered strong returns despite being more strongly linked to inflation, which has thus far been absent. If investors have stopped questioning these contradictions, dangerous times for financial markets may lie ahead.

Exhibit 2: Change in government net debt as % GDP

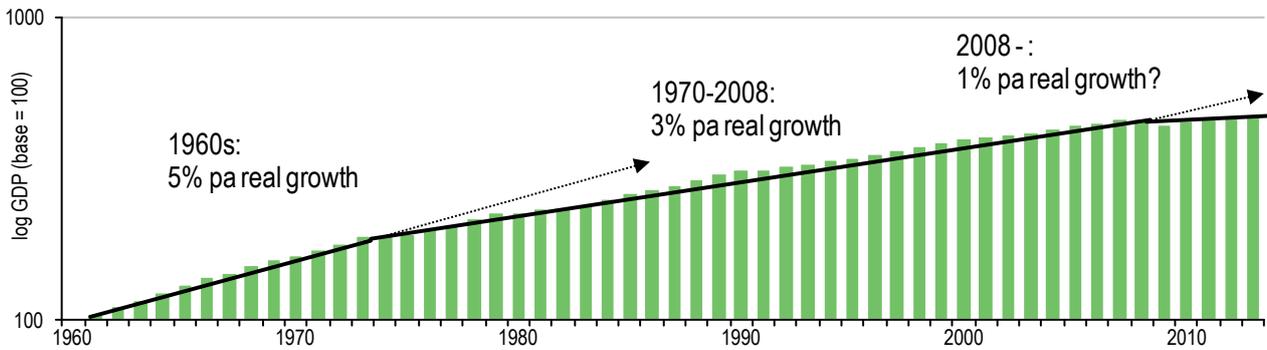


Source: OECD

For us, intellectual tensions have never been higher. We could attempt to rationalise evidence of inconsistency between still very low bond yields and high equity valuations with a new model of growth later, but stronger for longer. However, perhaps a better and simpler interpretation of the

data would be that markets and economic data are in fact giving conflicting signals as a direct result of experimental central bank policies. The correlation between central bank balance sheet expansion and asset prices has only been strengthened by the recent global market volatility, both to the downside and upside. This volatility is directly linked to clear indications the US QE program will be tapered by end-2013, followed by no action being taken at September's Fed meeting.

Exhibit 3: G7 Real GDP growth trends



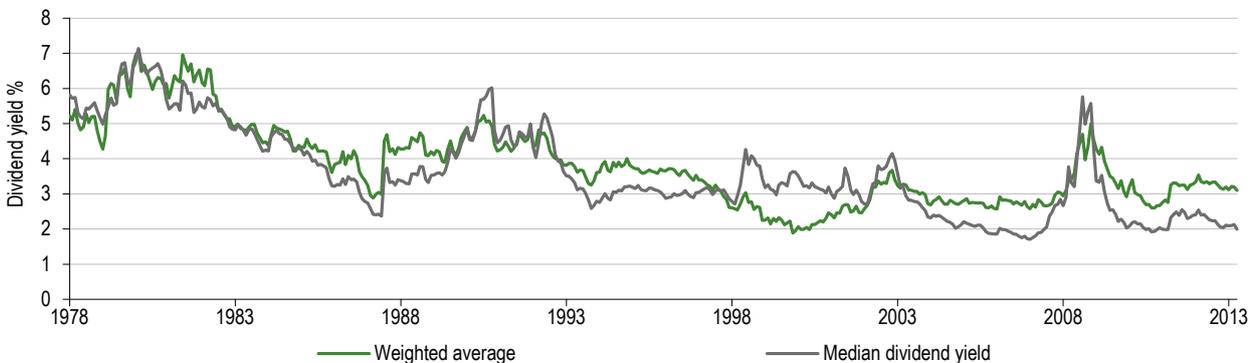
Source: OECD

During the four-year period between 2009 and 2013, we have been very bullish at times but more recently changed tack. Much of the world's economic activity remains supported by record-high volumes of government debt, Exhibit 2, and there is increasing evidence of a structural break away from previous G7 GDP growth rates, as shown in Exhibit 3. This lack of GDP growth is translating into a lack of top-line growth for the corporate sector and in our view puts a big question mark over equity valuations, which are at or near 2007 levels. The wall of worry may have been climbed, but the risks are now elevated.

Equities – valuation signals flashing red

If we were to choose a single measure to guide our investment strategy, it would be to completely ignore the noise from economic analysis and focus solely on valuation. The key advantage is the historic stability of the mean reversion in returns, both for individual sectors or securities within equity markets and at the index level. Investing at an attractive rate of return with an adequate margin of safety generally trumps the uncertainty of trying to predict a specific economic outcome over a specific timeframe.

Exhibit 4: UK non-financial equities – median dividend yield



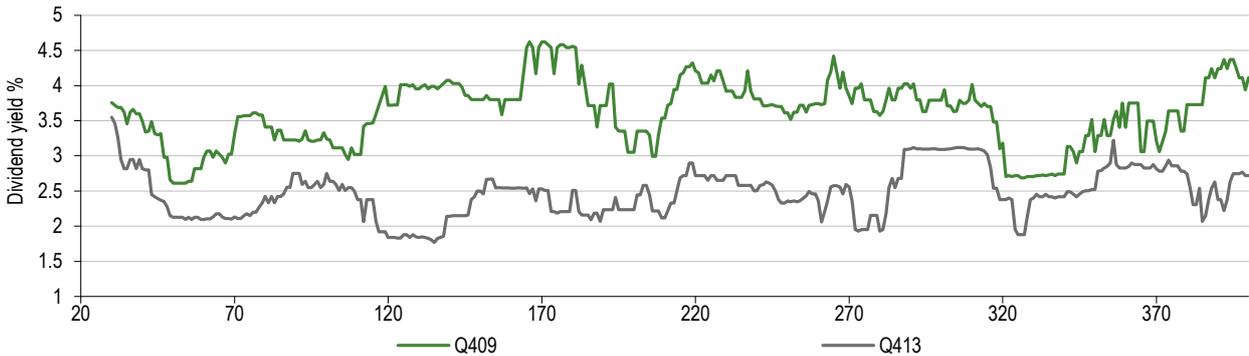
Source: Datastream, Edison calculations

In terms of equities, valuation signals are flashing red. For example, the median UK stock is trading at a dividend yield very close to the 25-year record low of 2007, Exhibit 4. The more typically quoted measure of weighted average dividend yield for market-capitalisation-weighted indices such

as the FTSE100 is less extended. However, the non-normal distribution of market capitalisation means the weighted average dividend yield is effectively dominated by a few very large cap stocks.

To illustrate just how far much of the UK equity market has been re-rated, in Exhibit 5 we have calculated a 30-company “windowed” dividend yield by first ranking the UK market by size and then sliding the “window” through the list. We have repeated the exercise for the present day and Q409. Q409 represented the period immediately after the first (successful) round of US quantitative easing and was by no means a distressed environment.

Exhibit 5: UK non-financials – 30-company sliding ‘window’ dividend yield calculation



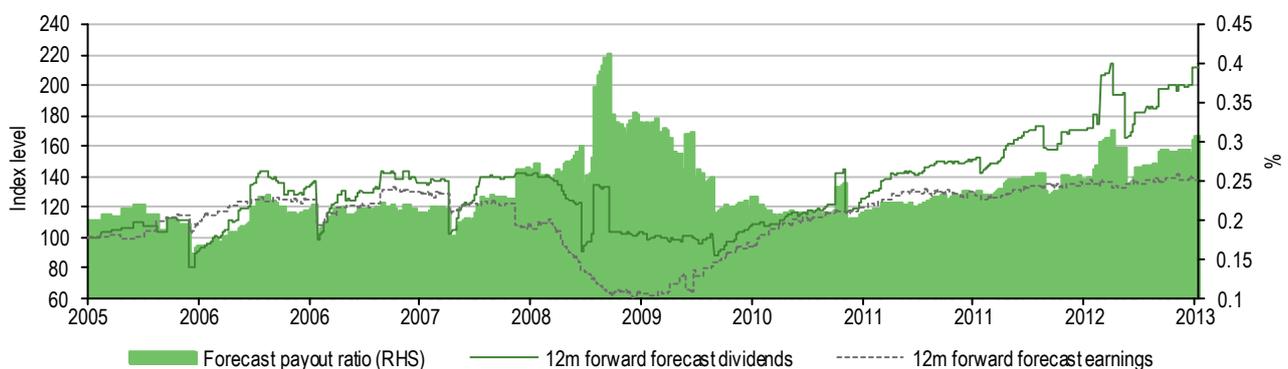
Source: Datastream, Edison calculations

Exhibit 5 shows, as expected, that while dividend yields for the 30 largest UK non-financials are effectively unchanged, there has been a substantial compression in yield throughout the remainder of the market. The average ‘windowed’ yield is now 2.5% compared to 3.6% in Q409. This means the opportunity set for active portfolio managers who wish to build a diversified portfolio of perhaps 30 UK names is nowhere near as attractive as only a few years ago.

Dividends rising faster than earnings

We would be less anxious about the compression in dividend yields if dividends themselves were at a cyclical low. However, the reverse is true; dividends have been growing much faster than earnings for mid-cap indices in both the US and UK in recent years, Exhibits 6 and 7. The forecast payout ratio (dividends/earnings) is also exceptionally high for a non-recessionary period.

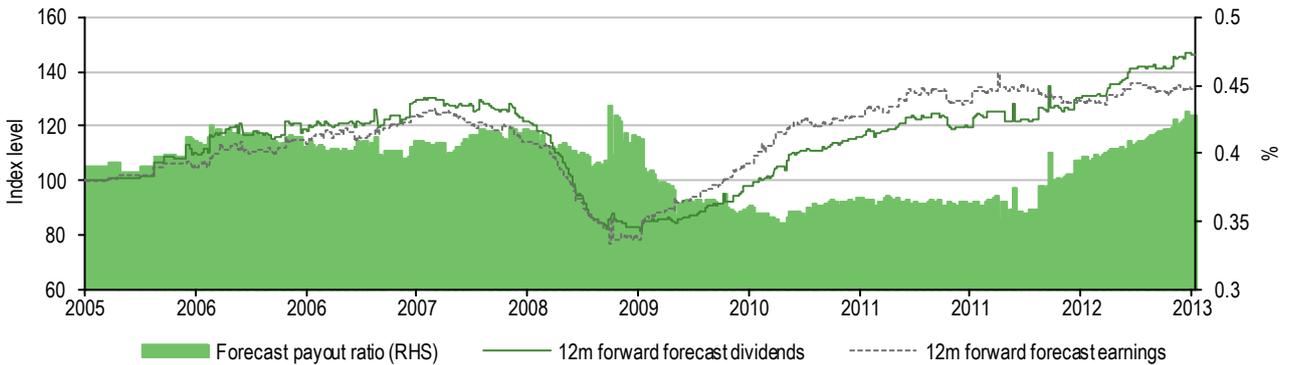
Exhibit 6: US mid-caps – median dividend growth outstrips earnings growth post 2011



Source: Datastream, Edison calculations

The focus on dividends will be welcome for institutional shareholders starved of yield, but raises the question of whether the corporate sector is investing sufficiently for growth. The lack of sales momentum for the corporate sector in developed markets is telling in this regard, a topic we have highlighted in earlier notes. Thus far, the recent improvement in economic momentum in Europe and the US has not been reflected in improving sales forecasts for the corporate sector.

Exhibit 7: UK mid-caps – median dividend growth outstrips earnings growth post 2011



Source: Datastream, Edison calculations

Non-financial margins high and declining

It is also straightforward to show that in turn, earnings themselves would seem closer to cyclical highs than trend levels. An examination of consensus margin forecasts for 2014 versus their long-run history shows that analyst optimism runs strong; the median UK non-financial margin forecast is a standard deviation above the normal level for the last 10 years, Exhibit 8, with similar stretch forecasts for other markets.

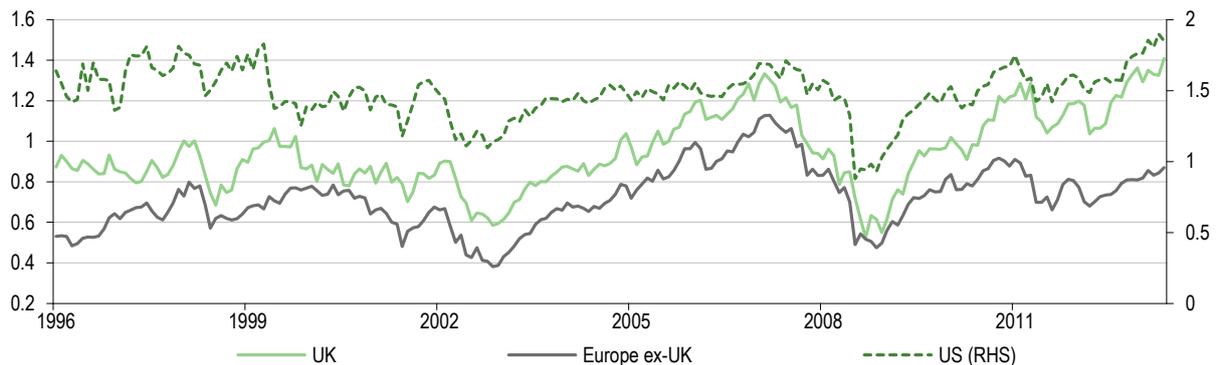
Exhibit 8: UK non-financials – median consensus margin forecast at peak levels



Source: Datastream, Edison calculations

Price/sales at a seven-year peak

Sticking with the policy that the simplest measures are the best, we have also calculated the median price/sales ratio for non-financials in each of the developed economic regions. On this measure, UK and US non-financials are close to the peak levels of 2007, Exhibit 9. No doubt some of this premium could be justified by the robust profits performance of the corporate sector over the last three years. However, this argument feels rather close to a rationalisation to ease the anxiety of investors who have bought stocks after they have risen so much. We note that European stocks appear cheaper on this measure.

Exhibit 9: Median price/sales for UK, US and EU non-financials


Source: Datastream, Edison calculations

Asset prices no longer the focus for central bank policy

Although central banks have been somewhat coy about the policy of pumping money into the economy to raise asset prices in recent years, QE is now giving way to forward guidance with the specific aim of increasing employment, subject to an inflation constraint. By implication, asset prices may no longer be a policy objective.

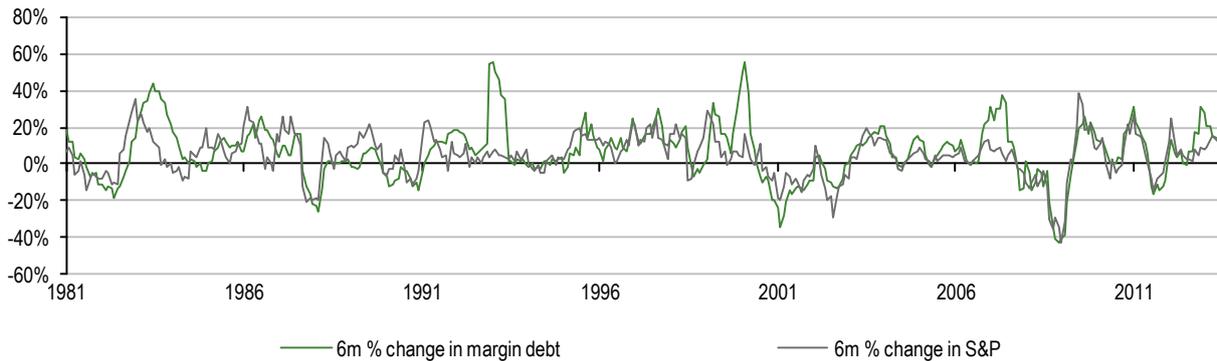
In this regard, we note also the unevenness of the economic recovery that has entered the political domain. Weak economic growth, combined with strong increases in asset prices, has benefited the wealthier segments of the US population much more than the poor. The potential for a political interaction with markets is high as the next US Fed Chair is currently being chosen. President Obama has been remarkably specific on wanting a Fed Chair “who makes sure we’re not seeing artificial bubbles”. However, in the light of recent events it would appear his favoured candidate Larry Summers has been blocked by Senate Democrats and the dovish Janet Yellen is now the front-runner.

Regardless of the individual ultimately appointed to lead the US Fed, any change in policy emphasis from QE to forward guidance in effect takes away portfolio insurance and adds increased employment costs to the aggregate corporate income statement. In other words, profit margins may have good reason to have peaked in 2012. Rising employment will also improve the fiscal position of sovereigns as personal incomes and payroll taxes increase; thus declining deficits will mechanically lower the corporate profits share of GDP.

Technical factors – NYSE margin debt

There is a remarkable correlation between the 6m change in NYSE margin debt and the performance of the S&P 500 over the same period. Although excess growth in margin debt has previously been associated with events such as the market collapse of 2008 and dot-com bubble, more recently it appears to have cycled in tandem with US QE policy, Exhibit 10.

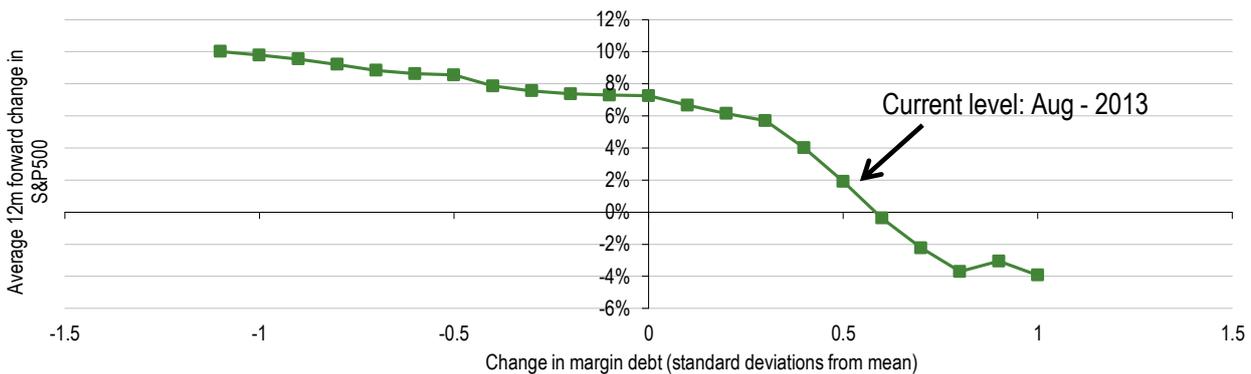
Exhibit 10: 6m growth in NYSE margin debt and 6m change in S&P 500



Source: Datastream, Edison calculations

Since the 1980s, there has been a very non-linear relationship between the growth of NYSE margin debt and the *subsequent* performance of the stock market. Exhibit 11 shows that as the growth in margin debt exceeds 0.5 standard deviations from the mean – the current level – the average performance of the S&P over the next 12 months declines substantially. Although a secondary factor relative to fundamentals, these data indicate an increased likelihood of a muted H2 S&P 500 performance, even if QE tapering is on hold for now.

Exhibit 11: Non-linear relationship between NYSE margin debt and *future* S&P performance



Source: Datastream, Edison calculations

Global bond yields closing in on economic danger point

It is easy to forget that in aggregate there has been no meaningful deleveraging in developed markets since 2007. Government debt as a percentage of GDP has increased, as shown in Exhibit 2, as the private sector has deleveraged. Therefore, the world economy remains acutely sensitive to both short- and long-term borrowing costs. We have already seen US mortgage applications decline sharply as US government bond yields nearly doubled to a little less than 3% since February of this year.

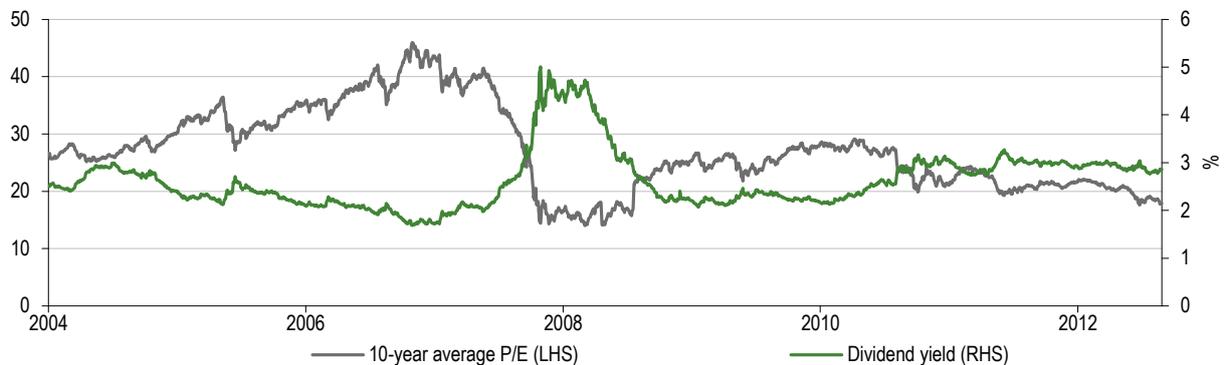
In our view, a further rise in real interest rates would risk choking off the nascent US economic recovery. An over-steep yield curve had exactly this effect in Japan in the 1990s. Although bond yields remain low in a historical context, an increase in US yields much over 3% would appear to be self-defeating. This tightening in monetary conditions seems to have spooked the Fed into keeping easy policy for now. For this reason, we see less near-term risk in the bond market than in growth-exposed equities.

Finally, some exposure to emerging markets

The recent sell-off in emerging markets is presenting some valuation opportunities in both emerging market debt and equities. Although these markets are still some way from depressed, they would have been the first to benefit from the delay to tapering. In the meantime, dividend yields are close to decade highs (excluding 2008) and the ratio of market value to 10-year average earnings has fallen close to decade lows, Exhibit 12.

The underperformance relative to developed market equities has also been severe as emerging market currencies have declined against the US dollar. While we have always wanted to add exposure to these faster-growing, better demographically positioned and less-indebted economies, the question has been price. As hot money seeks an exit, for patient investors it would seem to be a better time than average to be adding a modest allocation to emerging markets.

Exhibit 12: Emerging market non-financials – much better value following underperformance



Source: Datastream

Responding to challenging conditions

A period of tightening monetary conditions combined with relatively high market valuations is a challenging time in which to invest. It would have been relatively straightforward to have interpreted the incoming data much more negatively and suggest a wholesale reduction in portfolio risk was the only course of action. However, we have resisted this temptation for the following reasons.

Firstly, although the case for a cautious positioning can be clearly laid out – high valuations, slow growth, tightening monetary policy and potentially over-leveraged stock market investors, any short-term stock market prediction is in reality subject to a high degree of uncertainty. Statistical approaches to decision making under uncertainty indicate that in such circumstances extreme portfolio positioning is sub-optimal and would reflect over-confidence in our predictions.

Secondly, given the extraordinary level of sovereign debt to GDP worldwide, it is unclear that cash is still a risk-free asset in purchasing power terms. On the basis of the current economic outlook, it is not at all unreasonable to assume that cash will keep earning a negative real return in the US, UK and eurozone for at least the next two years. We note also the historical evidence that significant inflation outbreaks often follow a major debt crisis.

Thirdly, while we pay close attention to market developments in shaping the overall risk profile of the investment strategy, we are still finding specific situations that have a good risk/reward, especially among larger cap stocks and in Europe. Therefore, while we would suggest keeping equity risk at the lower end of the range by taking profits in mid-caps, we expect there would remain a number of holdings that are still highly likely to outperform cash over the medium term. In our view, sector exposures should be tilted toward those less geared to the economic cycle.

While retaining a significant amount of cash on hand, valuation signals are pointing to adding a modest allocation to emerging markets for those investors who can bear the short-term volatility.

We are more relaxed about US government bond yields now they are close to 3% and we also highlight niches within the credit markets where interest rate and credit risk is modest and yields of over 4% are on offer. A position in gold is appropriate as a partial hedge against inflation and geopolitical risk.

In short, even if focused on capital preservation, by accepting a modest level of volatility investors should be able to build portfolios that will perform adequately in a range of scenarios while waiting for more compelling macro opportunities.

Company profiles

2G Energy

Investment summary: Resumption of growth

Growing international emphasis on cogeneration and an increased focus on the use of natural gas as a feedstock should render 2G Energy less sensitive to changes in German biogas subsidies. Consensus numbers show the company trades at a small discount to European utility stocks.

Favourable outlook for the international CHP market

The outlook for combined heat and power (CHP) systems appears favourable. German legislative targets seek an increase in the share of combined heat and power in electricity production, from 15% currently to 25% by 2020. An amendment to the Combined Heat and Power Act, passed in 2012, saw subsidy rates for CHP systems in the 50-250kW range almost double to 4c/kWh. In the US the government is also targeting an increase in installed CHP capacity of 40GW (equivalent to an increase of c 50%) by 2020.

2G Energy repositioned

The growth of the international CHP market supports 2G Energy's increased focus on expanding its business outside Germany. A reduced exposure to the biogas market and greater focus on natural gas has already helped diminish the company's sensitivity to German biogas subsidies, and will also position it to take advantage of the burgeoning international market for natural gas. 2G believes that it has a technological edge with 20kW to 500kW CPU units, especially with respect to gas motor optimisation, which is key in delivering efficiency improvements.

Growth forecast to resume in 2013

Consensus estimates for 2013 predict a rise in revenue to €152.5m (+4.1%) vs guidance of €160m, and a flat outlook for profit before tax. The 2013 estimates are for profitability to remain below the level achieved in 2011, which was boosted by a sharp rise in orders for German biogas plants resulting from an announced change in the EEG (Renewables Energy Act) on 1 January 2012 to less favourable terms. The projected growth rates appear modest in a historical context, given the CAGR achieved in the period 2007-12 of 39% in revenue.

Valuation: Trading at a discount to the utility sector

2G Energy is trading on a 2013e P/E of 11.6x and 8.5x for 2014 and EV/EBITDA of 6.6x and 4.9x respectively. The current rating is at a small discount to the European utilities sector despite similar forecast growth rates and a stronger balance sheet.

Consensus estimates

Year End	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/11	167.3	19.5	3.0	0.00	9.6	N/A
12/12	146.5	16.5	2.6	0.37	11.1	1.3
12/13e	152.5	16.5	2.5	0.43	11.6	1.5
12/14e	178.3	23.0	3.4	0.50	8.5	1.7

Source: Company accounts, Bloomberg

Renewable energy equipment

Price €28.9

Market cap €127m

*Priced as at 18 September 2013

Share price graph



Details

Code	2GB
Shares in issue	4.4m
Net cash (€m) as at December 2012	3.7

Business description

2G develops, produces and installs cogeneration systems (20kW to 2MW) for decentralised energy production. The plants can utilise a variety of feedstocks including natural gas, biogas or biomethane.

Bull

- Strong international focus on CHP development.
- Growing international gas market.
- Strong balance sheet.

Bear

- Biogas markets driven by legislation.
- Historic over-reliance on Germany.
- Historic over-reliance on biogas.

Analysts

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All for One Steeb

Technology

Investment summary: In SAP's slipstream

With focused M&A complemented by robust organic growth, All for One Steeb has established itself as the leading supplier of SAP solutions to the Mittelstand. Recent results suggest that the company is gaining leverage from the increased scale and brand awareness this has brought about. Neither consensus estimates nor the 14x 2014 P/E rating look demanding.

Buy-and-build strategy to consolidate No 1 position

The acquisition of Steeb, a wholly owned subsidiary of SAP, for €39m in December 2011 created one of the largest SAP solutions providers to the German-speaking mid-market. Since then, a number of smaller acquisitions complemented by robust organic growth (20% in 2012) have projected the company into the number one position. All for One Steeb strengthened its balance sheet with a €35m promissory note (repaying a €29m syndicated loan) to support a continuation of the buy-and-build strategy and consolidate its position in its core market. The company also recently established an operation in Turkey, primarily to provide additional capacity and strengthen delivery capability. The company continues to hire in Germany.

Full suite of services to the mid-market

The company has over 2,000 clients, mainly in the manufacturing, consumer goods and services sectors. It offers a full suite of services. Outsourcing (including hosting) and software maintenance (47% of ytd sales) provide a bedrock of recurring revenues. Consulting (both management and implementation) accounted for 38% of sales ytd, hardware 3% and software licences 13%. The company offers 75 proprietary add-on SAP solutions. Itelligence (now essentially a subsidiary of NTT Data) is the company's closest competitor.

Q3 results suggest synergies are coming through

Momentum in the business looks good, with financial performance benefiting from the increased scale and brand awareness established over the past two years. Sales grew by 24% to €135.7m (17% organically) for the nine months to the end of June. EBIT increased by 83% to €7.3m, with margins expanding from 3.6% to 5.3% helped by exceptionally high software sales, which grew from €5.3m to €7.0m (+34%) in Q3, and a high consultant utilisation rate. While we naturally expect some degree of normalisation in margins in Q4, the company looks firmly on track to deliver FY guidance of €180m sales and €9m EBIT or better.

Consensus estimates

Year End	Revenue (€m)	PBT (€m)	EPS (fd) (€)	DPS (€)	P/E (x)	Yield (%)
09/11	90.1	5.0	1.41	0.30	11.3	1.9
09/12	153.2	5.0	0.76	0.27	21.1	1.7
09/13e	182.3	7.9	0.87	0.20	18.4	1.3
09/14e	194.2	9.4	1.11	0.26	14.4	1.6

Source: Company accounts, Thomson Reuters

Price €16.0
Market cap €79m

*Priced as at 18 September 2013

Share price graph



Details

Code	A10S
Shares in issue	4.9m
Net debt (€m) as at end Q313	9.8

Business description

All for One Steeb is the leading SAP solutions provider to the German-speaking mid-market. It supplies a full suite of consultancy, implementation, outsourcing and cloud services to more than 2,000 clients, mainly in the manufacturing, consumer goods and services sectors.

Bull

- Market leadership position.
- Good business momentum.
- Bedrock of recurring revenues.

Bear

- Possibility of near-term margin contraction.
- Exposed to an economic deterioration.
- Limited operational leverage.

Analyst

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GESCO

Investment summary: Transition year

Management has described FY14 as a transition year, characterised by subdued trading, integration of the previous year's acquisitions and a significant (€30m) investment programme. The business model enables subsidiary companies to take progressive steps in less favourable market conditions and invest for future growth.

Guidance lowered following Q1 results

FY13 results were modestly ahead of guidance, but in the absence of any growth pick-up, management expectations for FY14 are now toward the lower end of a previously indicated range (ie revenue €435-450m, EPS €5.56-6.17) following Q114 results. In this quarter, although group revenue rose by 2% y-o-y, with a book-to-bill ratio for new orders just above 1x, the EBIT margin declined by 200bp to 7.2%, owing to lower capacity utilisation and pricing pressures. Order intake, while in line with revenue, was below the previous year and this was felt in tool manufacture/mechanical engineering rather than the smaller plastics technology segment, where order intake increased. Indications for the performance of subsidiary companies in the second quarter of the year showed a further slowdown in order intake for the group, with quarterly revenue stable sequentially (but down c 4.4% y-o-y) and ongoing margin pressure.

Financially strong, investing for growth

While the current trading environment is subdued, this highlights the strength of GESCO's business model with a diversified portfolio of subsidiary companies in a range of established industrial sectors. GESCO is a long-term investor in, and developer of, its businesses, as illustrated by plans to invest a record €30m in capex in the current year. We understand that around half of this relates to strategic projects over and above maintenance requirements (depreciation is c €16m pa). Hence, subsidiary companies are able to retain their operational independence, but benefit from being part of a financially strong group (net debt to equity of 1x) and continue to invest during less favourable market conditions when competing companies may not be able to do so.

Valuation: Growth pause, healthy yield

The share price is c 13% above the level a year ago, having reached a high of €83 during this period (following a positive Q313 update in February). The current P/E rating, based on FY14 consensus, reflects a growth pause, but the yield – even with lower DPS – remains healthy.

Consensus estimates

Year End	Revenue (€m)	PBT (€m)	EPS (€)	DPS* (€)	P/E (x)	Yield (%)
03/12	415.4	35.7	7.40	2.9	9.9	3.9
03/13	440.4	33.8	6.30	2.5	11.7	3.4
03/14e	443.3	31.1	5.80	2.28	12.7	3.1
03/15e	467.6	37.1	6.82	2.63	10.8	3.6

Source: Company accounts, Thomson Reuters. Note: *DPS = 40% of net income after minorities.

Investment companies

Price €73.6

Market cap €243m

*Priced as at 18 September 2013

Share price graph



Details

Code	GSC1
Shares in issue	3.3m
Net debt (€m) as at end-June 2013	46

Business description

GESCO was founded in 1989 to invest in SME companies in the German Mittelstand, focusing on companies facing succession challenges and with ongoing growth potential. There are currently 17 companies in GESCO's holding structure. These companies are substantially focused on tool manufacturing/mechanical engineering, with some plastics technology exposure too, addressing a range of end-markets.

Bull

- Financially strong (1x net debt to equity).
- Record capex programme planned for FY14.
- Long-term growth investment strategy.

Bear

- Current trading conditions are subdued.
- Guidance toward lower end of previous range.
- Order intake slowing.

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GFT Technologies

Investment summary: GFTS Q2 acceleration

H1 results were strong, with organic revenue growth of 14% from the core GFT Solutions (GFTS) division, including 21% in Q2. Growth came from across the customer base, as customers extended IT projects to new areas. There was particularly strong demand from UK investment banks, and management is optimistic it will continue to see healthy growth from the Solutions division, to be boosted in H2 by the Sempla acquisition. The stock looks attractive on a c 9x FY14e P/E and a 4% yield given the potential to leverage market growth internationally and increase margins.

Investment case: Scaling up, outsourcing benefits

GFT is building a global IT services and consulting business, focused on the growing opportunity in the financial services sector. It is diversifying geographically and broadening its customer base, and we estimate that two-thirds of revenues are recurring in nature. Its main division, GFTS, benefits from high levels of IT spending and complex business requirements in the financial services industry. It also benefits from favourable outsourcing trends in banking and has integrated near/far-shore hubs in Spain and Brazil. Sempla adds a significant presence in Italy, boosts group margins and brings cross-selling opportunities. The strategy in Southern Europe is opportunistic and potentially highly rewarding if the timing proves right.

H1 results: GFTS growth accelerates to 21% in Q2

Group revenue fell 2% to €114m. Excluding the discontinued third-party management contracts within emagine, organic growth was 6%. The profits improvement came from GFTS, while the resourcing business, emagine, which generated 39% of revenues, only broke even. Group profit before tax on an IFRS basis jumped 46% to €5.5m; after adjusting for a €1.18m credit relating to an earn-out payment and €250k in M&A expenses, underlying growth was 21%. The acquisition of Sempla, an Italian IT services and solutions provider, announced in late May, was completed on 3 July. The purchase price was €21.08m for an initial 80% stake in Sempla; this reduces the pro forma net cash pile to c €4m.

Valuation: Discount to international peers

The stock trades on 0.3x FY14 revenues and c 5x operating profit. These numbers look favourable when compared to c 1.5-2.4x sales and c 10-13x operating profits for larger global IT services businesses. Our DCF model (which assumes a WACC of 12%) values the shares at c €7.0, or 40% above the current share price, which is up from our €6.53 valuation at the time of the initiation note.

Edison estimates						
Year End	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/11	272.4	11.6	0.34	0.15	14.7	3.0
12/12	230.7	9.5	0.22	0.15	22.7	3.0
12/13e	260.2	16.3	0.42	0.18	11.9	3.6
12/14e	300.3	21.7	0.53	0.20	9.4	4.0

Source: Company accounts, Edison Investment Research

Software & comp services

Price €5.0

Market cap €132m

*Priced as at 18 September 2013

Share price graph



Details

Code	GFT
Shares in issue	26.3m
Net cash (€m) as at 30 June 2013	25.1

Business description

GFT Technologies is a global technology services and recruitment business primarily focused on banks and insurance companies.

Bull

- GFT Solutions organic growth of 21% in Q2.
- Sempla (c €49m FY14e revenues) boosts margins.
- Strong balance sheet with a net cash position.

Bear

- emagine currently has low profitability.
- Deutsche Bank generates c 30% of revenues.
- Exposure to Southern Europe.

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GFT Technologies is a research client of Edison Investment Research Limited.

Grammer

Auto & transport

Investment summary: Shaping up

Grammer is firing on all fronts, which is especially impressive given challenging conditions in its major European markets (two-thirds of H1 revenues). A focus on the premium segment, customer proximity, new products and the success of its Nectec acquisition drove a 36% rise in Q2 EBIT, and, encouragingly, a sharp upgrade in 2013 guidance, with management expecting revenue and earnings to be “appreciably higher” than last year.

Q2 acceleration

The second quarter saw Grammer consolidate on a positive start to the year, with a 17% y-o-y increase in revenue (+9% in Q1) at a significantly higher trading margin (4.9% against 4.2% in Q212). Although progress was across the board, of particular note was the step change in Seating Systems profit (+57%), while Automotive improved revenue by almost a quarter. The company continued to outperform each of its core markets, most importantly Europe, where, for example, in the first half its 15% increase in revenue from passenger car products contrasted with a 5% decline in car registrations. Notwithstanding an initial boost from the February acquisition of Nectec, a headrest manufacturer (c €35m revenue in 2012), market share gains from new products were again to the fore. Net debt at June would have been down 15% y-o-y but for M&A.

Consensus estimates look cautious

Raised post-Q2 guidance appears not to be reflected in current 2013 forecasts. In particular, market expectations of increases of just 9% and 14% in revenue and EPS respectively are arguably at odds with management’s newly heightened confidence (both measures now set to be “appreciably” up on 2012, compared with “slightly” up, post-Q1). In likely unchanged conditions, consensus assumptions are evidently for only flattish revenue and trading profit in H2, against +13% and +24% achieved by Grammer in the first half, which suggests the scale of potential market caution.

Valuation: Still attractive

Despite signal outperformance (ytd share price +78% against DAX +6%) and even on probably conservative estimates, Grammer appears undervalued given its strong market position, global reach and established brand. With H1 interest cover of 5.7x, the company remains well-financed (its recent €90m bond issue was three times oversubscribed) and cash generative, with an increasingly generous dividend policy (the dividend has good cover of c 4.2x).

Consensus estimates

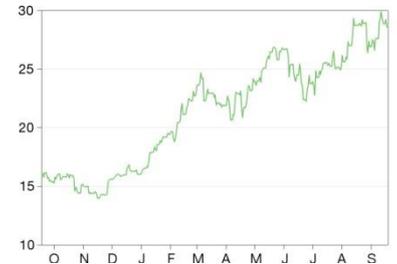
Year End	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/11	1,093.5	34.3	2.02	0.40	14.2	1.4
12/12	1,133.0*	38.5*	2.39*	0.50	12.0	1.7
12/13e	1,235.5	44.6	2.73	0.65	10.5	2.3
12/14e	1,331.6	53.0	3.24	0.82	8.9	2.9

Source: Company accounts, Thomson Reuters. Note: *Restated.

Price €28.7
Market cap €330m

*Priced as at 18 September 2013

Share price graph



Details

Code	GMM
Shares in issue	11.5m
Net debt (€m) as at end-June 2013	102.1

Business description

Grammer is a leading supplier of automotive interior components and seating systems.

Bull

- Well-known, innovative brand.
- Global presence (more than 30 production and distribution sites in 18 countries).
- Comprehensive product mix and customer base in both automotive and seating systems divisions.

Bear

- Mixed outlook for European car market.
- Weak global commercial vehicles markets.
- Capital-intensive.

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Mensch und Maschine Software

Technology

Investment summary: CAD/CAM specialist

Mensch und Maschine Software made good progress in H113, with organic growth in both businesses. As the transition from distributor to value-added reseller (VAR) business model is substantially complete, the pace of VAR acquisitions is slowing. Demand remains strong in the Software business. Management's focus is shifting to consolidating the recent VAR acquisitions and driving profitability across both business lines.

H113 trading: Still on track to meet FY13 expectations

A strong Q1, followed by a slightly weaker Q2, generated H113 results in line with management expectations. The Software business (M+M's proprietary CAM software) grew 8.4% in H113 (all organic) and drove gross margin up 240bp y-o-y to 93.5%. The VAR business grew 13.1% y-o-y, with around half of this growth from the acquisition of VARs over the last 12 months, which also depressed the gross margin (36.9% vs 39.3% a year ago). The group EBITDA margin of 6.6% was lower than the 8.5% achieved in H112 due to the higher level of staff after the VAR acquisitions, increased investment in developing own software and a lower level of earn-out received from the Distribution business sale.

Focus moves to improving profitability

The business generates gross profit in roughly equal shares from the Software and VAR businesses. While the company may make several more small acquisitions in the VAR business, the transformation from distributor to VAR business model is substantially complete, and the focus now is on integrating the acquisitions and improving the profitability of the business, with a long-term aim of achieving VAR EBITDA margins of c 10% (H113: 2.2%). The Software business already generates EBITDA margins close to the long-term target of 20-25% (H113: 18.2%).

FY13 guidance – reflected in consensus

With customer demand picking up from mid-year, management reiterated FY13 sales guidance of €135-140m, with EBITDA similar to last year's €10m level (7.1-7.4%), net profit of €4.5m and EPS close to 30c. To reach the low end of guidance would require H213 revenue growth of 7% h-o-h or 12.6% y-o-y and an EBITDA margin of at least 8.1%. Considering H113 growth, this appears achievable. Forecasts assume 12.8% group revenue growth for FY14 with improving profitability, resulting in a modest 12.6x P/E multiple for FY14. Combined with a strong dividend yield of more than 4%, in our view the valuation is undemanding and the share price could respond positively to evidence of stronger end demand.

Consensus estimates

Year end	Revenue (€m)	PBT (€m)	EPS (fd) (€)	DPS (€)	P/E (x)	Yield (%)
12/11*	97.0	2.8	0.09	0.20	54.4	4.1
12/12	118.8	5.1	0.23	0.20	21.3	4.1
12/13e	136.9	5.0	0.27	0.20	18.1	4.1
12/14e	154.5	8.2	0.39	0.23	12.6	4.7

Source: Company accounts, Thomson Reuters. Note: *Continuing operations only.

Price €4.9

Market cap €76m

*Priced as at 18 September 2013

Share price graph



Details

Code	MUM
Shares in issue	15.5m
Net debt (€m) as at end-H113	23.0

Business description

Mensch und Maschine Software (M+M) sells proprietary and Autodesk CAD/CAM software. It reports across two business lines: M+M Software (27% of H113 revenues) and VAR (73% of H113 revenues). The company has operations in Europe, the US and Asia-Pacific.

Bull

- Largest European Autodesk value-added reseller.
- High-margin internally developed software.
- Loyal workforce.

Bear

- Reliant on the technology development plans of Autodesk.
- Net debt position.
- Acquisition/integration risk.

Analysts

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SKW Stahl-Metallurgie

Investment summary: Positioned for recovery

SKW is experiencing reduced demand from its customer base, reflecting lower global steel production volumes currently. Its global manufacturing footprint and investment programme puts SKW in a strong position when this pattern reverses and it has financial flexibility with which to develop the group further.

Actions taken to offset the effects of weaker markets

Steel production in SKW's leading markets (EU, US and Brazil) fell by 5.1% in the first half of 2013. Accordingly, SKW experienced lower volumes, compounded by passing through lower input costs to leave H1 revenues down by 20% (slightly less in Q2). The group EBIT margin was 1.8% (down 210bp) and although disappointing indicates that significant action was taken to preserve profitability despite lower activity levels. In fact gross margins increased in the period (+230bp to 31.3%) from greater focus on higher value added products and improved mix. There is ongoing caution regarding market demand levels in the remainder of the current year. In the absence of a recovery in the steel economy, management indicates that revenue and EBITDA in FY13 are unlikely to attain FY12 levels, though actions taken are expected to benefit results in FY14.

Investment benefits to come through

While the global steel production picture is currently challenging, this should not detract from SKW's global manufacturing structure of 15 facilities located in a mix of traditional and emerging markets. It has completed a significant investment expansion and investment phase and the implications of this are twofold. Firstly the benefit of newer plants can feed in progressively as market conditions improve and, secondly, this should enhance cash flow through both lower capex spend and rising profitability. SKW has continued to generate positive profits and free cash flow during the down cycle and remains conservatively financed (net debt to equity of 0.66 at the end of June). Hence, SKW has the flexibility to continue to build its global positions and, in particular, emerging market exposure.

Valuation: Expected FY15 recovery

SKW's share price has weakened in the last quarter, having traded in the €12-14 range for the first six months of the year. The current year P/E rating acknowledges reduced earnings but, on existing estimates, this compresses rapidly in FY14 with the expectation of an accelerating recovery. Consensus estimates suggest a lower current year yield of c 3%.

Consensus estimates

Year end	Revenue (€m)	PBT (€m)	EPS (€)	DPS* (€)	P/E (x)	Yield (%)
12/11	428.9	16.2	1.86	0.50	5.9	4.5
12/12	404.6	6.1	0.65	0.50	16.9	4.5
12/13e	372.5	5.2	0.49	0.32	22.4	2.9
12/14e	395.7	10.3	1.00	0.38	11.0	3.5

Source: Company accounts, Bloomberg

Price €11.0
Market cap €72m

*Priced as at 18 September 2013

Share price graph



Details

Code	SK1A
Shares in issue	6.5m
Net debt (€m) as at end-June 2013	75

Business description

SKW Stahl-Metallurgie Holding (SKW) has leading positions with the steel producing industry internationally as a supplier of specialist materials and services. The Cored Wire division (c 46% of group revenue) supplies wires, with a mix of chemical combinations, injected into the refining process for high-grade steels. Powder and Granules (c 44%) supplies metallurgical materials used in hot metal desulphurisation. In total, these two divisions operate 15 facilities in 10 countries, chiefly the Americas, Europe and Asia. (There are two further plants in an Indian JV.) The remaining operation (Quab) produces starch-based reagents used in paper manufacturing.

Bull

- Leading market positions.
- Broad international footprint.
- Low financial gearing.

Bear

- Weak steel production in major markets served.
- Cautious demand outlook for H2 production.
- Limited exposure to China.

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SNP Schneider-Neureither & Partner

Technology

Investment summary: Rebuilding the pipeline

After a weak H1, SNP's management is focused on building the sales pipeline for both own-software licence sales and professional services, and is strengthening its sales team to achieve this. The recent signing of a services partnership with SAP should drive higher professional services revenues in the medium term, and the acquisition of a US-based specialist in Oracle-related transformations adds Oracle ERP-based technology and consulting expertise. H113 should mark a trough in revenues and losses, with a return to growth and profitability in FY14.

Weak H113 results trigger operational changes

SNP reported disappointing results in H113 as it struggled to win new consulting projects and sign new licences for its T-Bone software. Revenues declined 24.6% y-o-y and 24.2% h-o-h, resulting in an EBIT loss of €2.3m. In response, SNP is working to strengthen its sales team, adding specialist expertise for direct sales and partner support, with progress expected in the next six to nine months.

Recent deals expand SNP's growth potential

Since the beginning of Q213, the company has taken several significant steps to stimulate top-line growth. In April, SNP signed an OEM agreement with SAP to integrate SAP Data Services into its T-Bone software, and in May it joined the SAP PartnerEdge programme in Germany as a SAP services partner. In August, SNP acquired GL Consulting (GL) for low single-digit millions of euros (funded from existing cash balances). GL offers consulting services and a software-based approach to Oracle ERP transformations. This gives SNP access to more of the ERP software market – it has typically focused on SAP-related transformations, but can now work with Oracle-related transformations (SAP has ERP market share of 22% and Oracle is the next largest with 15%).

Forecasts point to FY14 recovery

In early-July, SNP withdrew FY13 guidance. Consensus forecasts for a revenue decline of 9% in FY13 imply strong sequential revenue growth in H213 (+40% or +6% y-o-y) and EBIT margin improving to 0.2% in H2. Assuming the GL acquisition adds revenues of c €1.25m in H2, underlying revenues would need to grow by c €2.8m or 27% h-o-h, reasonable if the company sees a typically strong Q4. FY14 forecasts assume 24% revenue growth (we estimate 14% organic). Assuming SNP's drive to rebuild and convert the sales pipeline starts to take effect from H114, the EV/sales multiple of 2.0x FY13e and 1.6x FY14e appears undemanding.

Consensus estimates

Year end	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/11	26.6	4.7	0.88	0.58	16.3	4.1
12/12	27.2	2.9	0.52	0.24	27.5	1.7
12/13e	24.6	(2.3)	(0.57)	0.0	N/A	N/A
12/14e	30.6	0.8	0.07	0.18	204.3	1.3

Source: Company accounts, Thomson Reuters

Price €14.3
Market cap €53m

*Priced as at 18 September 2013

Share price graph



Share details

Code	SHF
Shares in issue	3.74m
Net cash (€m) as at end-H113	7.0

Business description

SNP is a software and consulting business focused on supporting customers in implementing change, and rapidly and economically tailoring IT landscapes to new situations. It has developed a proprietary software product called SNP Transformation Backbone (T-Bone).

Bull

- Recent acquisition expands addressable market to Oracle ERP installations.
- Resumption of SAP partnership adds indirect sales capacity.
- T-Bone software replaces manual processes.

Bear

- Software sales cycle longer than anticipated.
- Loss-making for last two quarters.
- Low consultant utilisation.

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VTG

Investment summary: Robust business model

VTG delivered a solid set of H113 results, driven predominantly by growth in the Railcar division as a result of past fleet investment, while 95% of the group's EBITDA was contributed by the core Railcar business. Top-line growth was also delivered in the logistics divisions, although profitability was held back here by weak agricultural markets and highly competitive markets in the tank container business. Having come from a background in bulk liquids and petrochemical transportation, the group's strategy remains the diversification of revenue streams, both in terms of end markets and geographies, while continuing to strengthen its logistics business. This was highlighted by the April 2013 announcement of a letter of intent to combine its rail logistics business with that of Kuehne + Nagel.

Half year on track driven by previous investment

VTG delivered a set of half-year results on track with expectations, with revenues up 6.5% to €404m, EBITDA up 9.3% to €89.6m and EBIT up 18.2% to €37.1m. Divisional performance highlighted differing fortunes: Railcar increased revenue 8.7% to €169m and EBITDA by 13.6% to €88.3m driven by new build investment and price increases, offset by lower utilisation; Rail Logistics increased revenue 7.6% to €156m, but EBITDA decreased 42% to €2.7m as a result of difficult agricultural sector sales offsetting better performances in petrochemicals and industrial goods; and Tank Container Logistics revenue remained flat at €79m, while EBITDA reduced 5.9% to €5.5m due to continuing competitive environment.

Strategy to grow railcar and strengthen logistics

VTG's strategy is based on four key areas: 1) growing existing markets – driven by deregulation and liberalisation, as well as increased focus on environmental benefits opening new markets; 2) geographic diversification – specifically the US and the CIS (starting with Russia); 3) strengthening the logistics divisions – with an increased focus on industrial goods and special niches; and 4) optimising organisation and process – in terms of international organisation and IT systems to enhance operational performance.

Valuation: Core visibility with upside potential

The rating is c 15x 2014 EPS. We feel this is supported by the high visibility from the core Railcar division, which benefits from the infrastructure-like business model and long-term contracts with customers. In addition, performance improvement of the logistics divisions provides long-term upgrade potential.

Consensus estimates

Year End	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/11	750.0	15.8	0.55	0.35	26.2	2.4
12/12	767.0	16.5	0.41	0.37	35.1	2.6
12/13e	806.1	27.1	0.78	0.40	18.5	2.7
12/14e	833.2	33.1	0.97	0.45	14.8	3.1

Source: Company accounts, Thomson Reuters

Logistics & infrastructure

Price €14.4
Market cap €308m

*Priced as at 18 September 2013

Share price graph



Details

Code	VT9
Shares outstanding	21.39m
Net debt (€m) as at end-June 2013	724.5

Business description

VTG is a leading European railcar leasing and rail logistics company. The railcar fleet consists of 53,400 railcars globally with a focus on tank cars and high-capacity freight and flatbed cars. The group also offers rail logistics and multimodal transportation with tank containers.

Bull

- Core, predictable contribution from the Railcar division.
- Attractive market environment with ongoing deregulation and globalisation to favour rail transportation.
- Potential JV with Kuehne + Nagel (could conclude in H213).

Bear

- Predominantly European exposure.
- Continued weakness in agricultural transportation.
- Highly competitive tank container logistics market.

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WashTec

Technology

Investment summary: Positive H2 outlook

The first half results reflected the various challenges in WashTec's core European markets, including limited financing opportunities for individual operators and the impact of poor weather – particularly the floods experienced by key markets towards the period end – on wash counts. Interim revenues at €139.9m (H112: €142.6m) did include some negative forex effects and a lower contribution from core Europe, particularly Germany and France, which was partly offset by year-on-year growth in Asia-Pacific and Eastern Europe. Most positively, the group order book at end June was higher than 12 months earlier.

Cost cutting to address margin pressure

Despite the mixed market backdrop, WashTec increased gross margins in the first half from 58.1% to 59.7%; gross profit was 1% ahead y-o-y at €83.6m. That reflects changes to the product mix, with sales of new and used equipment down 6% y-o-y at €72.5m, but revenues from chemicals and operator businesses were ahead by 10% and 7% respectively. However, personnel costs were €3.2m higher at €53.1m due to higher wage and pension costs; the group personnel expense ratio was 38% (H112: 35%). That put pressure on the EBIT margin, which was 2% in the first half (H112:4%), and the pre-tax margin was 1.5% (H12: 3.4%). A series of cost-cutting initiatives are expected to benefit these measures from FY14.

Revenue outlook underpinned by better order book

The interim statement included a positive outlook for the second half, based upon a higher mid-year order book, which should result in a 5-6% EBIT margin. Performance in the eurozone is constrained by the continued limited access for individual operators to finance to fund expansion. The performance from Asia-Pacific is mainly derived from Australia, a stable market, with only a small contribution so far from growth markets such as China.

Forecasts and valuation

The group anticipates stable revenues this year at a 5-6% EBIT margin, but does not expect the second half to fully offset a slower first six months. Initiatives to cut expenses are expected to benefit future periods. WashTec's forecasts see further weakness in core European markets, but better performances from North America, Eastern Europe and Asia-Pacific. The shares have drifted this year in line with consensus estimates and the current rating looks fair, pending positive news flow.

Consensus estimates

Year end	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/11	293.3	(11.9)	(1.04)	0.00	N/A	N/A
12/12	301.5	16.5	0.72	0.58	13.6	5.9
12/13e	302.3	14.0	0.68	0.30	14.4	3.1
12/14e	309.5	16.3	0.81	0.36	12.1	3.7

Source: Company accounts, Thomson Reuters

Price €9.8

Market cap €137m

*Priced as at 18 September 2013

Share price graph



Details

Code	WSU
Shares in issue	13.98m
Net debt (€m) as at end June 2013	6.4

Business description

Headquartered in Augsburg, Germany, WashTec is a global provider of vehicle washing equipment. It has over 40 years of experience in the carwash industry and provides a range of services, from spare parts delivery to 24-hour self-staffed maintenance.

Bull

- Stable revenues. Margins to benefit from cost cutting initiatives.
- Improving order book despite tough markets.
- Diversifying revenues into faster growth markets.

Bear

- 81% of revenues generated in Europe.
- Core markets still affected by financial crisis.
- Higher employee costs affecting margins.

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