

German industrials spotlight

Synchronicity

- Potential for synchronised growth in exports and domestic demand.
- Introducing two Edison stock screens based on Value and Momentum.
- We highlight four new investment ideas.

Export-led growth

Over the past three years the weaker euro has boosted exports for the German industrials sector. If exports continue to prosper and industrial production (IP) growth cyclically recovers then we could see a 'demand nirvana' in the sector akin to conditions in 2010. The Ifo business confidence indicator, which rose sharply in February, lends credibility to this synopsis. Using our proprietary value and momentum screens, we highlight four companies we recently met that screen well and could potentially re-rate: Koenig & Bauer, Deufol, Homag Group and R Stahl.

Koenig & Bauer: 1.9x EV/EBITDA and 0.6x P/book

Koenig & Bauer's core business is printing presses. For years management has battled the substitution effect of traditional printed media for online publications. The company has regularly disappointed investors, generating razor-thin operating margins with miniscule returns on capital. Trading at very low multiples with a free float of 83% the stock can re-rate as management diversify into growth segments via acquisition.

Deufol: 5.6x EV/EBITDA and 0.4x P/book

Deufol produces packaging for a variety of consumer and industrial products. It has a free float of 47% and lacks research coverage. New management is working hard to rebuild credibility following an embezzlement scandal in 2010. The value case is compelling and the balance sheet has net cash. If operating margins can move up to the last peak of 5.5% from the current 3.4% then the stock should perform well.

Homag Group: Strong upward earnings revisions

Homag produces sophisticated woodworking machinery. Consensus forecasts were materially revised upwards following the Q3 results. Homag is a direct play on the urbanisation of China and other newly industrialised nations. Revenues are expected to grow by 25% over the next five years, a third of this generated by China. This is a research driven business (R&D/sales = 6%, gross margins = 57%) with a global market share estimated at 28% and growing. Valuation is attractive (P/S = 0.2x; P/OpCF = 4.6x).

R Stahl: Attracting earnings upgrades

R Stahl is a global supplier of electrical explosion protection products. It is well positioned in this niche area and primarily supplies the oil & gas and chemical industries. R Stahl first raised earnings guidance mid-2012 and then beat their numbers following a strong Q4. Exports to Asia and the Americas have been a key driver of performance. Free float is only 41%; however, stock valuation is supportive (P/BV = 1.8x, EV/EBITDA = 5.7x).

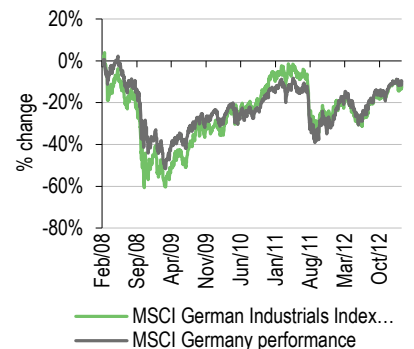
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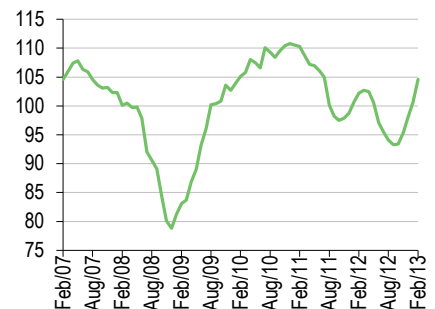
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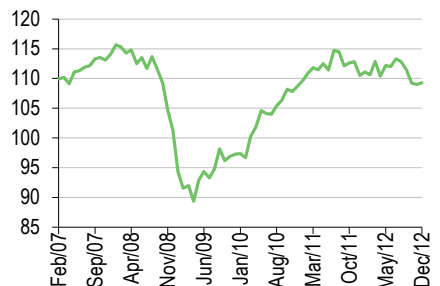
MDAX Industrials Index



German Ifo business



Industrial production



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	48	-29.3	16.62	0.5	0.9	1
KOENIG & BAUER	Industrial Machinery	268	-20.0	0.61	0.6	1.9	2
JOYOU AG	Building Products	229	-13.3	19.06	0.7	3.5	3
DEUTSCHE LUFT-RG	Airlines	6,984	26.2	2.78	0.8	3.1	4
SALZGITTER AG	Steel	2,171	-10.4	-2.23	0.5	4.5	5
STEICO SE	Building Products	59	-3.5	6.32	0.7	4.3	6
SFC ENERGY AG-BR	Electrical Components & Equipment	42	-53.0	-38.85	1.2	-5.5	7
EUROKAI KGAA	Marine Ports & Services	321	28.0	10.52	0.8	4.2	8
BREMER LAGERHAUS	Marine Ports & Services	212	100.2	4.47	0.6	4.6	9
NORDWEST HANDEL	Trading Companies & Distributors	44	-51.2	0.65	0.9	2.0	10
NORDDEUTSCHE STE	Building Products	22	68.1	4.41	0.7	4.6	11
SCHUMAG AG	Industrial Machinery	12	16.2	-19.21	0.9	3.6	12
TRIPLAN AG	Construction & Engineering	21	N/A	1.78	1.1	0.0	13
GREIFFENBERGER	Industrial Machinery	28	130.8	2.10	0.9	4.2	14
DEUFOL SE	Air Freight & Logistics	41	70.3	3.09	0.4	5.6	15
WESTAG & GETALIT	Building Products	97	-9.3	6.31	0.9	4.5	16
DELIGNIT AG	Forest Products	12	N/A	0.68	1.2	0.0	17
AIR BERLIN PLC	Airlines	273	457.9	-1.70	1.5	-6.9	18
YOUBISHENG GREEN	Paper Packaging	56	-50.6	23.38	1.2	1.4	19
HESS AG	Electrical Components & Equipment	18	301.5	7.29	0.1	6.2	20

Source: Bloomberg. Note: * Three-year historical average; **Aggregate of P/BV and EV/EBITDA valuation ranks.

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	42	-2.1	-3.7	43.2	44.2	44.2	70.8	1
DUERR AG	Industrial Machinery	1,470	10.5	28.3	87.9	7.3	9.5	42.3	2
HOMAG GROUP AG	Industrial Machinery	199	3.2	19.2	13.2	7.7	10.3	33.9	3
WASHTEC AG	Industrial Machinery	151	24.4	20.5	31.1	27.4	17.7	8.6	4
SMT SCHARF AG	Construction & Farm Machinery & Heavy Trucks	102	-3.1	16.8	-8.2	5.2	7.6	12.1	5
ZHONGDE WASTE TE	Industrial Machinery	26	0.1	22.1	-34.1	0.0	175.0	225.0	6
KUKA AG	Industrial Machinery	1,167	18.8	30.5	103.0	1.6	3.8	35.9	7
AURUBIS AG	Diversified Metals & Mining	2,402	-4.0	10.0	27.4	1.9	2.9	7.4	8
R STAHL AG	Industrial Machinery	186	-0.7	9.6	16.6	2.9	3.4	-4.0	9
KSB AG	Industrial Machinery	807	1.4	17.8	10.0	0.8	0.8	6.7	10
SIXT AG	Trucking	749	-4.9	9.8	8.5	0.6	0.4	9.1	11
VILLEROY & BOC-P	Building Products	224	12.5	20.4	19.8	12.0	12.0	-15.2	12
BERTRANDT AG	Research and Consulting Services	861	7.9	15.3	42.1	0.8	1.0	5.3	13
GILDEMEISTER	Industrial Machinery	1,131	2.8	31.5	57.0	0.1	0.6	21.8	14
NORMA GROUP	Industrial Machinery	825	18.4	29.9	43.1	1.0	0.7	1.3	15
SCHALTBAU HOLD	Industrial Machinery	212	-2.1	17.7	35.6	0.0	1.6	8.4	15
MBB INDUSTRIES	Industrial Conglomerates	134	6.5	20.1	223.4	0.0	0.0	155.4	17
FUCHS PETROLUB	Commodity Chemicals	4,039	6.3	13.9	56.1	0.2	0.3	8.8	18
RATIONAL AG	Industrial Machinery	2,842	11.8	18.0	41.7	0.2	0.7	5.8	19
BILFINGER SE	Diversified Support Services	3,708	6.9	7.4	14.4	2.7	0.2	-0.3	20

Source: Bloomberg. Note: *Total return; **Aggregate of one-month, three-month and 12-month EPS revisions ranks.

Appendix 1: Screening methodology

Universe

We include all non-DAX30 stocks classified under GICS Level 1 Industrials or GICS Level 1 Materials, and subject to a minimum market cap of €10m. This provides a universe of 148 stocks.

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 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 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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