

German industrials

Global ambitions

- German industrials companies plan to invest significant capital abroad.
- Diversification away from Europe, an ongoing theme.
- We highlight four stocks with strong financials that also screen well.

Diversifying out of Europe

Corporate releases suggest that German industrials plan to grow international sales through direct foreign investment in regions such as China and the US. For example, Grammer and SHW both outlined plans for acquisitions and/or greenfield developments in the US in order to align costs and revenues in the NAFTA region. Their confidence is borne out of export success, often on the back of supply contracts with German OEMs. We think it signals a belief that economic growth in these regions will outperform Europe over the long term (note, the US now has 14 consecutive quarters of GDP expansion and a recovering housing market). FDI outside Europe also helps German companies to diversify eurozone currency risk. Across the industrials sector, corporate balance sheets are healthy and cash generation is strong. Both act as great facilitators for FDI. Using our value and momentum tools we highlight four companies with international operations that screen well and have low financial gearing (and thus capital to invest): Steico, Deutz, WashTec and Krones.

Steico: Net gearing -4%; value screen rank four

Steico's core business is the manufacture of wood fibre insulation products for the building industry. Despite pricing pressure in the UK and French markets, Steico grew both sales and margins y-o-y in the nine months to 2012. The stock has limited coverage by analysts and looks excellent value on 2012 multiples (P/B = 0.7x, EV/EBITDA=4x).

Deutz: Net gearing 26%; value screen rank 17

Deutz is a leading producer of engines for industry and agriculture with manufacturing facilities in Europe, US, China and Argentina. Following a difficult first three quarters, Deutz reported a marked increase in new orders and revenues in Q412 and plans for increased investment in China. The stock ranks 17th on our value screen.

WashTec: Net gearing 6%; momentum screen rank seven

Washtec produces a full range of carwash systems for cars and commercial vehicles and sells into 60 countries including the US and China. Following a solid Q4, 2013 consensus earnings were revised up. Management are targeting high growth markets and the stock trades on a 2013 P/E of 12.9x (Bloomberg consensus).

Krones: Net gearing 21%; momentum screen rank 10

Krones produces large filling and packaging machines for the food and drinks industry, and liquid filtering technology. Around 65% of sales are to non-European customers with a growing representation in Asia, South America and Africa. The stock looks expensive on 2012 multiples (P/B=2.1x, EV/EBITDA=16x); however, consensus EPS is rising.

German industrials spotlight

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MDAX Industrials Index

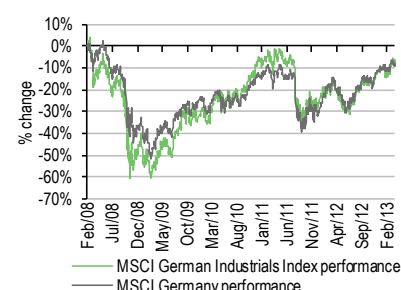


Exhibit 1: Overlooked and undervalued

Stock name	Sub-sector	Market cap (€m)	Quality		Value		Rank
			Net gearing %	EBIT margin* %	P/BV	EV/EBITDA	
KOENIG & BAUER	Industrial Machinery	299	-20	0.6	0.6	2.3	1
SALZGITTER AG	Steel	1,984	-10	-2.2	0.5	3.9	2
UNITED POWER TEC	Electrical Components & Equipment	44		16.6	0.7	1.9	3
STEICO SE	Building Products	56	-4	6.3	0.7	4.0	4
NORDWEST HANDEL	Trading Companies & Distributors	42	-51	0.6	0.9	1.8	5
SCHUMAG AG	Industrial Machinery	12	16	-19.2	0.9	3.4	6
EUROKAI KGAA	Marine Ports & Services	301	28	10.5	0.8	4.1	7
BREMER LAGERHAUS	Marine Ports & Services	229	100	4.5	0.6	4.7	8
JOYOU AG	Building Products	268	-13	19.1	0.8	4.3	9
NORDDEUTSCHE STE	Building Products	23	68	4.4	0.7	4.6	10
YOUBISHENG GREEN	Paper Packaging	51	-51	23.4	1.0	1.2	11
GREIFFENBERGER	Industrial Machinery	28	131	2.1	0.9	4.3	12
DEUFOL SE	Air Freight & Logistics	42	70	3.1	0.4	5.7	13
RHEINMETALL AG	Industrial Conglomerates	1,481	7	6.9	1.1	3.5	14
AURUBIS AG	Diversified Metals & Mining	2,251	3	4.2	1.0	4.1	15
WESTAG & GETALIT	Building Products	102	-9	6.3	0.9	4.7	16
DEUTZ AG	Industrial Machinery	480	26	0.2	1.0	4.5	17
WACKER CHEMIE AG	Specialty Chemicals	2,965	29	12.3	1.1	4.3	18
SIXT AG	Trucking	754	193	8.8	1.2	4.0	19
KSB AG	Industrial Machinery	833	-12	8.1	1.1	4.4	20

Source: Bloomberg. Note: * Three-year historical average

Exhibit 2: Rising revisions

Stock name	Sub-sector	Market cap (€m)	Performance* %			EPS revisions %			Rank
			1m	3m	12m	1m	3m	12m	
MBB INDUSTRIES	Industrial Conglomerates	120	-2.9	18.3	166.7	8.5	8.5	78.3	1
BAYWA AG-VINK.	Trading Companies & Distributors	1,267	-0.2	10.2	29.8	3.5	14.9	18.8	2
DUERR AG	Industrial Machinery	1,430	1.9	23.6	87.9	1.9	12.1	43.7	3
HOMAG GROUP AG	Industrial Machinery	223	11.3	27.2	31.7	12.3	22.4	3.9	4
SFC ENERGY AG-BR	Electrical Components & Equipment	41	-5.2	-9.3	34.8	0.0	44.2	70.8	5
AIR BERLIN PLC	Airlines	294	-1.2	60.1	8.7	16.7	15.5	-0.6	6
WASHTEC AG	Industrial Machinery	153	5.3	20.3	24.0	0.0	27.4	8.6	7
KUKA AG	Industrial Machinery	1,073	-9.4	12.8	110.9	0.6	2.9	36.6	8
R STAHL AG	Industrial Machinery	193	4.9	12.4	15.8	7.3	8.0	3.7	9
KRONES AG	Industrial Machinery	1,733	11.5	16.4	48.6	2.5	1.5	5.1	10
ZHONGDE WASTE TE	Industrial Machinery	28	1.7	23.8	-41.7	0.0	0.0	225.0	11
AURUBIS AG	Diversified Metals & Mining	2,251	-4.5	-4.4	29.9	0.0	1.9	7.0	12
NORMA GROUP	Industrial Machinery	777	-1.5	12.6	39.9	1.1	2.2	1.5	13
KOENIG & BAUER	Industrial Machinery	299	13.6	38.5	42.7	15.2	15.2	-17.4	14
KSB AG	Industrial Machinery	833	4.2	7.6	7.6	0.0	0.8	8.5	15
CENTROTEC SUSTAI	Building Products	260	-3.9	11.4	14.5	0.0	5.4	2.0	15
DEMAG CRANES AG	Construction & Farm Machinery & Heavy Trucks	1,219	3.5	8.0	10.4	0.0	0.0	22.1	17
BERTRANDT AG	Research and Consulting Services	911	5.8	20.7	61.6	0.0	1.1	4.6	18
GILDEMEISTER	Industrial Machinery	946	-16.9	2.1	17.5	0.6	1.5	0.6	19
BRENNTAG AG	Trading Companies & Distributors	6,014	6.3	17.5	37.2	1.3	0.8	-2.8	20

Source: Bloomberg. Note: *Total return.

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 140 stocks, some of which are excluded 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 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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