



### GERMANY CALLING

During my time as an Asian fund manager I did not build up any detailed knowledge or expertise on the German stock market. It was only after I moved on to become a global technology fund manager that I had my first experience of talking to German companies. Given however the small size of the German technology sector I only met a handful of German companies and therefore until recently my knowledge of Germany was quite limited.

At the time that I did meet those German technology companies I felt that they were unusually straight talkers. This was a complete contrast to my experience with Japanese companies. (As I have written before I learned to my cost that Japanese companies consistently lied to me.)

I particularly remember meetings in 2002 with German semiconductor company Infineon and electronic components company Epcos. Before I met them I had done some initial research and my instinctive conclusion was that both companies would struggle to generate decent long term returns. I reflected this opinion to the company representatives and expected them to do the Japanese thing of saying that their medium term plans showed a bright future. I was surprised to be told that they agreed with my initial conclusion. We then went on to have what I felt were full and frank discussions as to why they were only slowly changing and I remember feeling a bit frustrated by the lack of urgency. (Both companies were spun out of Siemens and had a tradition of protecting jobs).

Given that I met so few German companies I was unwilling to reach any broad conclusions but I have to admit that the few companies I met did make a good impression with regard to honesty even though I did not think that they were good investments.

A couple of years ago I was talking to a new client about investment when he told me that he had worked for many years in Germany for a machinery company and he felt that he would like to have a distinct German bias to any investments he made. Naturally enough I asked him about why he held such strong opinions. He said that from his experience most Germans were honest, hard working and prudent and he felt that this gave him a high degree of confidence to invest there. He also said that they continued to invest heavily in education, training and research and development to maintain a long term competitive position in manufacturing.

At the instigation of that client I began spending more time looking at German companies. I went to Germany and I also met them at conferences in London. I tried to meet companies from a range of sectors. I met financials, real estate, technology and machinery. I tried to devote some time to researching consumer and conglomerates but I kept away from anything related to automobiles (a sector I have no exposure to).

I was afraid that I might not find any companies that had a good franchise and sold for a reasonable price. I was afraid that too many companies might be like Infineon and Epcos.

Naturally enough once I started looking at Germany I decided to have a look at how Infineon and Epcos had performed.

The chart below shows that Infineon has indeed had a difficult time.

Infineon Chart:



(Interestingly only this month Infineon sold a division to Intel. This is on top of major changes in earlier years. In fact Infineon has now slimmed down to where it is a leading player in its remaining divisions. It may have taken a decade but I think they have slimmed down to a strong core and this might mean a brighter future.)

Ironically on the other hand, in 2008 just before the world fell apart Epcos was bought by the Japanese company TDK. Once more a Japanese company paid top dollar to get control of a middle of the road company.

At their recent results meeting TDK was asked about Epcos and this was the answer given:

Regarding EPCOS' first-quarter performance, due to the change in segment classifications and integration of the businesses of EPCOS and TDK along with this, products have been allocated to the various product categories in the passive component segment. It is now therefore more difficult than in the past to clearly separate EPCOS and TDK sales. That will also be the case going forward. Even including EPCOS goodwill in the first quarter, we were still sufficiently profitable. EPCOS goodwill of approximately ¥1.2 billion was recorded separately.

The cynic in me would say that it is very convenient for TDK to have buried Epcos in the new classification system and I would also say that I do not trust them when they say "we were sufficiently profitable".

I think you can guess that I do not intend investing in TDK in the near future.

Luckily not all German companies are like Epcos. Luckily there are some companies with great global franchises and luckily some of them sell for a reasonable price. As a result of all my research I now have two German companies in my own portfolio and I spend a relatively large amount of time looking at German companies. I have so far had a good experience with these companies and have come to respect that straightness. (I might write a future opinion piece about these companies).

### **Conclusion**

I have found interesting companies in Germany on reasonable valuations and I will be delighted if I find a few more.