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Siemens — A dividend play

Background

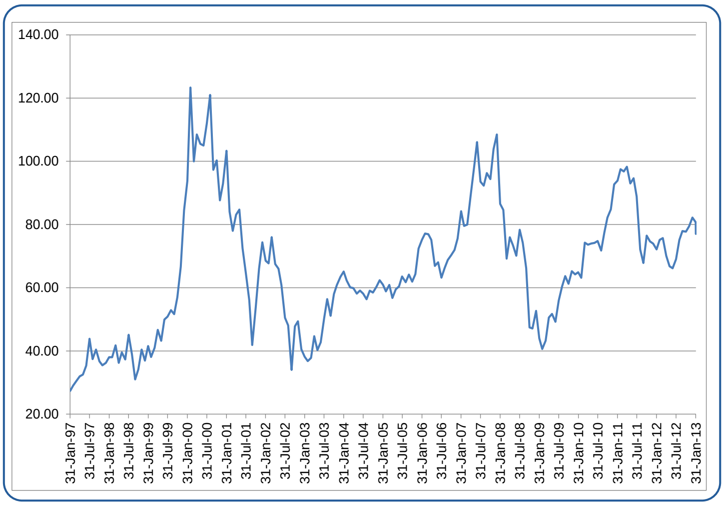
Siemens AG is an engineering and manufacturing company, founded in 1847 and based in Germany, which provides engineering solutions in automation and control, power, transportation, medical, information, communication and lighting.

Siemens' metrics are as follows:

Spot (EUR)	77.09
Mkt Cap EURmn	67916
12M traling P/E	13.56
12M fwd P/E	11.6
10-year average P/E	17.3
10-year average DY	2.21
FYE	30-Sep
P/Book ratio	2.2
12M trailing DY	3.89
12M fwd DY	4.2

Source: Bloomberg, Anchor Capital

Siemens share price performance (EUR)



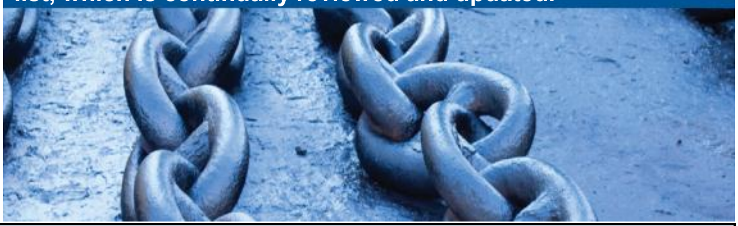
Source: Bloomberg, Anchor Capital

The company has the following six main sectors or segments: Energy (which consists of Fossil Power Generation, Wind Power. Oil & Gas [O&G] and Power Transmission divisions), Healthcare (consisting of Diagnostics), Industry (made up of Industry Automation and Drive Technologies), Infrastructure & Cities (Transportation & Logistics, Power Grid Solutions and Products, Building Technologies) - these make up its four main pillars, it then also has Equity Investments and its Cross-Sector businesses. Siemens currently employs 370,000 people globally.

The group was first listed in 1899 and its primary listing is on the Frankfurt Stock Exchange. It has a secondary listing on the London Stock Exchange (LSE) and is also listed on the Italian Stock Exchange and the New York Stock Exchange (NYSE).

Global Ideas is a newsletter published four times a week (Monday, Wednesday-Friday) and available only to clients of Investor Campus and Anchor Capital. Twice-weekly (in the Monday and Thursday editions) we feature an in-depth analysis of a company on our focus list. The key objective of this newsletter is to provide ideas for investment in the global investment universe.

We scan the globe looking for good opportunities. We provide our model portfolios, as well as news and views on our watchlist, which is continually reviewed and updated.



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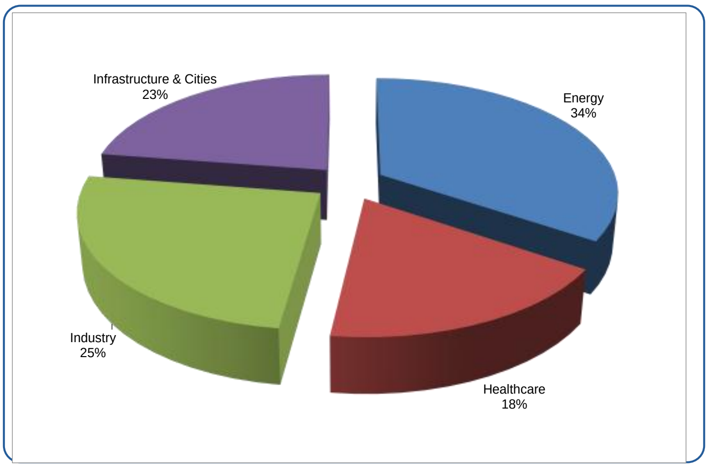
Cost-cutting initiatives

Siemens' Chief Executive, Peter Löscher (who took office in 2007) has come under pressure recently to trim costs after the group's strategy to accelerate growth at the beginning of 2011 saw gross margins and capital efficiency fall behind while the company's costs climbed. Siemens had invested heavily after the financial crisis in 2008, boosting staff by 20,000 to 370,000 and the company was seemingly taken by surprise as the European sovereign debt crisis decreased economic activity, especially in Europe. The decline in new orders reflected the poor state of the economy in Europe, where Siemens generates around half its revenue. As the global economy took longer than expected to recover growth hadn't kept up with the pace of investment and in July 2012 Siemens reported a large drop in new orders. In November, at its 4Q12 results presentation, Siemens announced cost-cutting measures which it said would save the company c. EUR6bn by 2014. The plan was in response to the decline both in profitability and orders as Siemens underperformed its rivals. The restructuring plan calls for Siemens to divest from its underperforming businesses, cut EUR6bn in costs over the next two years, tackle high production costs and simplify the company's internal processes. The basic strategy and structure of the company, which comprises the four pillars Energy, Healthcare, Industry and Infrastructure & Cities is unchanged and the aim of the programme is to enable Siemens to "meet its own ambitious goals and to underscore the targets defined in the One Siemens framework".

Loescher also said costs for research and development as well as administration and sales were too high, adding that Siemens needed to once again improve its cash flow. Around EUR3bn of cost savings are expected to come from improvements in the company's procurement and supply chain, while a further EUR2bn will be saved in optimising capacity utilisation, processes and project management. However, Loescher said he had no plans to dismantle Siemens' current four-pillar structure. The company also undertook to achieve an operating profit margin of at least 12% by FY14 compared with FY12's 9.5% margin.

In 2012, Siemens was also hit by a succession of home-made setbacks that forced it to book costly charges in offshore wind and particle therapy, a trend which continued in 4Q12 via impairments in solar, power transmission and Siemens' Iranian business unit. Owing to international pressure Siemens withdrew from any new business activities in Iran in 2010 but continued to generate revenue there by maintaining existing long-term contracts. However, tougher economic sanctions forced it to take a EUR327mn hit in 4Q12 in order to account for Iranian sales it had already booked in previous quarters and the worsening ability of Iranian customers to make good on these sales.

Siemens revenue by sector 1Q13



Source: *Company reports, Anchor Capital*

Siemens 1Q13 results:

Siemens released 1Q13 results on 23 January 2013. The company said its net profit fell to EUR1.2bn for 1Q13 vs EUR1.37bn a year earlier. Siemens largely blamed EUR116mn in charges at its high-speed rail unit and a loss at its solar business, which is earmarked for sale. It recorded a 12% drop in earnings for 1Q13 and said its orders sank, indicating tough times ahead. Revenue rose 1.5%, to EUR18.128bn, supported by 4% growth in emerging markets (EM). Organic revenue, excluding currency translation and portfolio effects, was 1% lower YoY, while orders received came in at EUR19.141bn, down 3% YoY. On an organic basis, the company reported that orders had declined 5% due in part to a higher volume from large orders in the prior year, with EM decreasing 6% and accounting for 36% of the total order intake. Thus the company's order intake decreased substantially (by 27%) from its extraordinary high level of the previous year.

Total sectors' profit rose 4%, to EUR1.698bn, on higher profit in the Energy and Healthcare sectors. Income from continuing operations came in slightly lower YoY, at EUR1.295bn, while corresponding basic EPS rose to EUR1.52. Net income declined to EUR1.214bn, with corresponding basic EPS of EUR1.42. The Energy sector margin was 9.0% (underlying 10.2%) impacted by -EUR46mn charges related to Iran (O&G) and EUR28mn project charges related mainly to grid connections to off-shore wind-farms at its Transmission segment. The Healthcare margin was 15.5% (underlying 16.8%) driven by a favourable business mix and improvements in cost position resulting from the sector's ongoing 'Agenda 2013' initiative. The Industry margin was 10.8% (underlying 11.8%) impacted by a more challenging market environment.

The 1Q13 results included EUR50mn in restructuring costs.

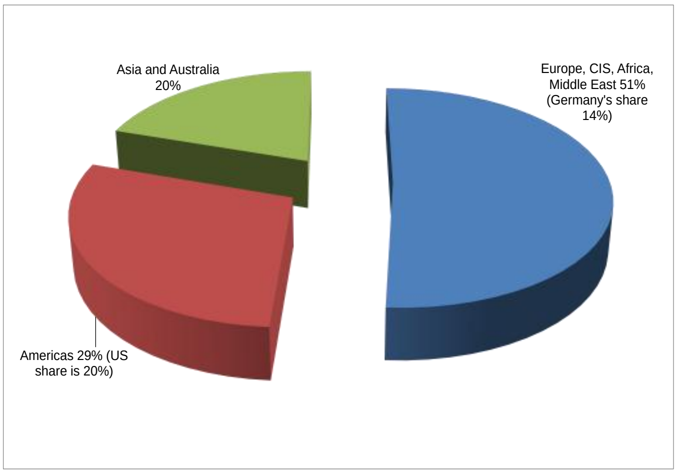
Weaknesses

- **Exposure to Europe:** The investment climate in a number of Western European countries in which Siemens has operations remains weak due to the ongoing austerity measures as well as restricted access to and the high cost of capital. Siemens also underestimated the sluggishness of growth in Europe (its main market) and the brevity of the economic upturn while new orders declined as customers in Europe grew more cautious. The company expects that economic output in the eurozone is likely to decline once again, with economic headwinds and pricing pressure expected to continue while economic forecasts for the US are still cautious.
- **Concern over Siemens' ability to execute major projects:** There have been shareholder concerns about Siemens's ability to execute major projects as its rail-unit charges was due to a delay in the company's delivery of high-speed trains to German railways. In October 2012, Siemens announced plans to exit its solar business, amid falling prices and cutbacks in government support for solar-thermal projects with the solar business' loss of EUR150mn weighing on group earnings.
- **Share price underperformance** vs peers: Siemens's shares have underperformed those of its rivals (Switzerland's ABB Ltd., Philips Electronics NV of the Netherlands and France's Schneider Electric SA) during recent months because of uncertainty about how quickly Siemens can improve its profit margins and its exposure to Europe.
- **Certain EMs seem to have lost steam:** Some of the EM (countries such as Brazil and India) in which Siemens has a presence seem to have lost some steam while there has been weakening investment in certain industries in China.

Positives

- **Turnaround initiative:** Siemens has faced mounting investor criticism of its strategy and corporate governance and last year announced its turnaround strategy which, if successful, could see the company running on all cylinders. Although the economic environment is likely to remain challenging, the implementation of its restructuring plan, where cost efficiency and productivity seems to be at the forefront of management's approach, could be key to an improved future company performance. Spinning-off Osram (the manufacturer of lightbulbs and LED lighting) into a standalone company is part of this broader overhaul. The spinoff received approval in January, with 98% of the shareholders attending the annual meeting voting in favour of the move. Siemens and its pension fund will keep a stake of less than 20%. Investors are receiving one Osram share for every 10 Siemens shares they own. An initial listing in Frankfurt and Munich would happen in April at the earliest, Siemens said in a statement.
- **Diversification:** The Siemens strategy of having a broad global presence (190 countries) in several sectors covering a significant array of products defines the company and is a definite positive in times of economic uncertainty.
- **EM:** Non-eurozone countries are becoming more and more important for German exporters according to Siemens and in this challenging global economy one way companies such as Siemens seek to grow is by cashing in on EMs, which are still performing far ahead of developed economies. For Siemens, its ability to ride out the current instability in Europe and the broader surrounding region (Middle East, Africa) is by maintaining a strong footing in Asia and the Americas which offers the company a hedge of protection (which follows on from our previous point re diversification). EM held up despite the 5% order decline in China, as Russian orders were up 24%, while orders from the Middle East and India increased 7%.
- **China:** In 1872, long before it became fashionable, Siemens had already started doing business in China and since then the company has significantly expanded its footprint in that country. It currently operates throughout China in all of the company's segments (industry, energy, healthcare, infrastructure and cities). Although there has recently been an order decline from China there is still a "*China push"* on the part of Siemens especially given the uncertainty in Europe and the company is investing heavily in its continued long-standing commitment to its China relationship. Also, despite the recent economic slowdown in China (as the country reported seven consecutive quarters of reduced growth before increasing again in 4Q12), the world's second-largest economy is still expecting continued annual growth in the high single-digits following double-digit growth to 10.4% in 2010. Consequently it makes sense for Siemens to continue investing heavily in China which is exactly what it has been doing and in terms of its global revenue c. 20% comes from Asia (with the bulk coming from China) compared with a 51% revenue portion from Europe, 14% of which comes from Germany. The remaining 29% is derived from the Americas

Siemens revenue by region

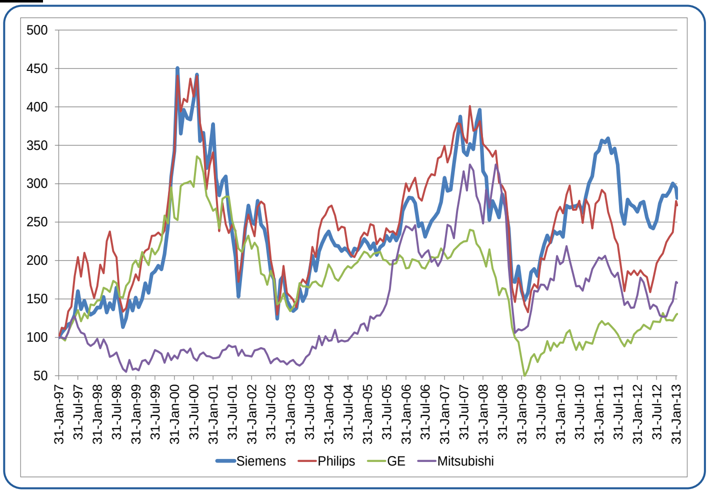


Source: *Company data, Anchor Capital*

Conclusion:

Siemens' share price was up 11.2% in 2012. Among its peers Philips' share price performed best in 2012 increasing by 26.7% for the year, followed by GE at 17.2%, while Mitsubishi Corporation lagged at 5.9%.

Siemens vs peers share price performance (rebased to 100



Source: *Company data, Anchor Capital*

Siemens is trading at a fwd P/E of 11.6x, higher than Mitsubishi but lower than GE and Philips while it offers investors a 12M fwd DY of 4.2%, highest amongst the peers listed in the table below.

Siemens vs peers P/E and DY comparatives

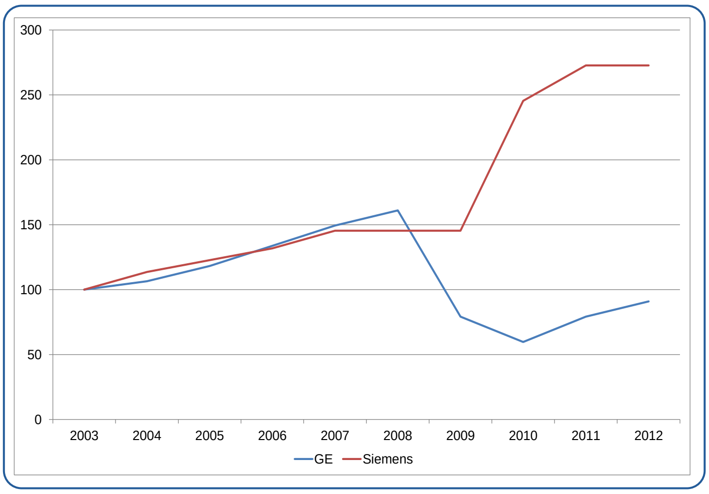
Name	Currency	Price	12M fwd P/E	Trailing DY	12M fwd DY	Mkt cap (mn)
Siemens	**EUR**	**77.09**	**11.6**	**3.89**	**4.2**	**67 916**
General Electric	$	22.50	13.3	3.22	3.5	235 942
Phillips	EUR	$30.45	16.38	3.09	3.54	$29 145
Mitsubishi	JPY	1 915.00	8.89	3.03	2.76	3 166 464

Source: *Bloomberg, Yahoo Finance, Anchor Capital*

Although Siemens' exposure to Europe is expected to weigh on the share price, its diversified business offering and its global presence is a positive (hedge) for the company. Siemens also has strong expected growth and is trading at enticing multiples. In order to try and offset the slow economies in Europe, Siemens has also been boosting its international business especially in high growth areas such as the Americas and China. The company is also well positioned in both the energy efficiency and healthcare sectors — two areas expected to see significant new investments over the coming years.

The company's dividend payment has also been consistent and has never been reduced over the past 10 years even during the global financial crisis.

Siemens vs GE dividend history (rebased to 100)



Source: *Company data, Anchor Capital*

Siemens' dividend grew from EUR1.10 to EUR3 from 2003-2012, an annualised growth rate of 11.79%. This improving shareholder returns are a huge part of the attraction at Siemens, and the announcement last year of its plan to cut costs by EUR6bn by 2014, could further boost the company's bottom line.

Also despite the current headwinds the company is facing in Europe and the softness in new orders, we think Siemens is holding up well in terms of profit margins and earnings.

Thus, while investors wait for the turnaround strategy and new projects to pay off, Siemens is a good share to own with its impressive 4.2%, 12M fwd dividend yield which, at 41% of net income, still has room to increase.

Marco de Matos

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