

## SW Umwelttechnik

### Romania – A Romanian Growth Story

SW Umwelttechnik announced strong results supported by the massive expansion of highly profitable Hungarian activities and high capacity utilisation in 4Q due to the mild winter. In 2007 management forecasts a further increase in earnings by at least 50% as the Romanian expansion should already contribute positive earnings.

Preliminary results 2006: Sales rose by about 12% to EUR 101.8 mn in 2006 due to a strong increase of Hungarian sales from EUR 58.2 mn to EUR 67.5 mn as well as Romanian sales (from EUR 4 mn to about EUR 8 mn), which more than compensated for the unexpectedly sharp sales decline in Austria from EUR 25.6 mn to EUR 22.9 mn. EBIT increased from EUR 3.9 mn to EUR 4.0 mn despite one-off closure costs of EUR 1.2 mn and ramp-up costs for the Romanian activities of estimated EUR 0.5 mn. Supported by a strong HUF recovery in H2 (EUR 0.1 mn FX gains in financial result) and FX gains of EUR 0.4 mn from the RON, EBT increased from EUR 1.9 mn to EUR 2.8 mn. Based on that we calculate EPS of EUR 3.18 compared to our previous estimate of EUR 2.55.

Outlook: We expect a sales increase of 4% to EUR 106 mn as we believe that the expansion of Romanian activities and the strong Hungarian market will more than compensate for the declining Austrian sales. Management forecasts earnings increases of at least 50% in 2007. In view of the comprehensive restructuring process in Austria and Germany of recent years and excellent perspectives in Hungary and Romania we follow this guidance and lift our EPS forecasts for 2007 from EUR 3.30 to EUR 5.06 and for 2008 from EUR 3.73 to EUR 6.21.

Valuation: Since the beginning of January, when SW Umwelttechnik raised the guidance for 2006, the share has more than doubled from EUR 40 to about EUR 90. The current PER 2007 of 17.4 already reflects most of the expected earnings increase. We lift our price target from EUR 45 to EUR 90 but maintain our "hold" recommendation.

**Preliminary results 2006:** Hungary was the main driver for the strong sales development in 4Q as the mild winter enabled strong construction activity in November and December and led to extraordinarily high capacity utilisation. Hungarian sales increased from EUR 58.2 mn to EUR 67.5 mn (RCB est.: EUR 59 mn). Sales on the Romanian market doubled to EUR 8 mn as expected due to the expansion of capacities. In 2006, the company opened one plant for water and started construction of a further plant. Compared to the boom markets Hungary and Romania, the sales development of Austria declined from EUR 25.7 mn to EUR 22.9 mn due to a continued weak market environment and the closure of two production sites as well as the discontinuation of the engineering business in Austria. The restructuring measures undertaken in Austria will lower the cost base by about EUR 0.5 mn p.a. beginning from 2007.

**Accelerated Romanian expansion:** 15 years ago, SW Umwelttechnik started its expansion in Hungary and transformed its activities in the country into the cash cow of the group contributing two thirds of group sales at an EBIT margin of 8% in 2006. The nearby, highly dynamic Romanian market offers SW Umwelttechnik a great opportunity for growth with twice the population figure of Hungary (22 mn vs. 10 mn in Hungary) at a lower stage of development than Hungary 15 years ago. SW Umwelttechnik's declared goal is to quickly establish top-3 market positions in the fields of water protection, infrastructure and

project business – as in Hungary. SW Umwelttechnik intends to invest at least EUR 30 mn in three plants until 2009, which are to generate sales of EUR 40 mn in 2010. The faster ramp-up of the facilities as well as the strong market demand should guarantee the break-even already this year and enable an estimated EBIT margin of Romanian activities of 5% next year. Financing of the expansion should be done by cash flows from Hungary, where the capacity expansion will largely be finished with an estimated CAPEX of EUR 8 mn in 2007 on the one hand and via bank loans on the other hand. Based on our current scenario the company should be able to realize this programme without a capital increase and by maintaining the equity ratio in the targeted corridor of 25 – 30%.

**Outlook:** We expect a sales increase of 4.1% to EUR 106 mn as we believe that the mild winter months in 1Q and the strong Hungarian market will more than compensate for the declining Austrian sales. The fast ramp-up of the Romanian plants should boost sales in Romania from EUR 8 mn to an estimated EUR 12.5 mn. While the group's Romanian activities still caused a slight EBIT loss due to start-up and construction costs in 2006, we reckon with a slightly positive EBIT contribution of EUR 0.5 mn as early as 2007. In combination with the absence of restructuring expenses in Austria of EUR 1.2 mn and of the operating losses of the closed facilities of an estimated EUR 0.5 mn we regard the earnings growth targets of > 50% as achievable. All in all, the discontinued Austrian activities as well as the turnaround of the Romanian plants should enable an EBIT improvement of EUR 2.5 mn in 2007. The further expansion in Romania will be the main driver for future EBIT increases. We lift our dividend estimates and calculate a 10% payout ratio as the higher profitability and the equity ratio of an estimated 28% at the end of 2006 provide room for a more shareholder-friendly dividend policy without endangering the financing of the group's growth course.

**Risks:** The business of SW Umwelttechnik depends heavily on the propensity to invest of municipalities in Austria and the CEE countries, so that the company is significantly influenced by budgetary constraints, environmental legislation and EU subsidies. SW Umwelttechnik finances the Hungarian subsidiaries mainly in EUR loans in the amount of about EUR 25 mn, due to the much lower interest rate level. A devaluation of the HUF vs. the EUR of 1% caused a non-cash loss of about EUR 0.3 mn in the financial result. As a result of the transfer of loans in the amount of EUR 8 mn from Hungary to Austria, currency movements for these loans are no longer shown in the income statement but reflected only in the equity position.

**Valuation:** Since the strong Romanian expansion seems to be well secured at the moment in view of the excellent perspectives of the whole group we also take the Romanian activities into account in our valuation considerations. We also consider the hidden reserves of an estimated EUR 7 per share (based on hidden reserves after taxes of EUR 4.8 mn). Based on our updated estimates the share trades at small discounts to the peer group, which seem to be reasonable in view of the low liquidity of the SW Umwelttechnik share and the high earnings volatility of recent years.

Peer group:

Our DCF model assumes continued strong growth from the Romanian activities in 2009 and 2010. Based on a WACC of 8.2% (beta: 1.3) we calculate a 12-month fair value of EUR 90 per share, which we regard also as our new price target.