

## Germany - Stability in the Heart of Europe

The mood of observers about Germany's situation currently fluctuates between doom and gloom and excessive admiration. Even if many have already predicted Germany's demise due to the problems in the automotive industry, there have recently been increasing signs that Germany is coping better with the current corona crisis than many other countries in the Western hemisphere. However, the reason for this lies neither in a positive nor a negative view, but rather in the basic characteristics of the country: Germany is a stable, slow-growing but at the same time successful country. This stability is based primarily on two pillars: The large number of highly specialized and flexible medium-sized companies and the decentralized economic and political system. These factors are often overlooked when the focus is only on the country's export rates or its dependence on individual manufacturing sectors such as the automotive industry.

### The German Mittelstand as innovator

The real driver of Germany's structural economic development is the large number of medium-sized companies. Medium-sized companies generate more than every second euro of net value added in Germany. It is often a specific product that is behind a company's success. Germany is also clearly number 2 in patent applications following the USA.

These medium-sized companies have often built up positions as global market leaders in niche segments as so-called "hidden champions" or defended these very successfully in global competition. The term "hidden champion" was coined by the economics professor and management consultant Hermann Simon in 1990, in which he described these companies as the "spearhead of the German economy". In the meantime, the term has come to define companies that are among the top three in the world market in their sector or are in first place in their continental market, for example in Europe. Most of the companies are virtually unknown to the public. As a rule, their sales are less than three billion euros. According to Hermann Simon, there are around 1,300 hidden champions in Germany, which corresponds to just under half of all "unknown global market leaders" or 16 hidden champions per million inhabitants. These are found in particular in the fields of mechanical engineering, electronics and medical technology. In addition, many of these companies are still partly in the hands of founders. In this size range, management has much more influence on company development than is the case with large corporations. In addition, there is a greater link to the interests of the shareholders. Their owners, characterized by a strong entrepreneurial spirit, are consistently on the lookout for new opportunities to further develop the company. It is therefore no wonder that they often dominate their chosen niche markets on a global scale.

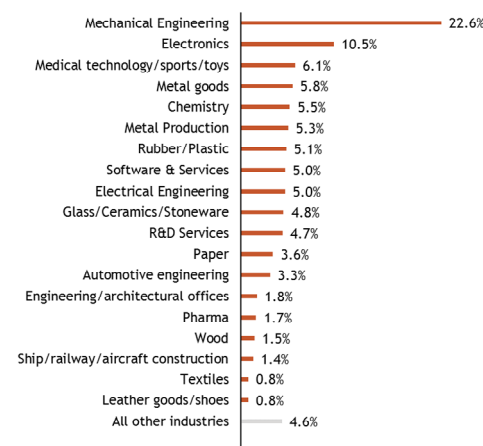
However, the German ecosystem of highly qualified skilled workers and engineers also makes a decisive contribution. Companies in Germany are also supported by a comprehensive and reformed federal social and economic system. For example, the system of short time working allowances and KfW loans provide companies with greater flexibility, especially in times of crises such as the current Covid pandemic.

The following publications are part of the series Berenberg Funds and Solutions:

- Insights
- **Spotlight**
- Equities
- Fixed Income
- Multi Asset
- Systematic Solutions
- Overlay
- ESG

***Spotlight** offers insights into the Berenberg product universe and highlights key topics related to current market developments.*

**Fig. 1: Distribution of German hidden champions by industry (Average from 2006 until 2012)**

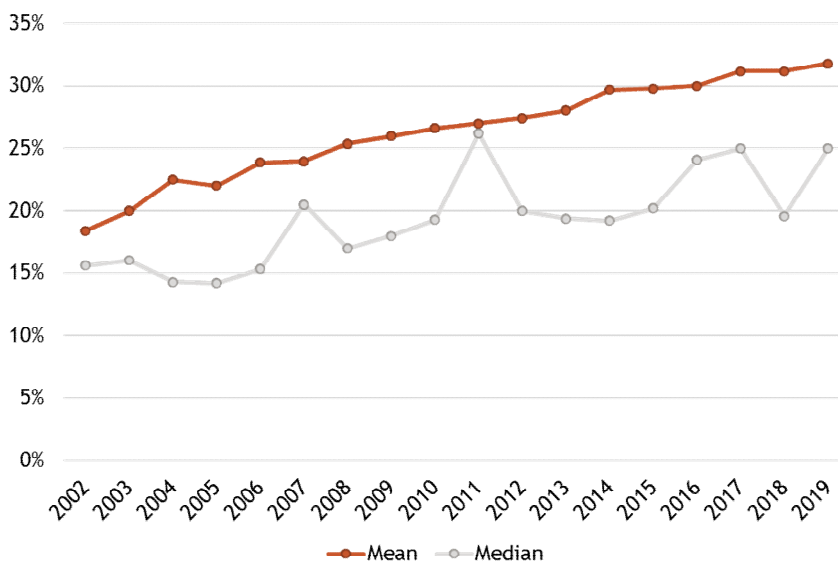


Source: ZEW; Mannheimer Innovationspanel.

These tools have already shown their positive effects during the financial crisis and are a real "location advantage" for German companies, especially in comparison with other European countries. Thanks to the reforms implemented with Agenda 2010 and its solid finances, Germany is now in a better position than many of its European neighbours to cope with the current burden from the Corona crisis, from which German companies are benefiting considerably.

In addition, medium-sized companies have done their homework over the past few years. Since the financial crisis, the equity ratio has improved year by year and is now at a record level. Certainly, the current Covid pandemic is having a negative impact on the sales, earnings and capital development of the German economy. For example, the profitability of German SMEs has fallen by 0.6 percentage points since the beginning of the year. However, this compares with a drastic drop of 7 percentage points in France. Here, as in Italy, capitalization is also significantly worse. This more comfortable financial situation should open additional opportunities for German SMEs in the near future. On the one hand, strong cash balances allow companies to continue investing in products and employees despite declining sales and profits, thus laying the foundation for future growth. On the other hand, the comfortable financial position allows companies to expand their own market position or open up new markets by acquiring struggling competitors. Similar to the aftermath of the financial crisis, the period after Covid will be characterized by market consolidation. Companies such as Sixt and Jenoptik have already used their financial cushions to make attractive acquisitions. This trend will gradually pick up speed in the near future. This above-average financial starting position, combined with the innovative and adaptable nature of SMEs, will also enable companies to better master major structural changes.

**Fig. 2: Development of equity ratio in medium-sized companies**

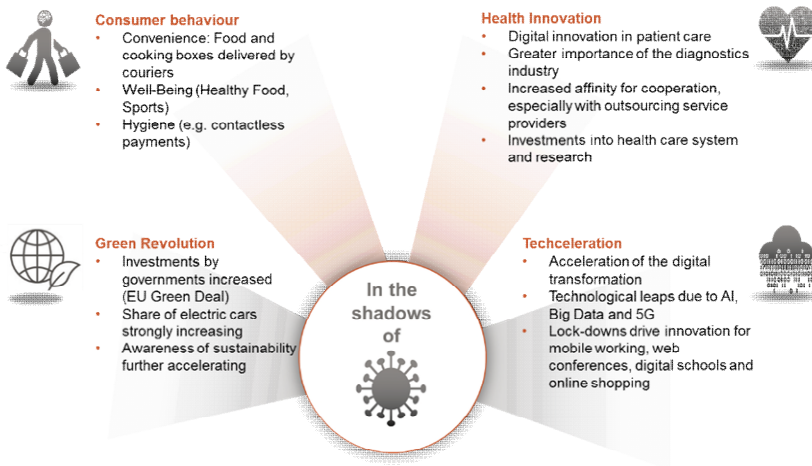


Source: KfW-Mittelstandspanel 2003 – 2020.

### The biggest structural trends

Ongoing digitization and the globally growing and aging population and the associated increase in healthcare spending are the defining megatrends. Economic crises such as the financial crisis or the current Covid pandemic are causing these structural trends to accelerate even further.

**Fig. 3: COVID-19 has accelerated important structural growth trends**



Source: Berenberg

IT system houses have been benefiting for some time from the pent-up demand in the area of digitization. The current crisis makes it even clearer that there is a great need for investment in IT infrastructure in industry and in the public sector (schools, public authorities), for example to enable work from the home office and digital education. With the „DigitalPakt Schule“ (Digital Pact for Schools), the German government is providing a total of EUR 5.5 billion for the digitization of the school system over the next few years. Many medium-sized German companies such as Bechtle, Teamviewer, and Datagroup are helping their customers to master these challenges and are benefiting themselves in the form of increasing sales and profits.

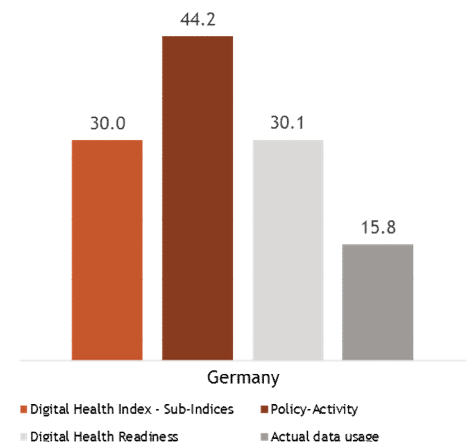
**Fig. 4: Trend towards digitization in companies**



Source: Consultport Digitalisierungsstudie 2020

Pharmaceutical and medical technology companies are also benefiting not only in the long term from an aging population, but also currently from a significant need for testing capacities in laboratories and personal protective equipment. The same applies to the more efficient setup of IT landscapes in the healthcare sector in the future. Compared with the rest of the OECD countries, Germany is currently only in 16th place in the Digital Health Index and thus has a significant need to catch up, reflected in significantly higher policy activity. Health Minister Spahn recently announced significant investments in the digitization of hospitals amounting to > EUR 4 billion. In addition, the telematics infrastructure will be further expanded, and the mandatory e-prescription will be introduced from January 2022. Companies such as Compugroup Medical are helping to implement these projects and are benefiting from corresponding orders from the public sector.

**Fig. 5: Digital Health Index in Germany**



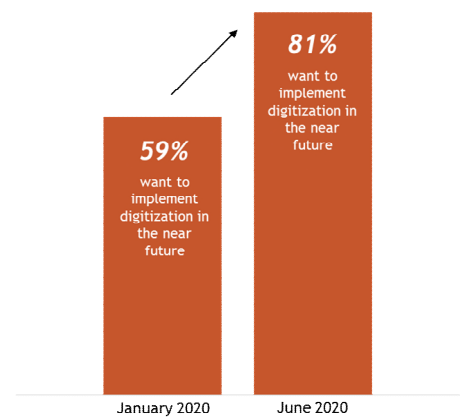
Source: Bertelsmann Stiftung, Spotlight Gesundheit – Thema: #SmartHealthSystems

The current crisis is also giving rise to new behaviors. Online shipping of cooking boxes, as well as increased cashless payments, are trends that are being accelerated by the current crisis. The high level of innovation and the associated generation of superior products and services should enable medium-sized companies to generate attractive growth rates in the medium term, often above the levels of large corporations. Consequently, however, these structural trends will also change the face of the German stock market.

### The stock market is becoming more digital

It is frequently said that the IT sector in Germany is virtually non-existent. But that is by no means the case. With SAP and Infineon, there are already some major German technology companies. In this context, however, it is particularly interesting to look at the so-called second tier. As already described, Germany's innovative strength lies especially with medium-sized companies. If the digitization trend continues, as we expect, this will also flush one or the other company up to the top league of the German stock market. This is a slow but important structural change in the leading German index: fewer cars, fewer banks, more high-tech and Pharma. However, this development will take the form of an evolution rather than a revolution. On the one hand, one or the other pure digital company will rise, but on the other hand, corporations like Siemens or BASF will not simply disappear in the foreseeable future. What this means in concrete terms is that digitization is not just a topic for digital corporations. All industries - some more, some less - will have to reinvent themselves. Consequently, the DAX will become more digital, but not just because digital companies are moving up, but above all because existing DAX members will or must continue to digitize themselves. This could remedy a structural weakness of the DAX that has been criticized for years: the predominance of old industries and large, but cumbersome banks and insurance companies. The rising stars will be companies whose products are perfectly positioned for long-term megatrends and which have built up a leading market position. The expansion of the DAX from 30 to 40 members is a sensible and important step. At the same time, however, it also further sharpens the face of the MDAX as a "Mittelstand-Index" alongside its little brother, the SDAX. Companies such as Symrise, Nemetschek or HelloFresh are examples of companies that have been able to grow strongly from an early age through unique products and innovation, intelligent acquisitions and operational excellence, and now have the potential to rise all the way to the Champions League of the German stock market.

**Fig. 6: Corona promotes the digitization offensive**

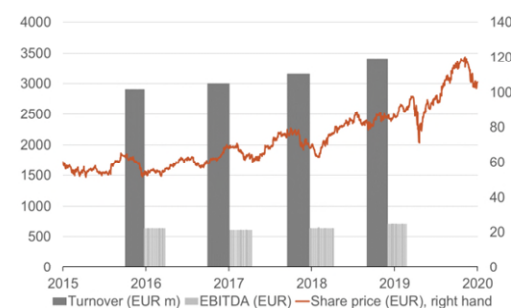


Source: Consultport Digitalisierungsstudie 2020

## Symrise

Symrise is one of the four largest suppliers of fragrances, flavors, cosmetics and functional ingredients. The company has a particularly strong position in the area of natural food ingredients. The company was founded in 2003 from a merger of Haarmann & Reimer and Dragoco, whose origins date back to 1874 and 1919 respectively. The founders of Haarmann & Reimer discovered a method for synthesizing aromatic vanillin. Symrise is now represented globally in 30,000 products. Even though the value-added share of the end products is only 1-2 percent for food (20-30 percent for perfumes), Symrise flavors and fragrances are often the decisive factor in the success of the end product. This gives Symrise a good negotiating position with its end customers. In addition, the company adds c. 30-40 new patents to its portfolio every year, which illustrates the company's innovative power. Every new flavor and fragrance trend comes to Symrise's desk sooner or later; vegetarian or vegan alternatives to meat, for example, need high-quality protein components, not allergens. The company has attractive, high single-digit growth rates combined with attractive EBITDA margins of over 20%.

**Fig. 7: Turnover, EBITDA and share price of Symrise**

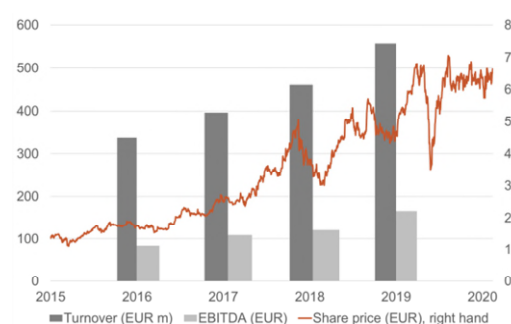


Source: Bloomberg

## Nemetschek

Nemetschek is the world's leading supplier of software for the AEC industry (Architecture, Engineering, Construction) with more than 2.3 million users worldwide. Founded by Prof. Dr. Nemetschek in 1963 as an "engineering office for the construction industry", the company first started working with computers in the engineering sector in 1968. With 80% market share in the DACH region, Nemetschek is now the de-facto market standard in the industry, but a large part of its business also comes from the USA. 24% of sales are invested annually in R&D to ensure innovation leadership within the company. The company benefits not only from the digitalization of the construction industry and increasing regulation, but also from sustainability factors through lower material waste and energy use due to better planning through Nemetschek software.

**Fig. 8: Turnover, EBITDA and share price of Nemetschek**



Source: Bloomberg

## HelloFresh

The global leader in the field of online cooking boxes was founded in 2011 by the current CEO, Dominik Richter, and COO, Thomas Griesel. After skepticism on the part of many investors because the approach was too innovative, the first round of financing was finally secured. After that, things took off at lightning speed and in January 2012, the first ingredients were delivered by the company's own bicycle - in bags, the founders bought the goods themselves at the supermarket. The company now has a network of many hundreds of regional suppliers, over 4 million customers and delivered over 280 million meals in 2019. The company has very attractive growth rates of well over 30%, accelerated further by the Corona pandemic. Through significantly better execution compared to global competitors, HelloFresh was able to further consolidate its strong market position in the last two years. Due to the vertical integration of the supply chain, the company can already show attractive EBITDA margins of up to 10% despite the high growth rates, which also shows the attractiveness of the business model compared to other online platforms. The company is also very well positioned in terms of sustainability. Compared to traditional supermarkets, the company produces c. 66% less food waste and 71% less CO2 emissions.

**Fig. 9: Turnover, EBITDA and share price of HelloFresh**



Source: Bloomberg

### ... positioning should be done at an early stage

In order to profit from these trends and the digital evolution, it is important to analyze the potential winners at an early stage. The two Germany funds Berenberg-1590-Aktien Mittelstand and Berenberg Aktien-Strategie Deutschland offer investors two ways to benefit from structural growth and megatrends. The decisive factor in the selection of securities within the portfolio is how the companies are positioned and how they are influenced by the megatrends. The fund management looks for the most promising candidates, whether blue chips or hidden champions from the second tier. The selection is not based on criteria such as stock market value or index membership, but on the growth and success prospects of the individual stocks. The selection is based on an active bottom-up approach, i.e. the fundamental data of the companies must be convincing. Important information and insights are provided by our equity research team and personal contact with the companies. In order for companies to be successful, they would have to grow sustainably and robustly - and have a solid financial profile. In line with Simon's "Hidden Champion" definition, the Berenberg-1590-Aktien Mittelstand focuses on the "German growth pearls" with a turnover of less than EUR 3 billion and a stock market valuation of less than EUR 5 billion. The aim is especially to discover new "rising stars" and to benefit from their above-average growth and returns as an investor within the framework of a concentrated portfolio of 25-45 stocks. For the Berenberg Aktien-Strategie Deutschland, a high proportion of small caps is also an important part of the successful investment philosophy, in combination with a clear overweighting and underweighting of the larger stocks. With this approach, it is thus possible to accompany the long-term winners on their path to success for years to come, without any limits of benchmark affiliations.

**Fig. 10: The funds at a glance**

	<b>Berenberg-1590-Aktien Mittelstand</b>	<b>Berenberg Aktien-Strategie Deutschland</b>
ISIN	DE000A14XN59 (Retail) DE000A14XN42 (Institutional)	LU146485932 (Retail) LU1599248827 (Minimum investment)
Inception date	04.12.2015	Aktuelle Strategie: 16.06.2017
Investment focus	Small and medium sized companies from German speaking area	German Large Caps; Small- and Mid Caps can be added (usually c. 40%)
Benchmark	50% MDAX / 50% SDAX	HDAX
Single stocks	25 - 45	40 - 60
Awards		

Source: Berenberg.



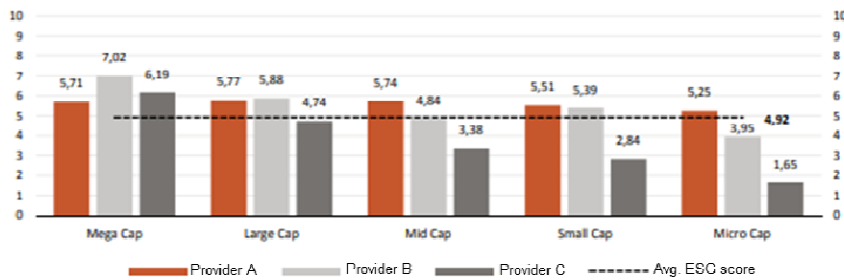
### Sustainable behavior allows for long-term success

For most family businesses in the German Mittelstand, sustainability is not a new topic or buzzword, but part of their DNA and corporate strategy. Owner-managed companies usually think in much longer cycles than larger companies, even if this runs counter to maximizing profitability in the short term. Sustainable product and company development also increase employee loyalty, a decisive factor for the company's long-term success. Only by acting sustainably in accordance with the interests of all stakeholders can the long-term success of the company be ensured. For this reason, ESG analysis is not a “compulsory exercise” for us, but an important instrument for determining the long-term competitiveness of companies.

*“More than two in three companies (69%) expect to benefit business-wise from increased sustainability activities, and just under a third (31%) are certain of this.”*

- “EY Mittelstandsbarometer”, 2019

**Fig. 11: Average ESG ratings of various providers broken down by market cap size of the companies**



Source: Berenberg.

Here, however, the focus is not only on the classic ESG ratings of providers such as MSCI, but the assumptions are critically examined by carrying out our own analyses and by the portfolio management team being in close contact with the companies. The main reason for this is that small to mid caps often unjustifiably receive lower ratings than blue chips or even fall through the cracks as they lack the resources, for example, to be able to provide the required documentation. As a result, the sustainability of smaller companies is often significantly underestimated. As “ESG-integrated” equity funds, both of Berenberg's Germany Funds are subject to the exclusion criteria of serious ESG controversies, in line with the motto: „Only a company that operates sustainably can be successful in the long term”.

With our Berenberg-1590-Aktien Mittelstand and our Berenberg Aktien-Strategie Deutschland, we offer two investment concepts to benefit from the sustainable evolution of the German economy, driven by the high innovative power especially of the Mittelstand and the underlying megatrends.



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