

An Economy in Upheaval

5 Conclusions for German SMEs

Dr. Michael Heise on Global Economics

February 2023

What does the crisis reality of the past years mean for German SMEs? What conclusions should companies draw from the current developments surrounding Covid, the Ukraine war, and inflation? Moreover, inflation, energy problems, and rising interest rates: the past year has demanded a lot from consumers. Which problems will remain with us, and where are solutions emerging?



1. Political and Economic upheavals

The year 2022 was marked by numerous political and economic upheavals. 2023 has begun somewhat more calmly for the economy and the capital markets, but it would be unrealistic to consider the crises over. There are still considerable macroeconomic uncertainties - inflation that is far too high and the possibility of even tighter monetary policy - the unpredictable war in Ukraine and considerable geopolitical tensions between the USA and China that are important for the entire global economy.

Changes in worldwide trade and capital flows and new forms of globalization have begun, which are of particular importance to Germany's business model. After all, Germany's economic success is based on a high level of internationalization of the economy, which has been driven by a strong SME sector and efficient industry.

One particularly visible geo-economic change is that China and Russia are growing ever closer together economically, while German companies based in Russia were once of dominant

importance, have largely withdrawn due to sanctions. More significantly, economic relations between Germany and its largest trading partner, China, are now also seen as risky dependencies that could become dangerous due to the difficult-to-calculate political developments in this huge "one-party country".

It will hardly be possible to replace business with China with other countries in the foreseeable future. However, it will rather be a longer-term trend to strengthen economic relations with other Asian partner countries and Western partners. Among Asia's major emerging economies, India and Indonesia are likely to benefit. The United States of America is also likely to be very attractive for investments by European and German companies due to its political framework, secure energy supply, and high subsidies. Significant changes in international production and supply chains are therefore to be expected.

An Economy in Upheaval

Prof. Dr. Michael Heise on Global Economics – February 2023

Page 2

What conclusions should small and medium-sized enterprises in Germany in particular draw from these developments? Here are five suggestions united by one thought: Profits are important, and so is resilience.

First: companies should be prepared for the seemingly "unforeseeable". After years of a "political crisis" that started with the Covid pandemic, they should be resilient to future surprises and be able to survive crisis scenarios.

Secondly: German SMEs had high equity ratios before the Covid pandemic, which enabled them to get through the crises without major waves of insolvencies. For financial optimizers, the equity ratios represent a limit to the possible returns, but maximizing returns is of little use if survival in crises is not ensured.

Thirdly: Medium-sized enterprises should also reduce strong one-sided dependencies on individual partners. This can concern the sources of supply of primary products, which are important for the stability of value chains, and it can mean the diversification of sales markets and production sites. In addition, somewhat higher inventory levels and less just-in-time optimization will shape the new reality.

Fourthly: It is right and important that small and medium-sized enterprises do not wait for politicians to improve the conditions in which they operate, but also adapt to adverse conditions. There is plenty of potential for improvement in economic policy: 1) in the reduction of bureaucracy, which is particularly close to the hearts of SMEs, 2) in the particularly high tax and contribution burden in Germany, 3) in a secure and cheap supply of energy for the economy, 4) in the expansion of infrastructure. If nothing changes in these framework conditions, further adjustment measures by companies are to be expected to maintain competitiveness despite difficult locational conditions. These conditions include labor-saving rationalization and relocation of production abroad, as is currently happening again in the energy-intensive sector, but also in research and development, or a reduced vertical range of manufacture and the import of required product components. Such strategies have kept companies competitive in the past, but they are often at the expense of investment and employment in Germany.

Fifth: The lesson from many crises in the past is not to reduce innovation efforts in difficult times, but rather to increase them. New technologies or new ways to meet customer needs even better are often the foundation for long-term market success.

Conclusion

Strong and successful development of small and medium-sized enterprises is essential for prosperity in Germany. This realization is hardly disputed, but unfortunately, it does not lead to a thorough improvement of the framework conditions for the SME economy. Although we are discussing so-called deindustrialization and have been observing a downward trend in German industrial production for five years, we cannot seem to find a consensus for effective structural measures. Relief measures in the context of (energy) crisis management are important but will not improve the competitiveness of the economy in the long run.

Notes on investment strategy - Investment recommendation pursuant to § 85 of the German Securities Trading Act (WpHG) in conjunction with the German Securities Trading Act (WpHG). Regulation (EU) No. 596/2014

General

The investment strategy and/or investment recommendations (hereinafter referred to as "analyses") are prepared by LeanVal Research GmbH for information purposes only.

Neither LeanVal Research GmbH nor its employees accept any liability for damages arising from the use of the analyses or their content or in any other way in connection with them. The analyses do not constitute an offer or invitation to subscribe to or purchase any security, nor do they or the information contained therein form the basis for any contractual or other obligation of any kind. An investment decision should be made on the basis of a duly approved prospectus or information memorandum and in no case on the basis of the analyses. Investors should seek the advice of an investment adviser in making their investment decision. In this respect, the analyses cannot assume an advisory function. The opinions, estimates and forecasts contained in the analyses are solely those of the respective authors. They are date-related, not necessarily the opinion of LeanVal Research GmbH and may change at any time without prior notice.

The information and assessments ("Information") reproduced here are primarily intended for clients of LeanVal Research GmbH in Germany. Should the original recipient forward the analysis, he/she is obliged to do so in compliance with existing regulations and laws and this does not result in any obligation of LeanVal Research GmbH towards a third party. In particular, the information is not intended for clients or other persons domiciled or resident in the United Kingdom, the United States or Canada and may not be passed on to such persons or imported into or distributed in these countries. Distribution of the analyses in other jurisdictions may be restricted by law and persons into whose possession the analyses come should inform themselves about and comply with any restrictions. Any failure to comply with these restrictions may constitute a violation of applicable securities laws. Reprinting, redistribution and publication of the analyses and their contents in whole or in part is only permitted with the prior written consent of LeanVal Research GmbH.

Sources of information

All analyses are prepared on the basis of data from a data provider and from generally accessible sources ("information") that LeanVal Research GmbH considers to be reliable. However, LeanVal Research GmbH has not checked the Information for accuracy or completeness and assumes no liability for the accuracy and completeness of the Information. Any incomplete or incorrect information does not constitute any liability on the part of LeanVal Research GmbH for damages of any kind whatsoever, and LeanVal Research GmbH is not liable for indirect and/or direct damages and/or consequential damages. In particular, LeanVal Research GmbH accepts no liability for statements, plans or other details contained in these analyses with regard to the companies investigated. Although the analyses are compiled with all due care, errors or incompleteness cannot be ruled out. LeanVal Research GmbH, its shareholders, corporate bodies and employees accept no liability for the accuracy or completeness of the statements, assessments, recommendations derived from the information contained in the analyses. Data source for all historical prices is Morningstar and LeanVal Research.

Summary of the valuation fundamentals

The valuations underlying the investment recommendations for stocks analysed by LeanVal Research GmbH are based on generally accepted and widely used methods of fundamental analysis, such as the DCF model, peer group comparisons, NAV valuations and - where possible - a sum-of-the-parts model. The calculated scores (Value, Quality, Stability, Growth) are the result of a proprietary model of LeanVal Research GmbH. They result from the comparison of fundamental key figures of the quantitatively analysed company in relation to comparable companies within a sector (or region). Information on the general approach can be found at www.leanval.investments. The absolute target price and the associated absolute assessment (undervalued, neutrally overvalued) are determined using a DCF or ROIC (Return on Invested Capital) method. Estimates of future profits serve as the basis for this. The earnings estimates are either based on a consensus or are made by LeanVal Research GmbH itself.

Updates

The recipients are not entitled to the publication of updated analyses. LeanVal Research GmbH reserves the right to update analyses without prior notice. Regular updating of this document is not planned.

Compliance

LeanVal Research GmbH has taken internal organisational and regulatory precautions in implementation of the statutory and supervisory regulations in order to avoid conflicts of interest in the preparation and dissemination of financial analyses. In particular, there are internal information barriers that prevent analysts from accessing insider information. Compliance is monitored by the Compliance Officer.

Explanation of the recommendation system

The relative assessment is based on the various scores of the individual companies in the areas of Value, Quality, Stability, Growth and Momentum, which are compared with the average values of the overall market and/or the respective sectors. The companies are ranked on a scale from 0 to 100. From this, the three ratings "unattractive" (0 to 30 on the scale), "neutral" (31 to 70 on the scale) and "attractive" (71 to 100 on the scale) are derived. The relative assessment can change at short notice due to the high complexity of the scores and the multiple interdependencies between the analysed companies.

The rating system of LeanVal Research GmbH for absolute valuation includes the ratings "undervalued", "fairly valued" and "overvalued". The rating of a share is based on the expected return for the next six to twelve months. The expected return is made up of the projected change in the share price and the expected dividend yield. Changes in the discount factor or projected cash flows can lead to significant changes in the target price.

Absolute valuation rating system:

| | |
|------|-----------------------------------|
| Buy | Potential > +15% |
| Hold | Low upside and downside potential |
| Sell | Potential < - 15% |

Conflicts of interest

In the financial analyses, circumstances or relationships that could give rise to conflicts of interest because they could jeopardise the impartiality - of the employees of LeanVal Research GmbH who prepared the analysis, - of LeanVal Research GmbH as the company responsible for the preparation or of companies affiliated with it, or - of other persons or companies working for LeanVal Research GmbH and contributing to the preparation, must be disclosed. Information on interests or conflicts of interest which must be disclosed shall exist in particular if

1. significant shareholdings (= shareholding > 5 % of the share capital) exist between the above-mentioned persons or companies and the issuers who are themselves or whose financial instruments are the subject of the financial analysis,
2. the above-mentioned persons or companies manage financial instruments, which themselves or their issuers are the subject of the financial analysis, on a market by placing buy or sell orders (market making/designated sponsoring),
3. the above-mentioned persons or companies have been involved in the management of a syndicate for an issue by way of a public offering of such financial instruments which are themselves or the issuers of which are the subject of the financial analysis within the preceding twelve months,
4. the aforementioned persons or undertakings have, within the preceding twelve months, been bound by an agreement for services in connection with investment banking transactions vis-à-vis issuers which are themselves or whose financial instruments are the subject of the financial analysis, or have received a performance or a promise of performance under such an agreement during this period, insofar as no confidential business information is affected by the disclosure of this information,
5. the above-mentioned persons or companies have entered into an agreement with issuers, who themselves or whose financial instruments are the subject of the financial analysis, for the preparation of the financial analysis,
6. the above-mentioned persons hold management or supervisory board mandates with issuers whose financial instruments are the subject of the financial analysis, or
7. the aforementioned persons or companies have other significant financial interests in relation to the issuers whose financial instruments are the subject of the financial analysis.

LeanVal Research GmbH
Bleichstraße 52

60313 Frankfurt am Main
Telefon: +49 69 9494 88 050
E-Mail: research@leanval.investments