

AS Creation Tapeten

Buy Price target: €37.00

Consumer Goods

Update

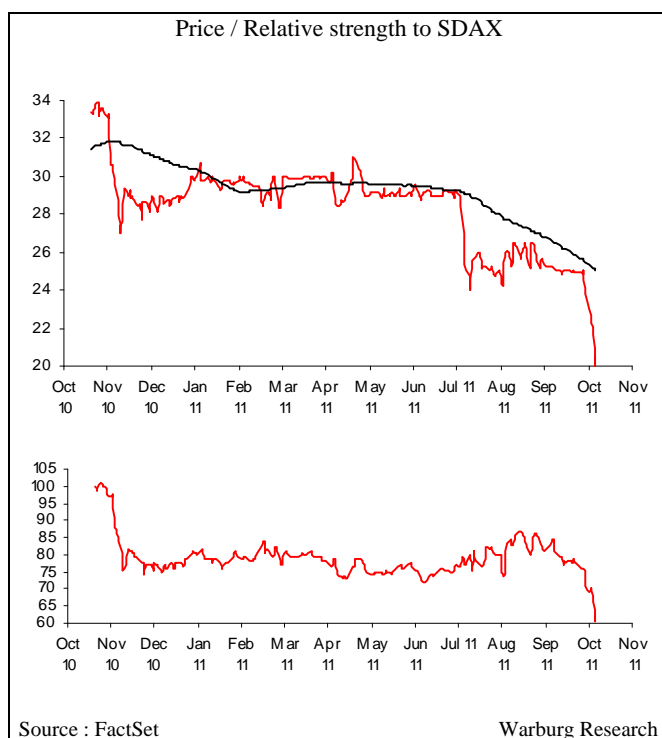
 Bloomberg Code: ACW
ISIN: DE0005079909

 Price on 4 November 2011: €20.50
High/Low 12 month: €34.00/20.02

Capital	Ownership structure	Upcoming events			
Market capitalization	€56.5 m	widely spread	ord 46.5%	22 Mar 2012 :	FY 2011
Number of shares	2.8 m	Franz J. Schneider	ord 29.6%	3 May 2012 :	Q1 results/AGM
Subscribed capital	€9.0 m	Karin Schneider	ord 10.1%	13 Aug 2012 :	Q2 results
		Treasury Stock	ord 8.1%	6 Nov 2012 :	Q3 results

- **Disappointing Q3 due to raw material prices**
- **Price increases expected to bring relief in 2012**
- **Maintain our Buy recommendation due to the attractive valuation and value accretive investments in Russia**

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in €	12/2010	12/2011e	12/2012e	12/2013e
EPS (current)	3.05	1.81	2.09	3.67
EPS (previous)	---	2.94	3.87	4.52
CFPS	6.97	5.70	6.00	7.55
Dividend	1.35	0.82	0.94	1.66
in €m	12/2010	12/2011e	12/2012e	12/2013e
Sales	184.6	195.7	206.5	236.9
EBITDA	24.8	20.1	22.4	25.0
EBIT	14.3	9.7	11.9	14.6
Net income	8.4	5.0	5.8	10.1
Cash flow	19.2	15.7	16.6	20.8
ROCE (EBIT/CE)	12.8%	7.2%	9.1%	10.9%
	12/2010	12/2011e	12/2012e	12/2013e
PER	9.9	11.3	9.8	5.6
PCFR	4.3	3.6	3.4	2.7
Div. Yield	4.5%	4.0%	4.6%	8.1%
EV/Sales	0.58	0.49	0.45	0.38
EV/EBITDA	4.3	4.8	4.2	3.6

Due to substantially higher than expected raw material price pressure (mainly in paint) A.S. Création's Q3 result disappointed. Despite the weak result we expect the company to increase earnings in 2012 again, as price increases and lower raw material prices should overcompensate the increasing start-up costs of the new Russian production facility. That said both 2011 and 2012 are transition years anyway, which are hugely distorted by one time costs. The success of the value accretive investments in Russia will only start to become visible in 2013. Meaning that earnings will remain relatively low and volatile over the next quarters, we consider the stock clearly undervalued on a DCF basis. We therefore stick to our Buy recommendation despite the lack of short term earnings momentum. Due to the profit warning and an expected delay of the production start in Russia into H2 2012 (instead of previously H1 2012) we cut our earnings estimates. Therefore our DCF based price target comes down from €42 to €37.

Q3 earnings had to digest raw material price shock

A.S. Création already pre-announced weak Q3 figures. While sales of €47.5m (+6%) were still broadly in-line with our €48.9m estimate, net profit of just €0.1m in the quarter was substantially below our € 1.5m estimate and the previous year (€1.9m). The main reasons for the shortfall were substantially higher than expected raw material prices leading to a gross margin of just 41% in Q3 (our estimate 48.5%). Management now expects to fall short of its full year guidance of € 6.5 to € 7.5m net profit. Sales are however expected to reach the target range of € 195 to € 205m.

Analyzing Q3, it is absolutely clear that with the exception of the raw material expenses all other line items have been within expectations. Of the other major cost positions both personal expenses and other operating expenses increased only 2.1% and 3.8% respectively, i.e. slower than the 6.1% sales increase.

In addition it is essential to bear in mind that Q3 is burdened

by higher start-up expenses for the new Russian plant. Overall we estimate that the build-up of the Russian production and distribution had a negative impact of around €0.6m in the quarter (thereof some €0.2m direct loss of the production joint venture, some €0.3m for the build-up of the distribution and roughly €0.1m in additional interest expenses).

2011 and 2012 are transition years

In its 50:50 joint venture with Kof Palitra the company is building a new wallpaper factory in Nishny Nowgorod since early 2011. Currently the bare brickwork is already completed, the start of production is however only expected in H2 2012 (in our early 2011 report we have been more optimistic and expected a start of operations already in H1 2012). In the first step there will be around 150 employees in production with a capacity of 6 to 7m rolls. Thus once the factory is fully operational it could increase sales by up to € 40m. The investment volume of the project will be around € 26m, half of which will be borne by A.S. Création.

This project will however lead to substantial start-up losses in 2011 & 2012, as the training and hiring of the production employees has to be started before the plant starts its operations. In addition A.S. needs to build up its own distribution and logistic network in Russia. Unfortunately most of the associated expenses can not be directly monitored in the P&L. Only cost associated expenses with the production joint venture can be seen in the financial result. For 2011 we calculate with a loss of around €0.6m in the joint venture (which includes part of the financing costs as well as the first costs for the training of the production employees). This figure is to increase to €1.25m in 2012 when most of the training and production ramp up will take place. In addition we expect around €1m for the setup of logistics and distribution for both 2011 and 2012. On top we calculate with some €0.1m and €0.25m in financing cost for the equity share in the joint venture. Therefore we assume total start up costs for Russia of €1.7m and €2.5m in 2011 and 2012. As we now expect a start of production in

Fig. 1: Q3 figures and estimates

in EURm, except EPS	Q3 2011a	Q3 2011WRe	Q3 2010a	+/- in %	9M 2011a	+/- in %
Sales	47.5	48.9	44.8	6.1%	146.6	5.8%
Gross profit	19.5	23.7	21.4	-9.0%	68.3	
Gross margin	41.0%	48.5%	47.8%		46.6%	
EBIT	1.0	3.1	3.2	-70.2%	8.5	-24.7%
EBIT-Margin	2.0%	6.2%	7.1%		5.8%	
EBT	0.4	2.3	2.8	-86.6%	7.0	
Net income	0.1	1.5	1.9	-95.3%	4.6	
EPS, basic	0.03	0.55	0.71	-95.3%	1.66	-32.1%

H2 2012 only our assumptions for 2011 are now €0.9m lower than initially assumed, whereas our old forecast of a red zero for 2012 in Russia was too optimistic.

With this investment management expects to generate higher margins in the mid term than the current group average. Assuming a 10% EBIT margin for 2014, i.e. the second full year in operation in Russia, the JV will increase EBIT by around €2m (A.S. Création's share, additionally assuming a distribution fee of 2% of sales for the non-AS part). This would be equivalent to a ROCE of around 15% (pre-tax) (reported pre-tax ROCE in 2010 12.8%). Thus even with this view the Russian facilities should increase the return on capital employed and should be clearly value creating.

Expect price increases in 2012

We don't expect a quick earnings recovery in Q4 nevertheless we assume that A.S. Création will be able to deliver a small net profit in the quarter. We therefore cut our full year 2011 net profit assumption to €5.0m from previously €7.15m.

In 2012 we expect management to pull through a general price increase. On average we therefore expect a 3 percentage points positive price effect for the year. As our baseline scenario assumes a recessionary environment in 2012 we expect flat volumes. On top of that the Russian joint venture should lead to some €5m in sales in 2012. Based on these inputs sales should increase 5.6% in 2012. In this kind of environment we can't expect another increase in raw material prices and consequently we expect a gross margin increase of 100bp (in 2009 management even delivered 200bp gross margin increase, thus confirming that prices can be maintained even during a severe recession).

Despite factoring in the mentioned higher start up costs in our 2012 model we therefore still expect an EBIT margin increase of 80bp in 2012 and a net profit increase of 15% to €5.75m.

Significant earnings increase in 2013 expected

In 2013 we expect some €20m in sales out of the Russian production and 5% underlying sales growth. Therefore we expect A.S. Création to generate record earnings in 2013. In terms of accounting it is important to bear in mind that A.S. Création is distributing the full production of the Russian JV, however it will only receive a small distribution margin on these sales whereas the largest part of the added value will accrue in the production JV. Thus technically the EBIT margin will decline; however this is offset by an improving investment income. In addition we changed our front page EPS definition, previously we added back the expenses for purchase price allocation from the French acquisition, in order to report EPS consistent with

management definition we now switch to reported EPS. This reduces our EPS figures by €0.35.

No news on the antitrust issue

Management has still not received the formal complaints of the antitrust investigation. Thus there is now news on the matter. However we still consider it very unlikely that A.S. Création is liable of material wrongdoings and thus consider it highly unlikely that the ultimate outcome will be anywhere near the maximum potential fine of 10% of group sales in 2010 per case (i.e. €18m or €6 per share).

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	12/2008	12/2009	12/2010	12/2011e	12/2012e	12/2013e
Income statement (in €m)						
Sales	176.2	181.3	184.6	195.7	206.5	236.9
Total operating performance	180.3	177.2	186.6	196.4	207.3	237.6
Cost of materials	-99.3	-90.2	-96.1	-106.9	-110.7	-131.6
Personnel expenses	-36.2	-37.7	-39.3	-41.1	-43.2	-45.6
Other operating income/expenses	23.1	26.0	26.4	28.4	30.9	35.3
EBITDA	21.7	23.3	24.8	20.1	22.4	25.0
Goodwill amortisation	0.0	0.0	0.0	0.0	0.0	1.0
Depreciation	-8.2	-9.9	-10.5	-10.4	-10.5	-10.4
EBIT	13.5	13.4	14.3	9.7	11.9	14.6
Operating profit (company definition)	13.5	13.4	14.3	9.7	11.9	14.6
Financial income	-0.6	-2.6	-2.0	-2.2	-3.1	-0.5
Extraordinary income/expenses	---	---	---	---	---	---
Pre-tax profit	12.9	10.8	12.4	7.4	8.9	14.2
Income taxes	-3.9	-3.3	-4.0	-2.4	-3.1	-4.0
(Tax rate in %)	30.6	30.8	32.0	32.8	35.0	28.5
Net income	8.9	7.5	8.4	5.0	5.8	10.1
EPS (ord.)	3.22	2.72	3.05	1.81	2.09	3.67
Growth (in %)	CAGR (08/13)					
Total operating performance	5.7 %	4.6	-1.7	5.3	5.3	14.6
EBITDA	2.9 %	-7.2	7.3	6.6	-19.2	11.6
EBIT	1.6 %	-10.0	-0.5	6.6	-32.5	22.7
Net income	2.5 %	-10.6	-16.0	11.9	-40.4	75.9
Cost ratios (in % of total op. perf.)						
Cost of materials / total oper. perf.	55.1	50.9	51.5	54.4	53.4	55.4
Personnel expenses / total oper. perf.	20.1	21.3	21.1	20.9	20.9	19.2
Depreciation / total oper. perf.	4.6	5.6	5.6	5.3	5.1	4.4
Cash flow (in €m)						
Gross cash flow	21.4	24.1	25.3	20.4	22.7	25.3
Operating cash flow	8.7	28.0	14.8	9.1	15.2	12.3
Cash flow from investing activities	-23.9	-5.8	-6.8	-22.0	-10.0	-6.0
Free cash flow	-15.2	22.3	8.0	-12.9	5.2	6.3
Cash earnings	16.9	18.2	19.2	15.7	16.6	20.8
Productivity (in €ts.)						
Sales / employee	245.1	230.4	240.7	246.1	251.9	282.0
Personnel expense / employee	-50.3	-47.9	-51.3	-51.7	-52.7	-54.3
EBIT / employee	18.8	17.1	18.7	12.2	14.5	17.4
Returns (in %)						
EBITDA / total oper. perf.	12.0	13.1	13.3	10.2	10.8	10.5
EBIT / total oper. perf.	7.5	7.6	7.7	4.9	5.7	6.1
Pre-tax profit / total oper. perf.	7.1	6.1	6.6	3.8	4.3	6.0
Net income / total oper. perf.	5.0	4.2	4.5	2.5	2.8	4.3
Return on equity	10.7	9.0	9.5	5.6	6.1	9.9
Return on total capital	5.4	4.6	5.2	2.9	3.3	5.6
ROCE	10.6	12.1	12.8	7.2	9.1	10.9
Balance sheet (in €m)						
Property, plant and equipment	51.3	54.7	50.8	46.9	42.5	38.0
Goodwill	9.3	9.3	9.3	9.3	9.3	9.3
Working capital	66.7	52.0	57.3	63.6	64.6	72.8
Current assets	101.8	96.0	99.7	101.1	102.0	111.9
Capital employed (CE)	126.9	111.3	112.1	133.9	130.4	134.2
Equity	83.1	83.8	88.8	90.1	93.6	102.1
Equity ratio in %	50.7	51.8	54.9	51.6	53.5	56.2
Net financial debt (+), liquidity (-)	37.8	20.6	16.3	32.5	29.2	25.2
Total net debt (+), liquidity (-)	43.8	27.5	23.3	39.9	36.9	33.2
Gearing in %	45.5	24.6	18.3	36.1	31.3	24.7
Price ord. on 4 November 2011: €20.50						
Valuation						
EPS ord. (€)	3.22	2.72	3.05	1.81	2.09	3.67
CFPS (€)	6.08	6.61	6.97	5.70	6.00	7.55
Number of shares ord., (m)	2.8	2.8	2.8	2.8	2.8	2.8
P/E ord.	9.8	7.2	9.9	11.3	9.8	5.6
P/CF	5.2	3.0	4.3	3.6	3.4	2.7
EV / Sales	0.75	0.45	0.58	0.49	0.45	0.38
EV / EBITDA	6.1	3.5	4.3	4.8	4.2	3.6
EV / EBIT	9.7	6.1	7.4	10.0	7.8	6.1

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- B Buy:** The price of the analysed equity security is expected to rise over the next 12 months.
- H Hold:** The price of the analysed equity security is expected to remain mostly flat over the next 12 months.
- S Sell:** The price of the analysed equity security is expected to fall over the next 12 months.
- “-“ Rating suspended:** The available information does not currently permit an evaluation of the company.

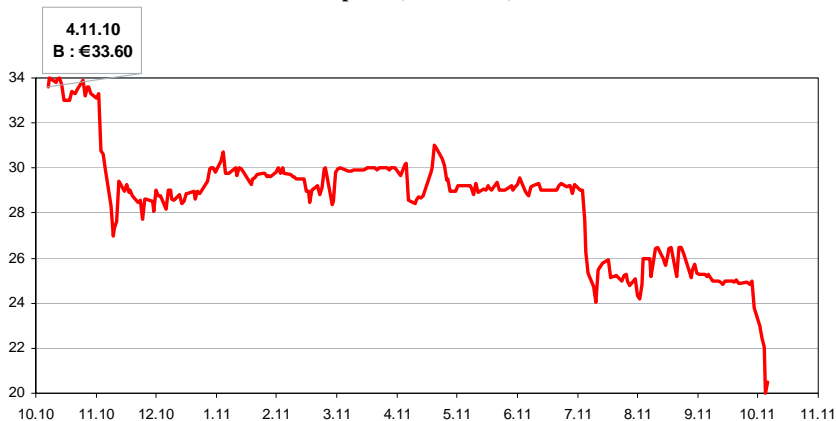
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Buy	131	70%
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Rating suspended	1	1%
Total	186	

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Rating suspended	1	1%
Total	146	

Price and Rating History
AS Creation Tapeten (ACWG.DE) as of 4.11.11



Sources: Factset (prices) / Warburg Research (ratings)

The boxes on the price and rating history chart indicate the date and rating of the Equity Alert issued by Warburg Research GmbH. Each box represents the closing price (Xetra) of the date on which an analyst publish a change to a rating, except for the first box, which may represent the rating in place at the beginning of the period or the first Alert written on the issue in the past 12 months.



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Completed on November 9, 2011

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