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Stock Highlight for the Quarter to 31 March 2022

This quarter we would like to focus on **Siemens AG**, a German industrial conglomerate founded in 1847 which focuses on industry, infrastructure, mobility, and healthcare. Siemens operates its business through five reportable segments namely digital industries (software, automation, digital services) smart infrastructure (electrification, buildings, electrical products), mobility (rolling stock, rail infrastructure, turnkey), healthcare, and financial services.

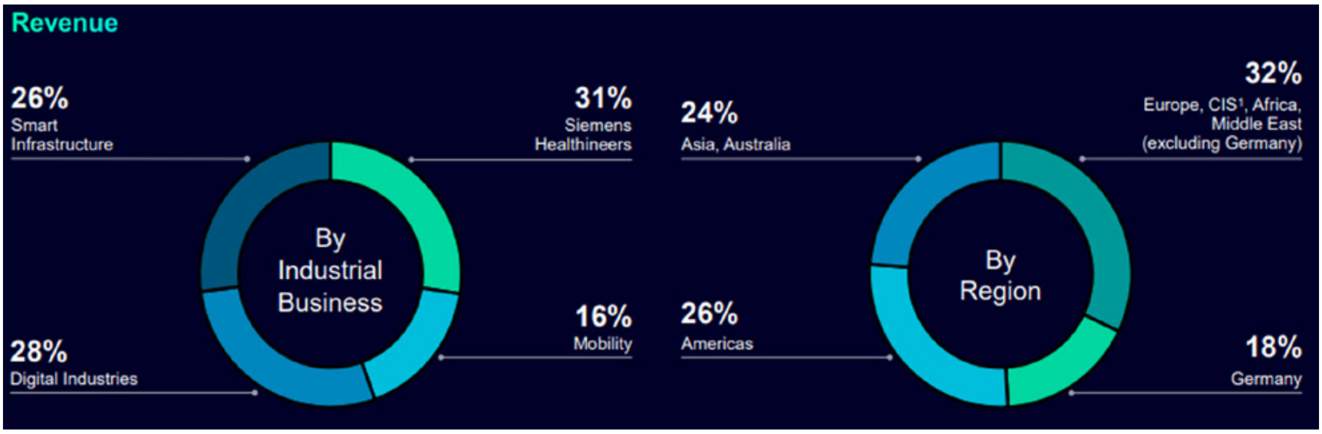
Siemens owns a majority stake in two publicly listed companies Siemens Healthineers, a globally leading medical technology which supply medical imaging equipment and in Siemens Gamesa, a manufacturer of wind turbines. In 2021, Siemens generated a revenue of €62.3 billion and a net income of €4.7 billion and has 305,000 employees worldwide. Siemens has been part of the industrials sector of the European share portfolio since April 2010.

Historical performance (total return in %)
Source: Bloomberg Finance L.P.

Year-to-date, Siemens is down 15.4% (as of March 31, 2022). However, we believe Siemens has sold off too much relative to its peers during the recent market correction. The relative sell off appears clearly overdone when considering that Siemens reported strong quarterly results in the first quarter of 2022, well ahead of expectations, and with a positive outlook versus the consensus. Orders for the first quarter surged 52% year-over-year, reaching €24.2 billion on double-digit increases in all industrial businesses, while revenue climbed 17% year-over-year, to €16.5 billion, as businesses stocked up on equipment and demand increased after the pandemic slowdown.

Siemens now has an order backlog of €93 billion, its highest ever level.

Therefore, despite Siemens being a cyclical company, we remain confident the company can perform well in the current challenging environment because Siemens' source of revenue is well diversified in terms of products, industries, and regions that will allow it to generate economic profits in the future. Siemens's exposure to automation, software, building technologies, public transport, and mobility are attractive in the current context and should deliver strong organic growth.



Revenue for fiscal 2021 (CIS [1] stands for Commonwealth of Independent States)
Source: Siemens AG

Regarding Siemens's portfolio strategy, the firm has changed its structure by giving divisions more freedom, while retaining the synergies with the rest of the group. This should over time improve operating performance and highlight value. In addition, Siemens invests 7.5% of its annual revenue in R&D to foster innovation and to expand its competitive strength and operating margin. This should enhance customer value, generate higher recurring revenues, and support long-term growth. Besides, after years of structural change and higher investments, Siemens is entering a period where the focus moves to execution, driving growth and improving margins, returns and cash.

Indeed, Siemens' portfolio optimization strategy is increasingly paying off, with significant value crystallization moves now taking place. For example, in January, Siemens signed an agreement to divest their Yunex Traffic business, a leading provider of intelligent road traffic solutions, to Atlantia. In February, Siemens announced the sale of its 50% stake in the VSeA JV to Valeo. Given last year's losses of €250m, the divestment is a major relief and will improve the quality of the group's earnings going forward. Siemens also agreed to sell its mail and parcel business to Korber for €1.15bn. However, Siemens's Airport Logistics business remains for sale. Overall, the total proceeds from the announced sale of Yunex, Logistics, and VSeA JV already amount to €2.4billion.

We also like the fact that sustainability is an integral part of Siemens's long-term business strategy. Siemens set up a clear framework (DEGREE) for sustainability with the aim of taking its ESG (Environmental, Social, and Governance) commitment to the next level. The DEGREE framework sets clear and measurable ambitions in terms of decarbonization, ethics, governance, resource efficiency, equity, and employability. For instance, Siemens aims to lower its carbon footprint and supports the 1.5°C target to fight global warming. As such, it decided to target net zero emissions from its operations by 2030 and from its supply chain by 2050 with 20% carbon emissions reduction by 2030. In addition, Siemens supports and contributes to the 2030 ambition defined in the United Nations Sustainable Development Goals (SDGs) to drive the transformation toward sustainability.

Of course, Siemens is exposed to downside risks through potential weaker than expected global macroeconomic environment which would likely derail the current recovery (the industrial sector would bear the brunt of any power rationing imposed resulting from Europe's shift away from Russian energy). Whilst Siemens Energy was successfully spun off in 2020, Siemens's corporate structure remains complex. Besides, Siemens has a mixed M&A track record and may do further acquisitions, disposals, or partnerships with a negative impact on value.

In terms of public and commercial construction spending, Siemens is exposed in smart infrastructure to commercial construction which is negatively impacted by work-from-home and by pressures on retail. The mobility business segment is exposed to clients with severe revenue shortages due to lower traffic flow. The SaaS transition in digital industries may also progress less successfully than expected or cost substantially more to implement. Additionally, Roland Busch is taking over from Joe Kaeser as CEO and any transition introduces uncertainty.

As a conclusion, we strongly believe Siemens is a unique company which will continue to outperform in the future. The company benefits from a well-diversified source of revenue from its five businesses which are focused on the industries that form the backbone of the economy.

On the ESG side, Siemens has now very limited exposure left to fossil energies while its mobility and building technologies segments and smart grid business will benefit from efforts to reduce emissions. In fact, all the electricals should be supported by a likely acceleration of the decarbonization in Europe. Its exposure to Russia is very low and it accounts for just 1% of Siemens' global sales. We also see electric vehicles charging as a key area of growth that the group will continue to exploit. Overall, not only are the market conditions currently very favorable for Siemens, but its innovative portfolio, well aligned on the automation, digitalization, and decarbonization value chains, should continue to support Siemens' valuation.

In subsequent quarterly reports we will bring you further case studies in our "Highlights" series.
As always, please do not hesitate to contact us if you have any questions or comments,
about the contents of this report or your portfolio in general.

Portfolio Management Team ISGAM AG