

Clear rises in earnings expected as of 2010

CeWe Color Holding AG held its annual report press conference for the 2008 business year in Frankfurt on 7 April 2009. Around 20 interested participants, including Thorsten Renner for GSC Research, had gathered in the early hours of the morning to have the future digital photo market strategy explained to them by the CEO.

Report of the Board of Management

CEO Dr. Rolf Hollander started by giving a brief overview of the highlights since the beginning of 2008, saying that the company had been able to extend its market leadership and achieve excellent increases, particularly with the photo book, for which sales figures had risen by 74.8 per cent to 2.6 million books. Internet business increased considerably, by 36 per cent. With earnings before tax and restructuring at 22.1 million euros, turnover increased by 1.6 per cent to 420 million euros. According to Dr. Hollander, earnings after tax rose by 19.4 per cent to seven million euros. CeWe Color intends to pay out a dividend of one euro per share for 2008.

The company reports a sound financial structure with a capital ratio of 42.9 per cent. Investments were all financed from gross cash flow. As the company has considerable scope in terms of financing, growth financing for the future was secured. According to the CEO, the five-year phase of restructuring is to be completed in 2009. Once the operations in Paris and Teplice have been closed down in May this year, the number of labs will have been reduced from 29 to only 13. This means that extra costs of around ten million euros will be incurred for the last time in 2009. And this in turn means that profits will be rising again as of 2010, Dr. Hollander emphasised.

Dr. Hollander expects to see continued growth, notably in the areas of Internet business and with the photo book. CeWe Color has also commenced with web-to-print digital printing with the acquisition of diron GmbH & Co. KG, a leading provider of software programs and consulting services in the area of professional digital printing.

Dr. Hollander then went on to address the CeWe Color business model. The company develops both digital and analogue photos, with orders being placed in stores and for digital photos also in the Internet. The digital photo service is included in retailers' websites. Orders that have been placed are processed in the labs and are then sent by mail or they are collected in a store, with CeWe Color supplying 50,000 retail stores in Europe.

In addition to classical photo business, the CEO said that personalised photo products were steadily becoming more significant. These products included photo gift articles, print products and wall decorations. Examples of print products are calendars and greeting cards. Photo books are fast proving to be a top seller and a "godsend" says Dr. Hollander. CeWe Color offers a wide portfolio of products in this segment, with the photo book being mainly related to events. Users are also offered professional contents for use in their photo books and the books are also being used more and more for commercial purposes.

Thanks to investments made, the company now has more than 50 digital printers installed. The high quality and user friendliness of the photo book is evidenced by a large number of awards. This was also further confirmation of the technological leadership of the company.

CeWe Color reported a renewed decline in photos developed from films last year, with the number of photos dropping by 35.1 per cent to 829 million photos. In contrast, the volume of digital photos rose by 17.9 per cent to 1.786 billion photos. This meant an overall decline of 6.3 per cent to 2.615 billion photos, although the product mixture was of a higher quality, said Dr. Hollander. Orders for digital photos in the Internet rose by 36.1 per cent to 873.8 million photos, while orders placed in stores only increased by 4.5 per cent to 912.3 million photos. CeWe Color achieved a growth rate of 74.8 per cent for photo books, to 2.646 million books, with the trend shifting towards large books according to Dr. Hollander.

The company reported an increase in turnover of 1.6 per cent to 420 million euros in the previous year. In contrast to former quarterly distributions of business, the fourth quarter of the year was gaining rapidly in significance. Dr. Hollander believes that this was due to the fact that photo books made excellent Christmas gifts. Last year the company again incurred restructuring costs to the amount of 11.4 million euros. Earnings before tax were reduced by 16.8 per cent to 10.7 million euros, while earnings after tax increased by 19.4 per cent to seven million euros. Earnings are to be paid out in full to the shareholders in the form of a dividend of one euro per share, which is a dividend yield of currently six per cent.

A huge 84 per cent of the classical market for film development has been lost over the past seven years. This has resulted in some competitors giving up this line of business or even going bankrupt, Dr. Hollander announced. CeWe Color had mastered the technological transition far better than its rivals. The company had addressed the development of digital products as early as in 1994. Since 2002 CeWe Color has invested far more than 225 million euros in establishing the digital line of business. Capital expenditure could now be reduced as of 2009 since essential capacities had now been established.

Of the 13 operations of the company, five were located in Germany, three in Great Britain and in France and five in Central Eastern Europe. Dr. Hollander expected restructuring costs this year to amount to another ten million euros, but as of 2010 there would no longer be any more expenses. For 2009 Dr. Hollander expected to see analogue photos declining by 38 per cent to 0.5 billion photos, while the area of digital photos was set to rise by six per cent to 1.9 billion photos, so that the overall decline would amount to eight per cent, down to 2.4 billion photos.

The positive trend for photo books was to continue, with an increase of 35 per cent to 3.5 million photo books. Turnover is to amount to 420 million to 425 million euros and earnings before tax and restructuring is to be in the range of 20 million to 25 million euros. As already mentioned, expenses for restructuring were estimated at ten million euros, so that earnings before tax would amount to ten million to 15 million euros, according to the CEO. Capital expenditure was likely to be reduced by one third, to 22 million euros.

On 1 October 2008 CeWe Color acquired diron GmbH & Co. KG, thus realising entry into the market for digital printing for commercial customers. diron is one of the leading providers of web-to-print software and achieved turnover to the amount of approximately 2.1 million euros in 2007. The system is currently being integrated after the acquisition of the company. Dr. Hollander expects turnover to be in the lower single-digit million range in 2009, with EBIT at around minus one million euros. In the period up to 2012 turnover is to be raised to more than 20 million euros, with the EBIT margin at ten per cent by this time.

The CEO continued to say that initial orders had already been acquired. CeWe Color is reinforcing its competence base with the takeover of diron. Dr. Hollander believes that digital printing will grow strongly in future since this area of business was currently set to enter the mass market. CeWe Color intends to increase turnover to more than 500 million euros in the period up to 2012, especially since the company was now in a second phase of growth after completion of the process of transformation, said Dr. Hollander.

According to Director Dr. Olaf Holzkämper, the CeWe Color share price had developed far more strongly than the market itself over the past few months. The company had a sound shareholder structure, with the joint heirs of the company founder as the majority shareholders. According to Dr. Holzkämper, the average trade volume over the past 15 months was more than 7,400 shares a day. Profits were being paid out in full to the shareholders in the form of a dividend of one euro per share. The unanimous recommendation of the analysts for the share of the company was "buy".

Photo books were making the fourth quarter of the year more important for business and the company increased turnover by 9.3 per cent to 120.7 million euros during this period in 2008. The third and fourth quarters were also decisive for earnings. Dr. Holzkämper was convinced that the fourth quarter would become even more important in future. Operative profitability had already been significantly increased in the fourth quarterly period.

According to further information, other operating income had risen by 2.7 million euros. This was mainly due to profits from exchange rate differences. However, material costs also showed a rising

trend and reached a rate of 38.9 per cent. On the other hand, personnel costs were reduced by 3.4 million euros. Depreciation increased by 1.9 million euros to 40.4 million euros due to a higher amount of unscheduled depreciation in Bad Schwartau and Eisenach than for Berlin and Nuremberg in the previous year and due to additions to the basis of consolidation.

According to Dr. Holzkämper, other operating expenses rose by 4.1 million euros. A problem here was higher losses from exchange rate differences, as well as increases in advertising expenses. In terms of the regions, CeWe was able to achieve increases everywhere except in Western Europe. In the photofinishing division turnover decreased from 330.7 million euros to 319 million euros, while retailing increased from 82.8 million to 101 million euros. The company reported a sound balance sheet structure at the end of the year, with a capital ratio of 42.9 per cent.

The decline in fixed assets was mainly the result of special depreciation and transfers, Dr. Holzkämper explained. On the other hand, reported goodwill rose as a result of the acquisition of diron. Equity dropped from 120.6 million to 112.4 million euros in the wake of currency differences and the dividend payout.

Dr. Reiner Fageth, a member of the management of the company, then demonstrated the latest developments and possibilities for using the photo book.

General discussion

Asked about the future development of photo production, Dr. Hollander felt that there would be further declines. While the area of analogue photographs would continue to decline, the area of digital photography was only increasingly slightly, so that in general a marginal decline would result. Another question addressed the matter of turnover achieved with the photo book. Dr. Hollander explained here that sales were at 2.6 million photo books, but that no figures had been given for turnover. He did, however, disclose that turnover per book was in the region of about 30 euros.

A participant was critical in questioning whether there was any interest at all in the commercial use of photo books. According to Dr. Hollander, the number of orders placed showed that this was becoming increasingly significant. The Internet as a rival was a good medium for presentation, but customers also welcomed having haptic presentations made.

Other questions concerned the market share in Europe, major customers and the drop in earnings before tax. The CEO estimated that the market share for photofinishing was more than 40 per cent, and that CeWe Color was clearly ahead of Fuji. Due to the situation with competitors, Dr. Hollander believed that the market share for photo books was somewhat smaller. He said that pharmaceutical markets were the biggest customers. Last year the company had once again invested considerably in new machines and had also increased its marketing efforts, so that this had resulted in a drop in earnings.

One of those present asked for information about delivering photos to Spain. Dr. Hollander said that deliveries to Spain were made from France. There were, however, also other shifts. Only about 50 per cent of the company's customers were domiciled in Germany, but about 75 per cent of the photos were processed at the five major operations here.

Asked whether it would not be better to completely discontinue with analogue photography, Dr. Hollander felt that this would not make any sense at all, since CeWe Color was also generating a considerable contribution margin in this area, especially since the machines available had all been fully depreciated. Since turnover was set to rise to more than 500 million euros in the period up to 2012, a participant wanted to know whether acquisitions were also scheduled. Plans did not provide for any acquisitions, Dr. Hollander pointed out, but he did not wish to rule out the possibility of minor acquisitions.

Asked about current account advances, Director of Finance Andreas Heydemann explained that the company wanted to negotiate more fixed credit lines in the coming few weeks, since interest rates for loans would be rising in future. CeWe Color nevertheless had a good standing at present. Current credit lines of 70 million euros were to be raised by another ten million euros.

After prices for raw materials had risen substantially in the past, the Director, on being asked, said that he expected to see a stable price development in the current year. Another item of discussion was the negative development in earnings in the Central Eastern European region. Profits from currencies were matched by losses of 4 million euros, the majority of which had been incurred during the final few weeks of the year. The company intends to purchase more on a local basis in future in order to avoid currency problems. Personnel costs are extremely high in some parts of Poland, since businesses were open seven days a week and also had very long opening times.

Summary and own opinion

It can be pointed out that CeWe Color Holding AG reported attractive earnings in the previous business year. Although renewed restructuring costs need to be borne, these will be incurred for the last time in 2009. The company then intends to have concluded the process of transformation from analogue to digital photography. Now that this has been achieved, the company is entering the market for digital printing for commercial customers with the takeover of diron GmbH & Co. KG. This area is set to grow in the coming few years and to contribute to earnings with an EBIT yield of ten per cent.

In the current year, CeWe Color is likely to see turnover and earnings in the region of those of the previous year. As of 2010 at the latest, earnings are expected to rise markedly when restructuring costs are no longer incurred. The P/E ratio of the company will then once again be clearly in the single digit range. The company also offers a generous dividend yield of more than six per cent. CeWe Color once again shows share price potential from this long-term viewpoint; in the short term, however, the price may be reset again after the clear rise seen in the past few weeks.

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