

Ronny Ruchay: CeWe Color

CeWe Color is Europe's leading industrial photofinishing company with a market share of more than 40%. For more than 20 years now the company has not had a deficit year. On the basis of his "owner earnings" calculation, Ronny Ruchay believes that CeWe Color is a promising investment.

*Ronny Ruchay
Self-employed financial analyst*

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Ronny Ruchay studied Economics at Martin-Luther University in Halle-Wittenberg. He made initial contact with shares in his final years at high school. Ruchay most recently worked as a Senior Analyst in the team headed by Martin Wirth and Manfred Piontke at Frankfurt Performance Management AG (FPM AG). Prior to this he worked in fund management with Union Investment for several years. Here he was responsible for all the mandates in the section for European sideliners as a fund manager and analyst. For his investments, Ruchay seeks first-class companies with clear business models, a management that focuses on its shareholders, high returns on capital employed and attractive business prospects, ideally in an under-valued status. Owner earnings and high returns on capital employed are important indices for him. As a physical and mental balance to the mental exercise of analysing and investing, Ruchay does Kenjunkte, an Asian combatant sport, a few hours a week.

EVI: What makes CeWe Color (ISIN: DE0005403901) such an attractive investment?

Ruchay: There are a number of reasons why CeWe is such an attractive investment. CeWe is the European market leader in industrial photofinishing and has a market share of more than 40%. The company has not had a deficit year for more than 20 years, its business prospects are good, its management (almost always) focuses on the company's shareholders, it generates high, stable returns on capital and high covered owner earnings, all of which I believe results in undervaluation with a safety margin of 40%.

EVI: What is the competitive edge that can be defended long-term?

Ruchay: This has changed greatly as a result of the transformation in business away from analogue film products (i.e. photos from films) to new digital photo products, such as the CeWe photo book. Cost leadership and a cleverly devised logistics network were the most vital competitive edges in the analogue world. Since digital photo products began to take over, CeWe recognised at an early stage that the company could gain an even stronger competitive edge through the software that is now used for producing CeWe photo books. With intelligent software, CeWe Color has managed to significantly reduce the time required to produce digital photo books and at the same time the company has been successful in getting final customers used to the software program. The high costs involved in making a change prevent customers from switching to a rival product which may be more favourably priced.

EVI: This process of transformation was probably also distressing for the company.

Ruchay: It wasn't easy – not for CeWe employees and nor for the shareholders. The process has now dragged on for more than six years. However, the management has been successful in mastering this process without losing any market shares and without any considerable losses in income. On the contrary, business prospects are better now than ever before.

EVI: Who are the most important competitors in Germany?

Ruchay: The competitive environment has been considerably shaken out due to the process of transformation we spoke about. For example, major rival Kodak failed to invest in digital capacities early enough. The Kodak photo labs were closed down in 2004. The last major competitor in Germany is Fuji (ISIN: JP3814000000), of whom it is said that it will soon be commencing with a solution for its labs in Germany. New suppliers have also sprung up, for example OR WO Net AG, a company that is operating and expanding with great success in Central Germany.

EVI: How big is the potential market for digital photos? What growth rates can be expected here?

Ruchay: According to my calculations the number of photos produced every year in industrial photofinishing in Europe in the period from 2000 to 2008 dropped by 37% to 13 billion photos. While the market only comprised analogue prints in 2000, the proportion of digital photos such as photo books was as much as 76%, or around 10 billion photos, in 2008. This means that the market for digital photos has increased by an average of 50% a year since 2003, when it only accounted for 1.3 billion photos. However, the growth rate has fallen considerably since then. I see growth of around 15% for 2009. We are now very close to the point at which growth in the number of digital photos exceeds growth in the number of analogue photos and the market as a whole will be growing again. I expect this point to be reached this year already, or in 2010 at the very latest.

EVI: Would you describe CeWe as a cyclic company?

Ruchay: In the past 17 years, for which I have data available, CeWe has shown itself to be largely unaffected by economic cycles. Here I agree with the management, which, in its newly published first quarterly report for this year, presumes that the recession and more than anything else the rise in unemployment will not have any great impact on sales and profits in the area of industrial photofinishing.

EVI: What are the risks?

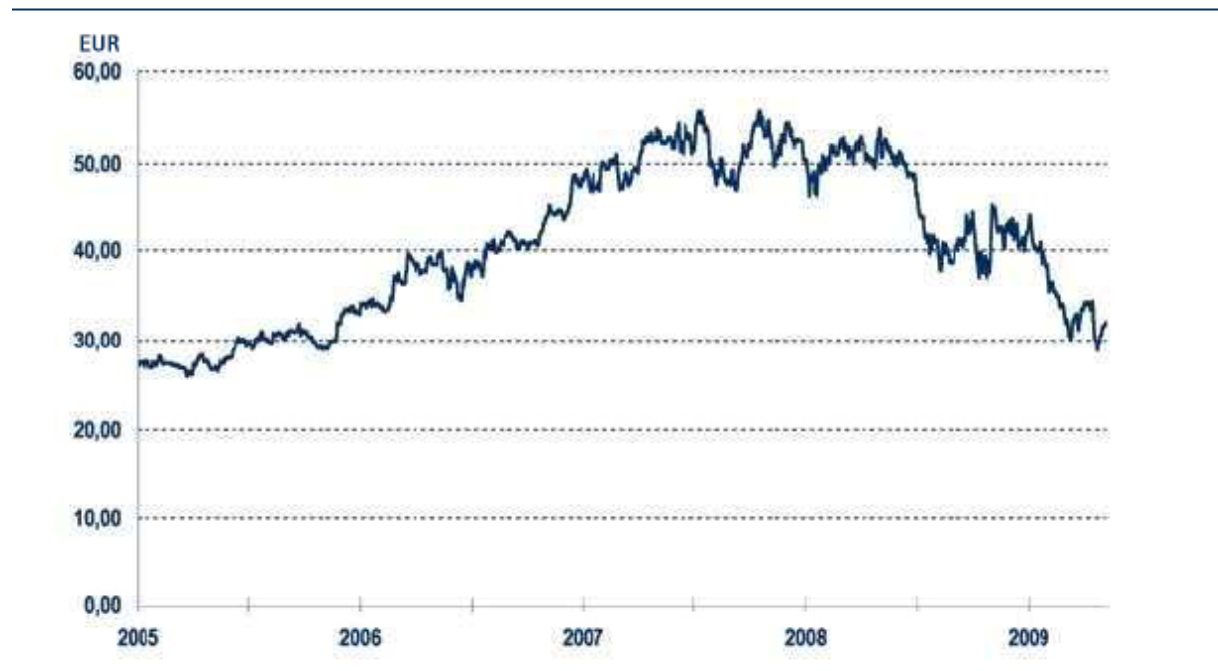
Ruchay: I understand risk to be the risk of a permanent drop in the value of my investment. This is why I do a simple test for every company. Along the lines of the motto of “kill your company”, every conceivable scenario is simulated in order to be able to analyse just how robust a company is. CeWe's margin is strongly contingent on the price of paper. For this reason, the rising price of paper is a clear risk. However, CeWe has several suppliers of paper and should be in a position, given the strong market position of the company, to pass structural price rises on to customers in the medium term. Another point is the potential substitutability of CeWe products with new technological developments, such as digital photo frames. Like with digital books and magazines, I presume that there will be substitution, but it will be very slow and will cover an extremely long period (cf. Amazon Kindle), so the calculation of intrinsic value is hardly affected.

EVI: Intrinsic value is a good cue. Where do you see it?

Ruchay: When calculating fair value or intrinsic value, I always abide by the simple rule of “count cash”! This is why I calculate owner earnings in a close relation to cash flow. They should also be an indicator of a sustained earning capacity. I estimate CeWe’s intrinsic value to be at around €34-41 a share. At a current share price of around €20, this constitutes a comfortable safety margin and an investment yield of more than 20% a year.

EVI: Many thanks for this interview!

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