

Hidden Champions: Opportunity in Obscurity



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Who or What is a “Hidden Champion”?

“Hidden Champions”, a term coined by German management consultant Hermann Simon, describes a set of smaller businesses that enjoy immense success despite operating in relative obscurity.

While Hidden Champions can be found anywhere in the world, many are located in German-speaking countries, and are often part of the Mittelstand, the small and medium sized enterprises (SMEs) that make up the backbone of this region’s economy.¹

KEY DEFINING CHARACTERISTICS¹



MARKET LEADERSHIP:

Ranked #1-#3 globally, or #1 regionally.



SMALL SIZE:

Revenues generally under \$5 billion.



OBSCURITY:

Not household names, very low profile.

Though both investors and the financial press spend a great deal of time analyzing the world’s largest firms, Hidden Champions offer a distinct set of lessons and investment opportunities of their own.

Examples of Hidden Champions

Hidden Champions are the world (or regional) leader in their respective markets. As we can see, however, these markets are often quite narrowly defined (airplane seat upholstery, electronic gas station price signs).



Winterhalter Gastronom GmbH

Manufactures commercial dishwashing systems, with a specific focus on the hotel/restaurant market. Today, they are estimated to have at least 15-20% of this market globally.²



Jungbunzlauer AG

Ingredient producer serving the food, beverage, pharma and industrial sectors. It is a leader in the production of citric acid, supplying it for every Coca-Cola produced globally.³



Lantal Textiles AG

World leader in the design, production and distribution of textiles for passenger aircraft interiors, serving over 300 airlines as well as the world's major aircraft producers.⁴



PWM GmbH

Supplies almost every German gas station with its electronic price signs. However, the company's operations span far beyond its home market, with a presence in over 75 countries and 85% global market share.⁵

Headquarters

Meckenbeuren, Germany

Basel, Switzerland

Lagenthal, Switzerland

Bergneustadt, Germany

Year Founded

1947

1867

1886

1961

Revenues

€325m

900m CHF

105m CHF

€44m

Employees

1,900

1,150

695

120

Laser Focus on Niche Markets

WHY NICHE MARKETS?

Leadership in hyper-niche markets can create a significant position-based competitive advantage:

- **Customer Captivity:** A clear focus on a single product/market results in close, client-centric relationships. Customer switching costs (both tangible and intangible) are high, creating a barrier to entry.⁶
- **Scale:** By dominating narrow markets, Hidden Champions can become the only economically viable player in the space. Would-be competitors choose to stay away.⁶

HOW DO THEY GROW?

A focus on niche markets leads many Hidden Champions to take unique approaches to growing their business:

- **Soft Diversification:** Some of these businesses seek to leverage their intimate industry knowledge and technical know-how to dominate other adjacent markets.¹
- **New Markets:** Many Hidden Champions have seen their core businesses grow with increased global prosperity and will likely continue to do so as they expand their footprint.¹

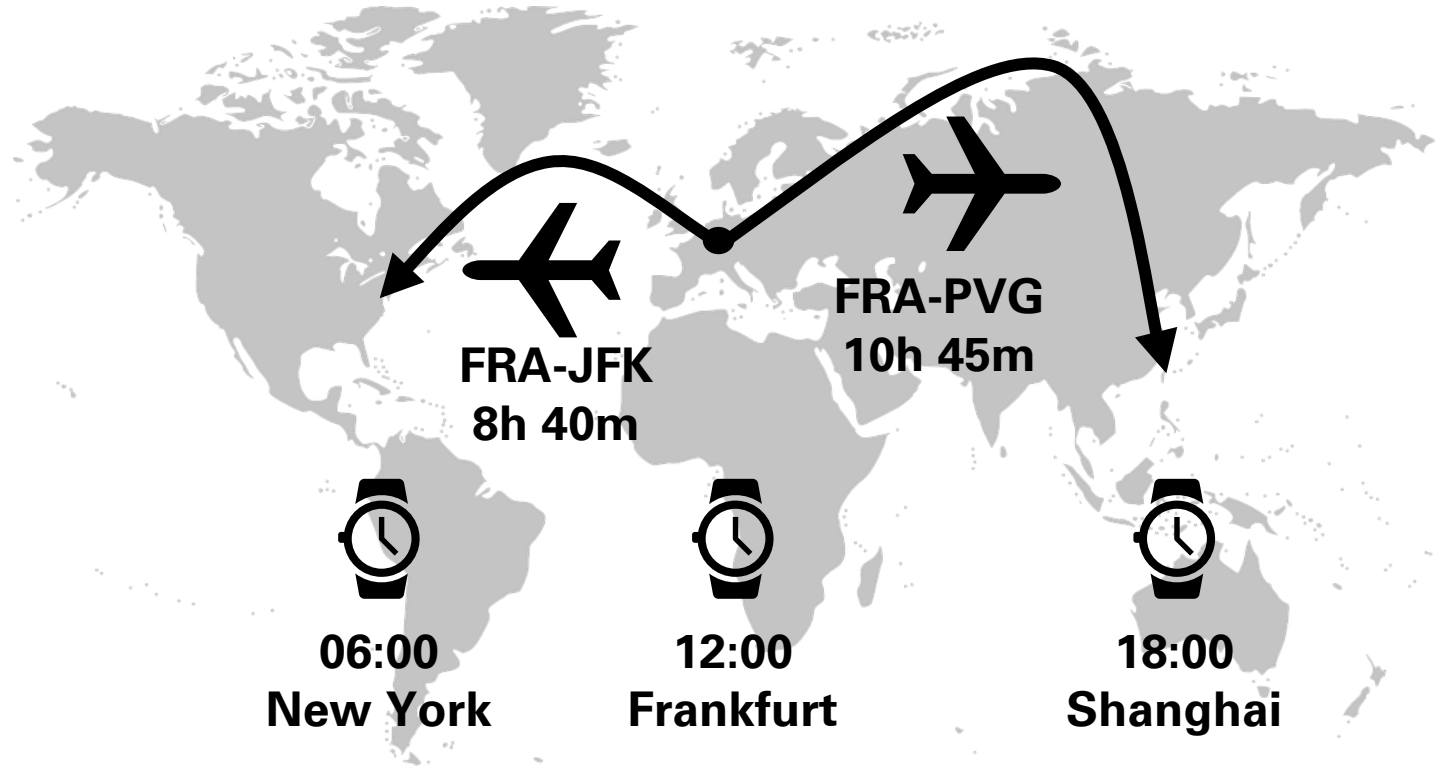
Unexpectedly Global Businesses

Typically, businesses of this size tend to be domestically focused- with little or no international operations to speak of. Hidden Champions, however, are quite different: in order to achieve sufficient scale in their highly niche markets, they have no choice but to think and operate globally.¹

WHY ARE SO MANY HIDDEN CHAMPIONS FROM GERMANY?

While we believe that many unique characteristics of the German economy (education, labor and capital markets, strong support for small/middle market businesses) may explain this, Hermann Simon points out that geography may also play a role.¹

- At varied points in the Central European Time workday, German firms can reach colleagues and customers during business hours in the Americas, Europe and Asia.
- No major commerce hub is more than a 12h flight away.



Persistent Innovation

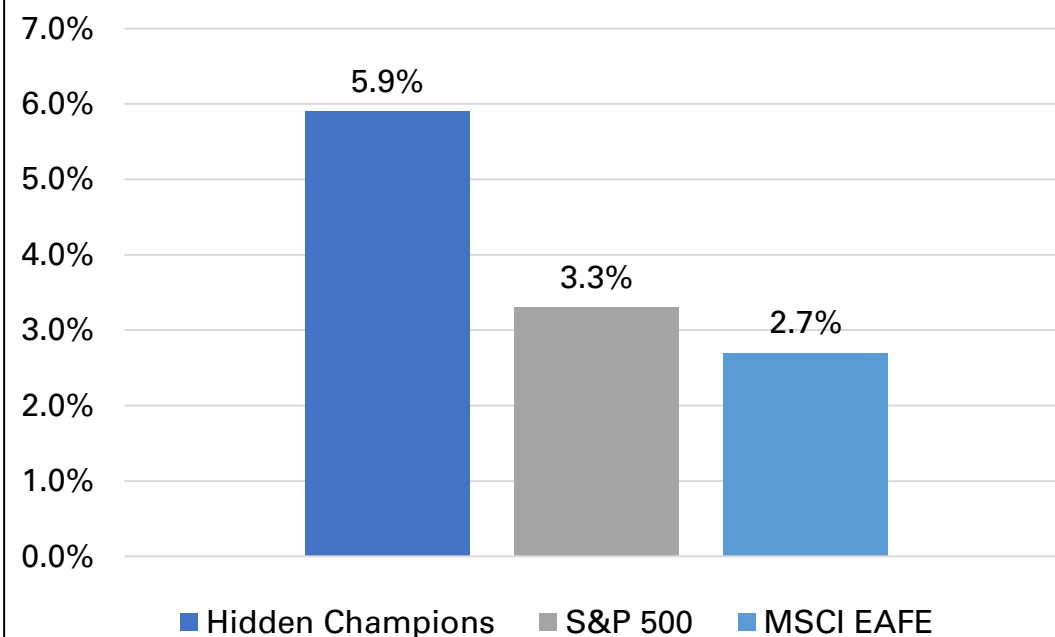
Innovation is key to Hidden Champions maintaining their wide moats: in order to keep their customers “captive”, these businesses must continually offer increased value or lower costs.

STAYING AHEAD OF THE PACK

Hidden Champions work hard to ensure that they can (and do) spend a significant amount on R&D.¹

- Innovation not only helps improve the company’s core products, but also helps develop new revenue streams.
- For example, many industrial Hidden Champions have sought to develop a service component, one which provides high-margin, recurring revenue.
- Digitalization offers further opportunities for Hidden Champions, with data-driven offerings enhancing these firm’s value propositions.

R&D EXPENSE (AS % OF SALES)^{1,7}



All in the Family: Leadership and Ownership

According to Hermann Simon, roughly 2/3 of Hidden Champions are family owned.¹ We believe this is an important contributing factor to the success of these businesses:



LONG-TERM THINKING

Family ownership allows for longer time horizons when it comes to investment decisions, whether it is R&D spending, building a new plant or expanding into a new region.



BUILDING INTERNAL TALENT

Though families are increasingly stepping away from day-to-day management responsibilities, the cultures of their businesses often breed top-notch internal executive talent.



DYNAMIC MANAGERS

Though Hidden Champion CEOs take the helm at a younger age, their tenures tend to be longer than average.¹ This results in a forward-thinking vision balanced with a long-term perspective.

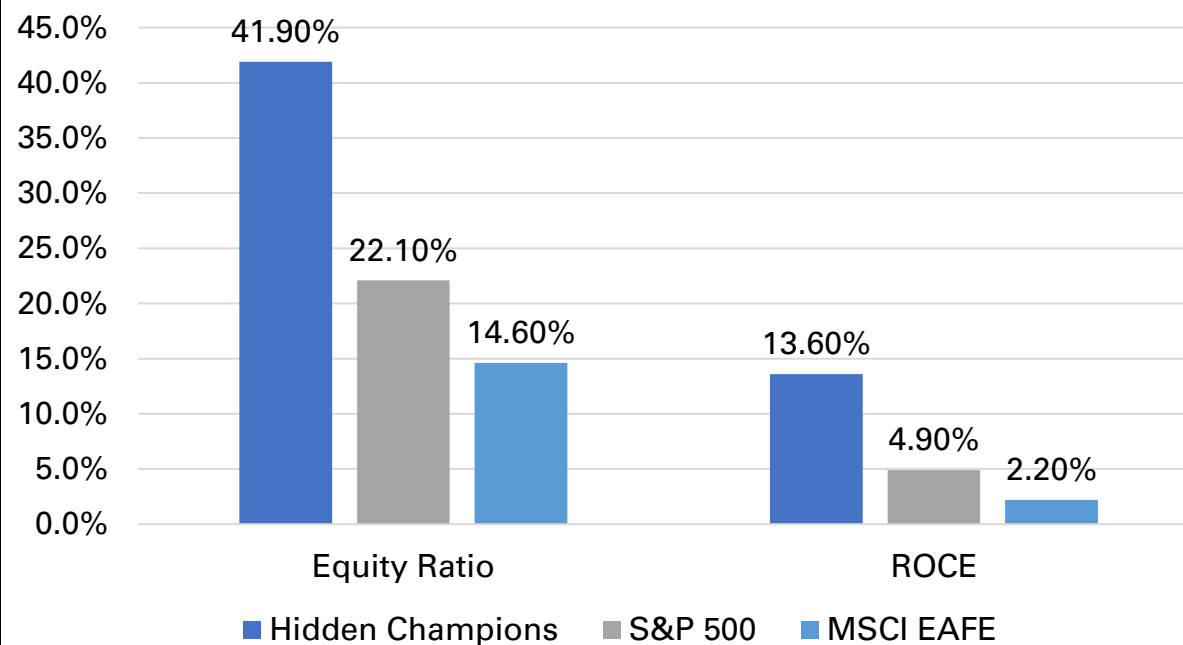
Capital Allocation and Financing Decisions

Hidden Champions tend to be quite conservatively financed, and their management teams appear to have an acumen for making solid capital allocation decisions.

SOURCES AND USES¹

- Where utilized, debt financing tends to come from traditional bank loans, made by lenders who have decades- (or even centuries-) long relationships with the businesses.
- External financing (capital markets, private equity) is not as common, but is seeing increased use.
- Hidden Champions rarely pursue massive, “transformative” acquisitions, and rather focus on reinvesting in the business or return of capital to owners.

EQUITY RATIO AND ROCE^{1,8}



How Can A Public Markets Investor Benefit?

Based upon Hermann Simon's research, ~10% of Hidden Champions are publicly traded, leaving a relatively limited investable universe. However, this is beginning to change as both family and private equity owners seek "exits", with IPOs seen as an increasingly attractive (and viable) option.¹

WHY ARE HIDDEN CHAMPIONS UNLOVED BY THE STOCK MARKET?

While impressive businesses, we feel the small but growing segment of publicly traded Hidden Champions remain underappreciated for a number of reasons:

- **Lack of a Good "Story":** Niche, unglamorous business models leave many sell-side analysts with little reason or desire to cover Hidden Champions.
- **Fewer Participants:** Smaller market capitalizations and lower trading volumes mean many institutional investors are simply too large to get involved.

As more Hidden Champions go public, market participants may begin to recognize the strength of both their competitive "moats" and ability to compound value over time.

For investors with a long-term orientation, we believe this presents an interesting opportunity. Even absent such a rerating, Hidden Champions have the potential to return significant amounts of capital to shareholders.¹

Company Profile: Dürr AG



KEY STATS

Headquarters	Bietigheim-Bissingen, Germany
Year Founded	1895
Revenues	€4B
Employees	16,384

ABOUT⁹

- Dürr is a global supplier of production technologies and plant engineering services.
- Though perhaps best known for supplying paint shops to automotive industry, Dürr also offers woodworking machinery to the furniture industry, and clean-tech and measuring systems to a wide variety of manufacturers.
- In most of its businesses, Dürr is the world leader, with 20-50% market share.
- Serving an increasingly diverse set of industries, the company is now exploring new opportunities to build its service businesses and increase digital offerings for manufacturers.

Company Profile: JOST Werke AG



KEY STATS

Headquarters	Neu-Isenburg, Germany
Year Founded	1952
Revenues	€775m
Employees	2,900

ABOUT¹⁰

- JOST is a German manufacturer of branded truck and trailer components.
- While the company produces a wide range of products, most central to the business are fifth wheels (which connect trailers to trucks) and landing gear (which allow trailers to stand on their own).
- The company holds 50%+ share globally in these mission-critical products and has strong relationships both with truck OEMs and the fleets they serve.
- JOST is seeking to build its business further through innovation to meet the demands of the changing logistics industry.

How Else Can A Public Markets Investor Benefit?

As one would expect, many publicly traded Hidden Champions are on the larger end of the spectrum in terms of revenues. Luckily, investors seeking to gain access to “small cap” businesses have a compelling alternative.

DOWNSIZING AND DIVERSIFYING

For investors seeking exposure to the smaller Hidden Champions, there are several publicly traded investment companies that specifically seek to purchase such businesses.

- We feel these provide investors with a way to own a diversified portfolio of smaller Hidden Champions, one which benefits from the financial/operational resources of the parent.
- What’s more, these investment companies each possess their own areas of expertise and investment philosophies, allowing for a wide range of strategy choices.

KEY PLAYERS

[INDUS]



MUTARES



Hidden Champions Investors



Indus Holding AG

Headquarters

Bergisch Gladbach, Germany

Year Founded

1989

Revenues

€1.7B

Portfolio Companies

46

Key Industries

Medical Engineering/Life Science
Construction/Infrastructure
Automotive Technology
Engineering
Metals Technology

Strategy

Indus Holding describes its business model quite simply: “buy, hold & develop”¹¹. With an ideal holding period of “forever”, Indus seeks to leverage its decades of operational knowledge and resources to promote sustainable growth and innovation at its portfolio companies.



MBB SE

Berlin, Germany

1995

€650m

7

Technical Applications
Industrial Production
Trade & Services

Owned and operated by its original founders, MBB seeks to identify Hidden Champion businesses with the potential to become platforms for high-growth businesses levered to key trends. Through prudent bolt-on acquisitions, and technological expertise, MBB has created businesses which today are themselves publicly traded.¹²



Gesco AG

Wuppertal, Germany

1989

€575m

18

Production Process
Resource
Health & Infrastructure
Mobility

Founded by a small group of private investors closely connected to SMEs, Gesco seeks to solve the issue of succession for the owners of industrial Hidden Champions. The company not only offers the operational expertise afforded by many of its peers, but also specifically focuses on solving the financing and strategy issues.¹³

Overview

- Hidden Champions represent a unique contingent of well-run businesses dominating niche markets globally. Though they may fly under the radar, we believe they are worth the attention of investors seeking both case studies in quality, franchise businesses as well as viable long-term investment opportunities.
- Hidden Champions tend to hold several common qualities that likely explain part of their success:
 - **Niche Markets:** Can build strong competitive advantage through scale and customer captivity.
 - **World Leaders:** Despite their small size, these businesses think (and operate) globally.
 - **Far-Sightedness:** Willingness to invest for the long-term, especially in innovation.
 - **Quality Governance:** Often family-owned, management possesses a strong sense of stewardship.
 - **Capital Allocation:** Conservative financing, clear focus on creating and compounding shareholder value.
- We feel investors, especially those with longer time horizons, can gain public markets exposure to Hidden Champions through two different methods:
 - **Direct:** Though most Hidden Champions are privately owned, a growing number are publicly traded.
 - **Listed Investment Companies:** For those seeking a diversified portfolio of smaller Hidden Champions, several listed investment companies focus specifically on buying these businesses. These investment companies have a diverse array of strategies and areas of expertise, providing choices for investors according to their respective philosophies.

Contact

Drum Hill Capital, LLC

200 Connecticut Avenue, Suite 4A
Norwalk, CT 06825

www.drumhill.com

For any inquiries:

David Nightingale | President and CIO
dnight@drumhill.com | +1 203 349 8183

Zach Olson | Director of Investment Research
zolson@drumhill.com | +1 203 349 8185

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