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10 Great Stocks

By VITO J. RACANELLI

High-quality, export-oriented companies such as Siemens, SAP, Pernod Ricard and BMW are smart ways to play European markets and a weak euro. Video: Our Top Ten

FROM NASTY VOLCANIC ERUPTIONS IN Iceland that halt air traffic to outbreaks of violent civil unrest in Greece, European problems are reverberating around the world. Top off those concerns with an immense Continental sovereign-debt problem requiring a nearly $1 trillion rescue package, and global financial markets have been spanked hard, none more so than Europe itself. The euro is down nearly 20% against the dollar since November, and European stocks have significantly underperformed American shares. This year, the euro zone's stocks are down 9% -- a very painful 22% in dollar terms -- while the Standard & Poor's 500 Index is off just 2%. The euro's rapid plunge to about $1.20 from about $1.50 and the severe debt troubles afflicting Greece -- and, to a lesser extent, Portugal, Italy, Ireland and Spain, the so-called PIIGS -- have shocked many investors.

Outflows from European equity funds in the week ended May 19, for example, were the worst since April 2008, according to EPFR Global, an outfit that tracks fund flows globally. Ever since the huge European Union bailout package was announced, skeptical markets have continued to stumble. In the U.S., gloomy headlines -- like those about Fitch's downgrading of Spain Friday -- lend credibility to the idea that the euro might become history, or that Greece or even Germany might leave the euro zone, threatening the integrity of the European Union. These possibilities are remote, but the inevitably higher taxes that Europeans will have to pay for the rescue, coupled with the fiscal belt-tightening needed to repair state balance sheets, will produce an economic slowdown in the already pokey Old World.

It's no wonder, then, that many investors have fled the region. Often enough, however, in tough times, investors find the winners are located not far from the losers. Not every country in Europe will be hurt as badly by lower growth. Germany, a global export monster, probably will sell more machines and cars, among other things, to the rest of the world. More important for equity investors, some internationally focused euro-zone companies, and their stocks, can be expected to do well, aided by the robust economic growth expected in the U.S. and emerging markets, gaining significant competitive advantage from a much lower euro.

Barron's has put together a list of 10 Europe-based global powerhouses that are relatively less exposed to the sovereign-debt uncertainties. They have healthy balance sheets and dividend yields, often better than those available from U.S. peers, as well as stable business models with roughly 50% or more of their sales outside Europe. All offer American depositary shares, though some are thinly traded. Topping it all: European stock valuations are the developed world's lowest, by a good margin.

Many of our picks are German, including **Siemens** (ticker: SI) and **SAP** (SAP), whose industrial and software products, respectively, are used from China to the U.S. and all points between. Many investors probably don't realize that the German DAX index has outperformed both the European market and the MSCI World Index this year.

But there are French companies, too, like luxury-goods maker **LVMH** (LVMUY) and wines-and-spirits company **Pernod Ricard** (PDRDY), whose products are increasingly desirable in fast-growing emerging markets as living standards rise, but whose costs are mostly euro-based. These companies have been handed a radical improvement in competitiveness by the faltering euro, with sales rising outside their homelands and the value of each sale translating into more euros.

On the face of it, things do appear grim for the Old World's economy. Economists expect a little less than 1% gross-domestic-product growth in the euro zone this year, and a bit more than 1% next year. And budget-tightening by euro-zone governments could keep economic expansion below even these modest expectations. In comparison, U.S. growth probably will be about triple the euro zone's.

"But European GDP growth doesn't equal European profits growth," notes Teun Draaisma, head of the Morgan Stanley European equity strategy. He says "big dollar earners" will benefit from the drop in the common currency. Earnings-growth rates might see some downgrades, but a weak euro will help offset that, he says.

After the sizable stock-market drop of May 6-7, Draaisma upgraded European stocks to an Overweight rating, noting that relative valuations had slid to unusually low historic levels -- levels that in the past were typically followed by a 15%-to-25% rally in 12 months.

Our Top 10

These European companies boast strong prospects, leading positions within their industries, stocks that look undervalued and strong sales outside the euro zone. All offer American depositary shares traded in the U.S.

German	Ticker ADR/Home Market	Business	Revenue Outside Europe	Recent Price Of ADR	2010E EPS	2010E P/E*	2011E EPS	2011E P/E*
Fresenius Medical Care	FMS/FME.Germany	Health Care	78%	$49.52	€3.35	14.8	€3.75	13.2
SAP	SAP/SAP.Germany	Software	47	42.95	2.04	16.9	2.31	15.0
BMW	BAMXF/BMW.Germany	Autos	52	45.75	2.16	17.2	3.46	10.8
Siemens**	SI/SIE.Germany	Industrial	44	91.52	5.24	14.0	5.98	12.3
Bayer	BAYZF/BAYN.Germany	Health Care, Agricultural, Chemical	57	56.80	4.15	11.1	4.64	9.9
French:								
Schneider Electric	SBGSY/SU.France	Electric Equipment	59%	$10.30	€5.37	15.4	€6.75	12.2
LVMH	LVMUY/MC.France	Luxury Goods	64	21.40	4.52	19.2	5.17	16.8
Pernod Ricard***	PDRDY/RI.France	Wines & Spirits	56	14.60	3.84	15.9	4.40	13.9
Dutch:								
ASML	ASML/ ASML.Netherlands	Chip Equipment	96%	$28.93	€1.79	13.1	€2.24	10.4
Italian:								
Luxottica	LUX/LUX.Italy	Eyeware	79%	$24.17	€0.91	21.4	€1.06	18.4

E=Estimated. * P/E is based on home-traded stock. **September fiscal year. ***June fiscal year. Sources: Bloomberg; Company Reports

Credit Suisse equity strategist Andrew Garthwaite notes that the dividend-yield differential between European and U.S. stocks has reached "extreme levels." Stocks representing 47% of the market cap of the Euro Stoxx 50 index, the Continent's rough equivalent to the Dow Jones Industrial average, offer a dividend yield higher than their respective government-bond yields. Garthwaite, who also has turned more bullish on Europe recently, estimates that a sustained drop in the euro to $1.20 would add about 13% to earnings at the very biggest European companies and says that "88% of the time the euro weakens, Europe outperforms in local-currency terms." Moreover, currency cycles tend to play out over years, so the euro could remain weak for a good while.

It isn't a coincidence that Germany, where 25% of GDP comes from exports to customers outside the euro zone, has outperformed its Continental peers this year, he notes. Or that one of the companies he likes is German premium-car maker **BMW** (BAMXF), a big exporter that is one of our top 10.

And what about worries that the euro zone or even the entire European Union might fall apart? While there has been some erosion of support for the EU, Germany historically has been one of its biggest backers, notes Jon Levy, an analyst with Eurasia Group, a political-risk consultancy. "To break up the euro zone is a radical, illegal and unilateral act, and I don't see a constituency that wants to or even can do it," he comments. The exit of even Greece from the euro zone isn't likely for the near or medium term, he avers. The mechanics of such a move are incredibly daunting, if not frightening for the entire EU, he adds. Of course, throughout history all currency unions eventually, have come to an end, but many Americans are underestimating the European

Union's resolve. Never say never, but it probably would take a lot more pain, particularly in Germany, before the euro dissolves. While Greece probably won't default, a restructuring of its debt is increasingly likely. That could knock stocks for another short-term loop, but our 10 are built for the long term.

Some specifics:

SIEMENS: This industrial giant competes with **General Electric** (GE) and makes everything from power turbines to trains to medical equipment. Owning its shares is "a way to gain exposure to a global recovery," says Audrey Kaplan, co-head of international equities at Federated Investors. The company has been raising earnings guidance and beating analysts' estimates, and she expects that to continue. Compared with peers, at about 12 times analysts' consensus estimate of 2011 earnings per share, its stock offers "better than average value" observes Kaplan, whose fund has been buying it recently.

Siemens, which derives about 44% of its sales outside the Old World, is also a restructuring play. Long viewed as a fat dinosaur unable to cut costs, the Munich outfit has begun reducing its head count, improving capital allocation and looking to move some production out of high-cost Germany.

In the Bargain Bin

Based on price/earnings ratios and dividend yields, European shares are, on average, the cheapest in the developed markets.

Global Valuation	P/E (Trailing)	P/E (Forward)	EPS Growth (Forward)	Div Yield	ROE (Trailing)
MSCI U.S.	15.4	13.2	16.6%	1.9%	11.6%
MSCI Europe	13.8	10.9	26.3	3.3	10.1
MSCI Japan	27.2	17.3	57.0	1.6	NM
MSCI World*	15.9	12.9	23.5	2.3	9.1
MSCI Emerging	13.4	11.5	16.6	2.0	11.6
Discount					
Europe vs. US	−11%	−17%			

Data as of May 24, 2010. NM–Not material. *Developed. Sources: Fortigent; MSCI; Bloomberg

"For the first time, the company has provided detailed cost cuts by division, and you're seeing some momentum on restructuring," notes Ron Holt, president of Hansberger Global Investors, which owns Siemens. Holt figures that Siemens will raise its operating margins to about 10% from 7% over the next few years.

SAP: There is plenty to like about this business-software maker, which has a dominant position in Germany and gets about half its sales outside Europe. SAP has a 24% market share globally, almost twice that of its nearest competitor, **Oracle** (ORCL), says Matthew McCormick, a money manager at Bahl & Gaynor, who adds that business-software "customers tend to be very sticky." Management, which owns about 10% of SAP, is shareholder-friendly, he says, and the firm has a strong balance sheet. Strong enough, in fact, to enable its recent $5.8 billion all-cash tender offer for **Sybase** (SY), a U.S. company specializing in enterprise and mobile software.

Martin Schulz, an international equity managing director at PNC Capital Advisors, is another SAP fan. He estimates that with Sybase added to its already large installed customer base and potential 2%-to-3% price increases, the German giant should be able to keep raising its operating margins, already in the high-20% range, and keep boosting its profit at a double-digit rate.

LVMH: Schulz also likes France's LVMH, which exports nearly 70% of its pricey Louis Vuitton bags and Mo[euml]t & Chandon champagne outside Europe. It has some of the world's strongest brands and a savvy grasp of what works in markets such as China, which is becoming one of the most important for purveyors of luxury goods.

With nearly all its costs in euros and two-thirds of its sales coming outside the euro zone, LVMH is perhaps one of the best examples of a European company that will profit handsomely from a drop in the euro, says Wendy Trevisani, a Thornburg Investment money manager. There is plenty of operating leverage, so any sustained drop in the euro should translate into a much higher proportionate rise in earnings. With a strong balance sheet and a 2011 price/earnings ratio of about 17 times, "unless we get a double dip, you are getting a nice opportunity," she argues. LVMH is one of Thornburg's largest positions.

BMW: For similar reasons, investors should look at this auto maker, which racks up more than half its sales outside Europe. Dominic Freud, a money manager at OppenheimerFunds, notes that BMW has a substantial cost base in euros, but lots of revenue in dollars. Moreover, the euro has dropped even more against the Japanese yen than it has against the greenback. That should give BMW a nice advantage over Lexus, made by Japan's **Toyota Motor** (TM), one of its biggest competitors.

10 Great European Stocks
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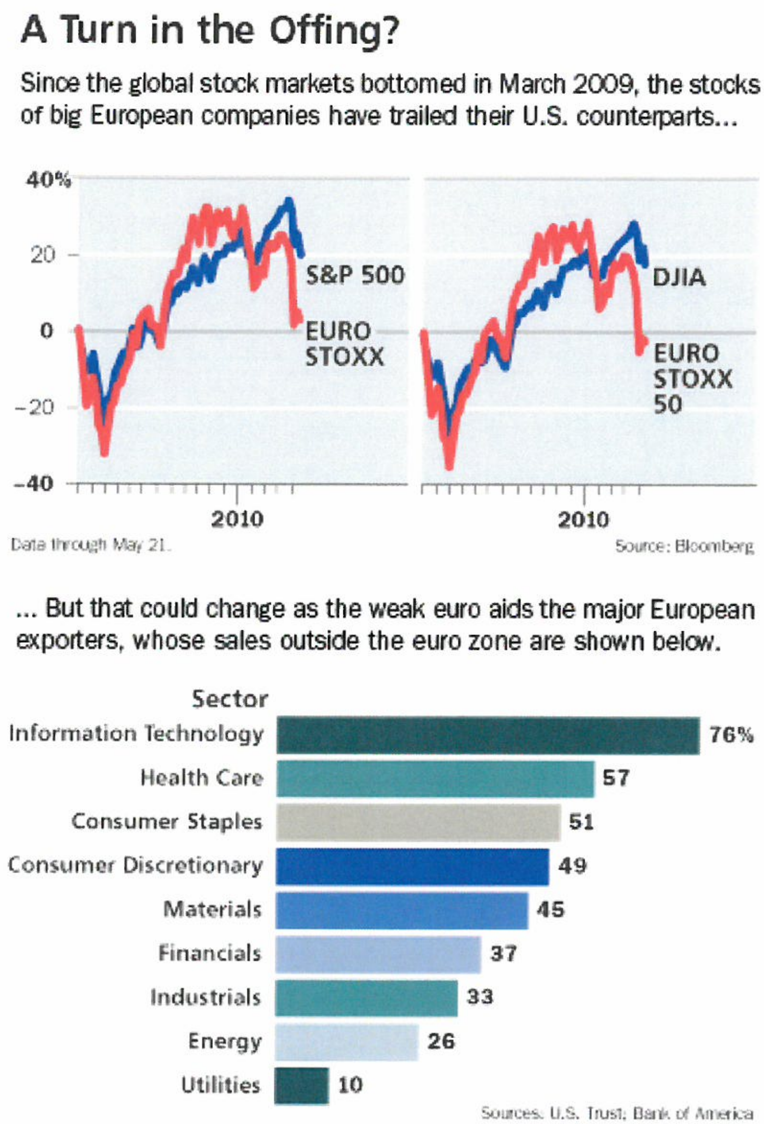
Despite the dark clouds over Europe, some global outfits based there should thrive. A big plus: the faltering euro. Barron's Vito J. Racanelli reports.

While BMW's German arch rival, **Daimler** (DAI), isn't on our short list, it could be. With more than half its car and truck sales outside Europe, it would benefit similarly to BMW, which doesn't make trucks, notes Francis Claro, the **Evergreen International Equity** Fund's (EKZYX)portfolio chief. Truck demand has been tremendously depressed and margins there are much lower than autos. But demand for these vehicles is growing sharply in emerging markets, and when it recovers in Europe and North America, Daimler will benefit nicely, he says.

PERNOD RICARD: This French maker of premium spirits, like Chivas Regal and Glenlivet Scotch whisky and Absolut vodka, gets 56% of its sales outside Europe. Pernod Ricard, which also produces wines, has been cutting costs and reporting solid financial results since global economies bottomed last year, notes Val¿rie Cazaban, a Paris-based fund manager with Strat[egrave]ge Finance, which has been adding shares lately. In April, Pernod raised its full-year outlook for profit from recurring operations, after rising demand in emerging markets, Russia and the U.S. drove revenue 14% higher in its fiscal third quarter, ended in March.

ASML HOLDING: Among the companies in the Euro Stoxx 50, the information-technology sector boasts the highest percentage of non-European revenue, about 75%. And, within



the sector, chip makers are among the most sensitive companies to changes in the euro. As their fortunes rise in the already rebounding tech economy -- German semiconductor manufacturer **Infineon Technologies** (IFNNY) recently raised its earning guidance for 2010 -- so will those of **ASML** (ASML).

The Dutch company makes lithography equipment used to make computer chips. It is the sector's dominant company, with arguably the leading technology. ASML's top rivals are dollar-based Taiwanese firms, so a weaker euro will let it cut prices and grab market share, says Barclays Capital European equity strategist Edmund Shing.

LUXOTTICA: Shing says that earnings per share of this Italian eyewear maker rises 9% when the euro falls 10% against the dollar, all else being equal. The company's brands include Ray-Ban, and it operates retailers Lens-Crafters, Sunglass Hut and Pearle Vision, among others. **Luxottica** (LUX) does half its business in the U.S and should get a nice boost from the stronger greenback, says James Moffett, who runs the **Scout International** Fund (UMBWX). The fund owns the stock, which at a P/E of 18 times 2011 analysts' consensus estimates, is reasonably priced and should post profit growth of 10%, he adds.

FRESENIUS MEDICAL CARE: This German health-care outfit, which gets two-thirds of its revenue from North America, stands out on our list as the only purely defensive name. Obesity is a growing problem in developed nations, with incidences rising 5% to 6% annually, says Matthew Benkendorf, who runs the **Virtus Greater European Opportunities** Fund (VGEAX) at Vontobel Asset Management, and **Fresenius** (FMS) treats one of its potential consequences: kidney problems. The company is the No. 1 provider both of dialysis clinics and the machines they use, notes Benkendorf. It is a quality global franchise with a 15% return on equity and consistent low-double-digit profit growth.

BAYER: With nearly 60% of its sales outside Europe. the German drug maker qualifies as a partly defensive stock, with its health-care divisions accounting for 50% of sales. Investors know the company's aspirin and other drugs well, but **Bayer** (BAYZF) makes lots of nonpharmaceutical products, including weed killer and car coatings. Sporting a price/earnings ratio of less than 10 times 2011 EPS estimates, its valuation is compelling.

The biggest single chunk of its business is in European pharma, notes Daniel Kerbach, a fund manager at LGT Capital Management, but it has a good mixture of businesses and is expanding nicely outside Europe. For example, Bayer reported sales of 530 million euros ($709.3 million) last year in China. Though only 2% of total sales, that was up 28% from 2008, and Bayer plans to invest [euro]100 million there over the next five years. It expects the Chinese market to grow 10-fold over the next decade.

SCHNEIDER ELECTRIC : This French company (SBGSY) is a leading producer of electrical equipment. Schneider is strong in China and venturing into new areas, like lighting, as well as products linked to climate change, such as the EnergyEdge building-management system, says Virginie Maisonneuve, head of global equities for Schroder Investment Management. The company has decent earnings growth, a solid balance sheet and strong management, she adds. While commercial construction is weak and the Chinese property market might cool, Schneider is finding niche areas to sell into, like Latin America and Asia.

The company also is focused on trimming costs. Sales fell 16% in 2009, a tough year all around, but operating margins slid less, to 13% from 15%, notes Emanuele Minotti, an independent money manager. Moreover, Schneider trades around 12.2 times 2011 EPS estimates, below peers' 13 and its own long-term average of 14.

THOSE ARE OUR 10 SELECTIONS. For investors wary of betting on individual stocks, there are other ways to play Europe's undervalued stocks and weak euro. One is to buy Germany, the Continent's strongest economy, through an exchange-traded fund, says Bill Witherell, chief global economist at Cumberland Advisors. Cumberland owns **iShares MSCI Germany** (EWG), which mimics the MSCI Germany index. It also owns **iShares MSCI Netherlands** (EWN), which focuses on another relatively robust economy.

However you approach them, the biggest, highest-quality, export-oriented companies in Europe look undervalued, even in the harsh light of the euro zone's current sovereign-debt crisis. With their global reach, they are likely to keep earning healthy profits in good times and bad, and particularly good profits whenever the euro is weak, as it is now. For long-term investors, the Old World is offering new opportunities.

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