

Ernst Russ

Market outlook supports further repositioning

Ernst Russ (ERAG) is making steady progress in repositioning as an asset and investment manager and asset investor, with the legacy business representing around 40% of the group's operations at end-June 2018 compared with 80% in 2016. However, ERAG's assets under management (AUM) increased only slightly to €6.1bn in H118, as new investments (especially in fleet expansion) were offset by disposals. Management reaffirmed the earlier FY18 guidance of at least 10% y-o-y revenue growth and operating profit close to the FY17 figure of €3.9m.

H118 results reflect several one-off effects

ERAG reported an operating profit (adjusted by the company for some non-operating items) at €3.3m in H118 (up from €2.1m in H117), while at the same time recording a 14% y-o-y decline in pre-tax profit to €2.9m. This is because the company's earnings continue to be influenced by a number of one-off factors (which we discuss in more detail below). We estimate that adjusted for these, ERAG's pre-tax loss stood at €0.6m compared with a loss of €0.8m in H117.

Fleet expansion coupled with disposal gains/fees

As the shipping markets continue their gradual revival fuelled by solid global trade volumes, the company is investing on its own and through the recently established joint venture (JV) Elbfeeder in expanding its fleet of predominantly container ships. Once the acquisition of two vessels scheduled for September is complete, ERAG should participate (as investor or co-investor) in income streams from a fleet of 10 ships. The company is also benefitting from the buoyant conditions in the European real estate markets through disposal gains and fees related to several transactions in Germany and the Netherlands.

Valuation: Trading below last reported book value

ERAG is trading at a 34% discount to peers on LTM EV/EBIT, respectively. Assuming an operating profit in FY18 stable vs FY17 levels (in line with management guidance), the company trades at a 29% discount to peer group on FY18e EV/EBIT. Simultaneously, ERAG's shares trade below its last-reported book value per share (€1.40), which assumes further equity erosion through accumulated losses and/or asset impairments or write-downs. If the company is able to successfully progress with the business turnaround while end markets remain supportive, the current valuation might prove an attractive entry point.

Historical financials

Year end	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/14	19.7	(1.6)	0.0	0.0	N/A	N/A
12/15	20.7	(6.6)	0.0	0.0	N/A	N/A
12/16	40.0	10.2	0.2	0.0	4.8	N/A
12/17	44.0	9.3	0.2	0.0	4.8	N/A

Source: Ernst Russ accounts

Diversified financials

28 September 2018

Price €0.96
Market cap €31m

Share price graph



Share details

Code HXCK
Listing Deutsche Börse Scale
Shares in issue 32.4m
Last reported net debt at 30 June 2018 €8.1m

Business description

Ernst Russ is a listed asset and investment manager and asset investor, with AUM of c €6.1bn, focused on shipping and real estate. The group was transformed in 2016 by the acquisitions of Ernst Russ Reederei and König & Cie, positioning it as a provider of a full range of services, including technical and commercial ship management.

Bull

- Strengthened investment and asset management offering.
- Strong maritime and real estate focus and position.
- Rising property values and rentals.

Bear

- Maritime market revival is early stage.
- Eroding legacy closed-end fund base.
- Legal risks attached to legacy funds.

Analyst

Milosz Papst +44 (0) 20 3077 5700

financials@edisongroup.com
[Edison profile page](#)

Edison Investment Research provides qualitative research coverage on companies in the Deutsche Börse Scale segment in accordance with section 36 subsection 3 of the General Terms and Conditions of Deutsche Börse AG for the Regulated Unofficial Market (Freiverkehr) on Frankfurter Wertpapierbörse (as of 1 March 2017). Two to three research reports will be produced per year. Research reports do not contain Edison analyst financial forecasts.

Financials: Impact of asset deals and one-off items

ERAG reported an operating profit (excluding non-operating items as classified by the company) of €3.3m in H118 compared to €2.1m in H117. Pre-tax profit came in at €2.9m, which is about 14% below last year. The company's bottom line in both H118 and H117 was influenced by a number of positive and negative one-time effects, which are summarised in Exhibit 1. These include reversal of provisions and negative goodwill, insurance indemnification, write-down of receivables and realisation of receivables previously written off. H117 results also include income from restructuring of liabilities to banks, income from deconsolidation of two former subsidiaries, as well as impairment losses. When adjusted for these items, ERAG's H118 pre-tax loss reached €0.6m compared with a loss of €0.8m in H117. The H118 results also include a loss from investments in associates of €0.6m (vs close to null in H117).

Exhibit 1: ERAG's adjusted pre-tax profit calculations		
€000s unless otherwise stated	H118	H117
Reported pre-tax profit	2,893	3,361
Reversal of provisions	1,799	811
Income from reversal of negative goodwill	1,588	2,424
Insurance indemnification	1,095	353
Realisation of receivables previously written off	465	865
Income from the restructuring of liabilities to banks	0	2,872
Income from deconsolidation of subsidiaries	0	550
Write-downs on receivables	(1,028)	(2,077)
Impairment losses included in D&A	0	(1,219)
Amortisation of goodwill	(400)	(400)
Adjusted pre-tax profit	(626)	(818)

Source: Ernst Russ, Edison Investment Research

Group revenues increased 34.5% y-o-y to €27.9m, driven predominantly by the real estate business, where sales went up to €10.8m vs €1.7m in H117. The result in this segment was primarily boosted by revenue from the disposal of a property in Essen (which yielded a disposal gain of €2.4m), as well as transaction fees from the disposal of three fund properties in Amsterdam, The Hague and Hanover. After the report date, ERAG also finalised the sale of the RWI4 property in Düsseldorf, which translated into fees in excess of €2.0m (to be recognised in Q318) and generated a total capital return of c 750%. Revenues in the shipping business rose slightly by 2.1% y-o-y. Through its JV with Pareto Securities, ERAG has disposed of two tankers in February (placed by Pareto in the Norwegian market), which generated transaction fees of €1.0m (of which half is attributable to ERAG). In line with management expectations, the scope of the Investor Management, Alternative Investments and other services (which include a fair amount of legacy business) is gradually being reduced. In particular, the number of funds under fiduciary management continued to decline. The reported (non-adjusted) net profit stood at €2.1m, down 34% from €3.1m in H117.

On the operating expense side, the considerable increase in ERAG's material expenses (€14.0m vs €3.1m in H117) is the consequence of the Essen property disposal (€5.5m), the increase in expenses from crewing subcontractors as ERAG seized to employ own maritime personnel (€3.5m, with a corresponding €3.6m decline in personnel expenses) and the operating expenses associated with the two ships acquired last year (€2.0m). This was somewhat offset by the decline in expenses for third-party services related to sub-management of ships (€1.3m compared with €2.0m in H117). Importantly, the company completed the merger of its sites into a new headquarters in Hamburg. This will translate into savings in rental expenses and more streamlined business processes.

The risks related to claims against ERAG in conjunction with its legacy business seem to be gradually diminishing and currently all claims associated with ERAG's liabilities for the prospectus or status as founding partners of the funds categorised by ERAG as unlikely or highly unlikely. The corresponding provisions declined to €0.3m from €1.3m at end-2017. Moreover, the value of

repayable liquidity distributions from ERAG's funds as at end-June 2018 amounted to €15.1m, down from €16.4m at end-2017.

Exhibit 2: H118 results highlights			
€000s	H118	H117	y-o-y change
Revenue	27,907	20,756	34.5%
Increase/decline in unfinished products	195	(170)	-214.7%
Other operating income	6,038	9,084	-33.5%
Cost of materials and services	(13,983)	(3,138)	345.6%
Personnel expenses	(7,723)	(11,748)	-34.3%
D&A and impairment	(3,504)	(3,924)	-10.7%
Other operating expenses	(6,343)	(8,277)	-23.4%
Net interest and investment income	306	778	-60.7%
EBT	2,893	3,361	-13.9%
Income taxes	(731)	(135)	441.5%
Earnings after tax	2,162	3,226	-33.0%
Other taxes	(58)	(42)	38.1%
Minorities	(34)	(52)	-34.6%
Net profit	2,070	3,132	-33.9%
EPS (€)	0.06	0.10	-33.9%

Source: Ernst Russ, Edison Investment Research

Stable AUM with declining share of legacy business

ERAG's AUM as at end-June 2018 stood at €6.1bn (vs €6.0bn at end-2017), of which €0.4bn represents assets where the company is investor or co-investor. This was divided into shipping (€2.8bn with a fleet of c 110 ships under management), real estate (€1.6bn) and alternative investments (€1.7bn). AUM increased only slightly versus end-2017, as new asset acquisitions and M&A activity was able to offset the decline from disposals. Importantly, ERAG estimates that the share of its legacy business declined to 40% at end-June 2018 compared with 80% in 2016.

The company continues to expand its fleet through the recently established JV Elbfeeder, with the acquisition of two further ships in April 2018. Moreover, ERAG acquired a 3,091 TEU vessel entirely on its own book in July 2018. Clarksons' data suggests prices of 10-year-old second-hand container ships bottomed out in late 2016/early 2017 and grew further in 2017 and early 2018, remaining stable in recent months. Prices for 2,500 TEU ships are currently close to 2013–2015 levels. Thus, it seems that ERAG was able to start ramping up its shipping portfolio in late 2017/early 2018 at a relatively fortunate (even if not optimal) entry point. The company plans to finalise the acquisition of two additional ships through Elbfeeder in September, which will bring the total owned fleet (including JV) to 10 ships. Importantly, the company holds a 49.99% stake in Elbfeeder, but it is in discussions to acquire a majority stake. On the divestment front, apart from the earlier mentioned real estate and shipping transactions, ERAG sold its 29.98% stake in Marenave Schifffahrts in March 2018. In addition, as part of the capital group restructuring, ERAG has also sold its 18% stake in eFonds (an online platform focused on the distribution of closed-end real assets investment funds) and will recognise a disposal gain of c €1.5m in Q318.

Outlook

Management reiterated its FY18 guidance of at least 10% y-o-y revenue growth and positive operating profit at last year's level (€3.9m). ERAG intends to stabilise the AUM around €6.1bn through the addition of new assets and portfolios, as well as new asset management mandates. This should be supported by the favourable conditions in the shipping markets, which benefit from continuing growth in global trade (IMF forecasts are 4.8% for 2018 and 4.5% for 2019), backed by the solid macro environment (IMF expects global GDP growth at 3.9% in both 2018 and 2019). Mutual trade tariffs recently introduced by the US, China and Europe have not significantly influenced trade volumes so far, although they pose a risk for the shipping industry. According to

Clarksons' data, the outlook remains positive in the container market segment (particularly in the segment of 1,000 to 5,000 TEU), where demand growth (5.1%) should outstrip supply growth (4.8% after scrapping). The historically low level of order book (ie the global pipeline of new container ships being built), which stands at 13.3% of current supply (as per Ernst Russ), suggests a potential slowdown in container ship supply growth. Time charter rates are generally rising across all container sectors this year and only 1.6% of available container capacity (as per Alphaliner) is unemployed. Although rates have eased recently, this is in line with the normal seasonal pattern. A downside risk over the rest of the year is the recent increase in idle tonnage, resulting not only from the low-season effect, but also new-built tonnage and low scrapping activity. Moreover, it seems the usual pass-through mechanism of fuel cost hikes has not yet been restored after the crisis.

In the bulker market, supply and demand looks relatively balanced at the moment. As scrap activity is relatively subdued, Clarksons expects fleet growth at 2.5% in 2018. This compares with their demand growth expectations at 2.7% in 2018, assisted by the expected increase in iron ore and coal imported by the sea, which should be driven by higher consumption in China. The charter rates were quite volatile recently, with the Baltic Dry Index's 52-week low and high at c 948 and 1774 points, respectively and the current level of 1,434 (as at 24 September).

The tanker segment, which was the weakest part of the shipping markets in recent years, is gradually improving. Supply growth remains modest with expectations (according to ERAG) for 2018 at 0.8% and 1.5% for crude oil and product tankers, respectively. However, there seems to be a certain degree of oversupply in the product tanker fleet based on ERAG's comments. Demand should be stronger, with 2.4% and 2.6% y-o-y growth in 2018, respectively. Tanker charter rates lag the other segments and are still at relatively low levels in H118, despite being slightly higher y-o-y.

Valuation

We believe a relevant peer group for Ernst Russ should contain local asset managers active in the shipping and/or real estate domain. We have selected six peers, with MPC Capital and Lloyd Fonds the closest competitors. Due to the lack of consensus estimates for ERAG, we have based our analysis on LTM numbers and management guidance of FY18 operating profit in line with FY17 levels (€3.9m). Please note that these figures contain a certain amount of distorting one-off items which are hard to eliminate completely. ERAG is trading at a 62% and 34% discount to peer group on LTM P/E and EV/EBIT numbers, respectively. Moreover, the company's EV/EBIT ratio based on management guidance for FY18 is around 29% below peer group. Also, ERAG's shares trade below last reported book value per share (P/BV) at 0.7x. The valuation looks relatively undemanding given the potential future benefits of ERAG's ongoing transformation and the good prospects for shipping markets. Given that ERAG's earnings are largely dependent on the size of its AUM, it may also be instructive to examine the market cap/AUM ratios for the company and its peers based on last reported asset figures. ERAG's market cap represents 0.5% of its AUM, which is below the figures for MPC Capital (3.0%), Corestate Capital (4.0%) and Patrizia (4.0%).

Exhibit 3: Peer comparison							
	Mcap (€m)	P/E (x)			EV/EBIT (x)		
		LTM	2018	2019	LTM	2018	2019
MPC Capital	154.0	12.5	10.7	8.8	8.7	9.8	8.3
Lloyd Fonds	55.0	36.4	18.8	14.0	nm	14.1	10.0
Corestate Capital	871.3	10.8	7.3	6.6	12.4	10.7	9.8
Patrizia	1,583.8	19.9	21.6	16.1	13.0	14.9	11.6
VIB Vermogen	620.5	11.8	12.8	12.1	14.9	14.8	15.3
TLG Immobilien	2,315.0	15.0	10.9	14.5	7.9	18.3	18.4
Peer Average	-	17.8	13.7	12.0	11.4	13.8	12.2
Ernst Russ	30.2	6.7	N/A	N/A	7.5	9.8*	N/A
Discount / premium	-	(62%)	N/A	N/A	(34%)	(29%)	N/A

Source: Company accounts, Bloomberg consensus as at 24 September 2018, Note: * Based on management guidance for FY18 operating profit in line with FY17 number (€3.9m).

Edison is an investment research and advisory company, with offices in North America, Europe, the Middle East and AsiaPac. The heart of Edison is our world-renowned equity research platform and deep multi-sector expertise. At Edison Investment Research, our research is widely read by international investors, advisers and stakeholders. Edison Advisors leverages our core research platform to provide differentiated services including investor relations and strategic consulting. Edison is authorised and regulated by the [Financial Conduct Authority](#). Edison Investment Research (NZ) Limited (Edison NZ) is the New Zealand subsidiary of Edison. Edison NZ is registered on the New Zealand Financial Service Providers Register (FSP number 247505) and is registered to provide wholesale and/or generic financial adviser services only. Edison Investment Research Inc (Edison US) is the US subsidiary of Edison and is regulated by the Securities and Exchange Commission. Edison Investment Research Pty Limited (Edison Aus) [46085869] is the Australian subsidiary of Edison. Edison Germany is a branch entity of Edison Investment Research Limited [4794244]. www.edisongroup.com

DISCLAIMER

Any information, data, analysis and opinions contained in this report do not constitute investment advice by Deutsche Börse AG or the Frankfurter Wertpapierbörse. Any investment decision should be solely based on a securities offering document or another document containing all information required to make such an investment decision, including risk factors.

Copyright 2018 Edison Investment Research Limited. All rights reserved. This report has been commissioned by Deutsche Börse AG and prepared and issued by Edison for publication globally. All information used in the publication of this report has been compiled from publicly available sources that are believed to be reliable, however we do not guarantee the accuracy or completeness of this report. Opinions contained in this report represent those of the research department of Edison at the time of publication. The securities described in the Investment Research may not be eligible for sale in all jurisdictions or to certain categories of investors. This research is issued in Australia by Edison Investment Research Pty Ltd (Corporate Authorised Representative (1252501) of Myonlineadvisers Pty Ltd (AFSL: 427484)) and any access to it, is intended only for "wholesale clients" within the meaning of the Corporations Act 2001 of Australia. The Investment Research is distributed in the United States by Edison US to major US institutional investors only. Edison US is registered as an investment adviser with the Securities and Exchange Commission. Edison US relies upon the "publishers' exclusion" from the definition of investment adviser under Section 202(a)(11) of the Investment Advisers Act of 1940 and corresponding state securities laws. As such, Edison does not offer or provide personalised advice. We publish information about companies in which we believe our readers may be interested and this information reflects our sincere opinions. The information that we provide or that is derived from our website is not intended to be, and should not be construed in any manner whatsoever as, personalised advice. Also, our website and the information provided by us should not be construed by any subscriber or prospective subscriber as Edison's solicitation to effect, or attempt to effect, any transaction in a security. The research in this document is intended for New Zealand resident professional financial advisers or brokers (for use in their roles as financial advisers or brokers) and habitual investors who are "wholesale clients" for the purpose of the Financial Advisers Act 2008 (FAA) (as described in sections 5(c) (1)(a), (b) and (c) of the FAA). This is not a solicitation or inducement to buy, sell, subscribe, or underwrite any securities mentioned or in the topic of this document. This document is provided for information purposes only and should not be construed as an offer or solicitation for investment in any securities mentioned or in the topic of this document. A marketing communication under FCA Rules, this document has not been prepared in accordance with the legal requirements designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of the dissemination of investment research. Edison has a restrictive policy relating to personal dealing. Edison Group does not conduct any investment business and, accordingly, does not itself hold any positions in the securities mentioned in this report. However, the respective directors, officers, employees and contractors of Edison may have a position in any or related securities mentioned in this report. Edison or its affiliates may perform services or solicit business from any of the companies mentioned in this report. The value of securities mentioned in this report can fall as well as rise and are subject to large and sudden swings. In addition it may be difficult or not possible to buy, sell or obtain accurate information about the value of securities mentioned in this report. Past performance is not necessarily a guide to future performance. Forward-looking information or statements in this report contain information that is based on assumptions, forecasts of future results, estimates of amounts not yet determinable, and therefore involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of their subject matter to be materially different from current expectations. For the purpose of the FAA, the content of this report is of a general nature, is intended as a source of general information only and is not intended to constitute a recommendation or opinion in relation to acquiring or disposing (including refraining from acquiring or disposing) of securities. The distribution of this document is not a "personalised service" and, to the extent that it contains any financial advice, is intended only as a "class service" provided by Edison within the meaning of the FAA (ie without taking into account the particular financial situation or goals of any person). As such, it should not be relied upon in making an investment decision. To the maximum extent permitted by law, Edison, its affiliates and contractors, and their respective directors, officers and employees will not be liable for any loss or damage arising as a result of reliance being placed on any of the information contained in this report and do not guarantee the returns on investments in the products discussed in this publication. FTSE International Limited ("FTSE") © FTSE 2018. "FTSE®" is a trade mark of the London Stock Exchange Group companies and is used by FTSE International Limited under license. All rights in the FTSE indices and/or FTSE ratings vest in FTSE and/or its licensors. Neither FTSE nor its licensors accept any liability for any errors or omissions in the FTSE indices and/or FTSE ratings or underlying data. No further distribution of FTSE Data is permitted without FTSE's express written consent.