EDISON Scale research report - Update

Ernst Russ

Diversified financials

7 April 2021

Price	€2.34
Market cap	€76m

Share price graph

Share details

Code	HXCK
Listing	Deutsche Börse Scale
Shares in issue	32.4m
Last reported net debt as at 31 December 2020	€51.5m

Business description

Ernst Russ is an international ship-owner and maritime investment manager. Its fleet under management consists of 71 container, tanker and bulker ships, in 31 of which it holds a majority or significant interest. The company's headquarters are in Hamburg.

Bull

- Repositioned to focus on maritime segment.
- Highly experienced team from the maritime and financial sectors.
- Revival in global trade should drive demand for shipping services.

Bear

- Higher risk aversion weighing on asset values.
- Exposure to the impact of any potential global trade disruptions.
- Higher risk profile of more asset-heavy business model.

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Specialising in shipping business

Ernst Russ (ERAG) continues to build its position in the maritime business with the acquisition of two ships in December 2020 and another two in February 2021. As a result, it now owns a majority interest in 18 vessels and a significant interest in a further 13. Management expects ERAG's own fleet to be the main driver of significant improvements in both revenue and operating income in FY21, as it should benefit from robust charter rates. As part of its strategic consolidation in FY20 to focus on ship owning and maritime investment management, ERAG has a new segment structure, which includes shipping and management services operations. These had c €0.8bn of assets under management (AUM) at end-December 2020, across 67 funds in both the shipping and alternative investment markets.

Increased share of shipping in the revenue stream

FY20 revenues dipped c 5.4% to €55.6m. A c 32.2% increase in the shipping segment only partly offset lower contributions from divested operations. With a more limited negative impact from one-off events versus FY19, combined with successful cost-cutting measures, net income ex-minorities reached €4.1m in FY20 versus €1.5m in FY19. An uptick in the global container markets, which started in Q420, assisted FY20 results to a limited extent and should provide more tailwinds in FY21.

Exiting a number of non-shipping activities

ERAG expanded its fleet and divested a number of non-core businesses in recent years. These included the disposal of investor management operations in May 2019, followed by the sale of residential housing projects in H120. Finally, in October 2020 the company fully exited the real estate segment through the disposal of its remaining fund and asset management companies from this sector, including Assetando, ERAG's former central real estate management unit. The remaining non-shipping activities at end-2020 mainly related to the secondary life insurance market and aircraft investment fund.

Valuation: Trading at a significant premium to peers

As there are no consensus estimates for ERAG, we compare its valuation with a group of peers operating in the shipping market using FY20 reported figures. Based on EV/EBITDA and P/E multiples, ERAG trades at a significant premium to peers, which may suggest that the market expects its earnings to grow significantly, in line with management guidance for FY21.

Historical financials

Year end	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/17	44.0	9.3	0.17	0.00	13.8	N/A
12/18	52.7	6.1	0.19	0.00	12.3	N/A
12/19	58.8	3.5	0.05	0.00	46.8	N/A
12/20	55.6	5.4	0.12	0.00	19.5	N/A

Source: ERAG accounts

FY20 financials: Positive earnings momentum

In FY20, Ernst Russ reported a 5.4% y-o-y decline in revenues to €55.6m, broadly in line with management guidance of €54.7m in December 2020. The lower top-line reflects disposals (and the subsequent deconsolidation) of the real estate (October 2020) and investor management businesses (May 2019) as part of ERAG's operating model streamlining to focus solely on the shipping segment. The 32.2% y-o-y increase in shipping revenue to €50.9m in FY20 was driven by fleet expansion, including in particular the accounting effect from full consolidation of the ElbFeeder JV after ERAG increased its stake by 2% to 52% on 31 July 2019. We also note that revenue in the real estate segment in FY19 included €8.6m income from the sale of a directly held property in Essen.

On the back of a €12.1m increase in the costs of shipping operations and crewing, resulting from fleet expansion, ERAG reported a c 15.7% y-o-y increase in cost of materials and services to €37.5m in FY20. However, it is worth noting that the FY19 figure of €32.4m includes c €6.0m expenses related to the sale of a property in Essen. Similarly, ERAG recognised a €1.6m loss from the sale of the investor management segment in FY19, while FY20 other operating income includes a €0.9m deconsolidation profit from the sale of the real estate business. Divestment of the whole investor management segment helped reduce average headcount to 63 in FY20 from 103 in FY19 (in full-time equivalent terms), resulting in a c 32.7% year-on-year decline in personnel expenses to €7.0m. It was further assisted by reducing the Executive Board from three members to just one – Robert Gärtner in 2019. In FY20, ERAG reported €9.7m EBITDA (excluding non-operating result) in line with management's forecast in December 2020. Cost savings and no significant negative impact from one-off events compared to FY19 enabled net profit ex-minorities to reach €4.1m, compared to €1.5m in the previous year.

Exhibit 1: Financial highlights

€m	FY20	FY19	y-o-y
Revenue	**55.6**	**58.8**	**-5.4%**
Shipping	50.9	38.5	32.2%
Real estate	2.5	14.8	-83.1%
Alternative investments	1.7	1.6	6.3%
Other services	0.5	0.7	-28.6%
Investor management	0.0	3.3	NM
Decrease/increase in unfinished products	0.0	(0.7)	NM
Other operating income	9.6	7.9	21.5%
Cost of materials and services	(37.5)	(32.4)	15.7%
Personnel expenses	(7.0)	(10.4)	-32.7%
Other operating expenses	(6.3)	(12.0)	-47.5%
EBITDA (excluding non-operating result)	**9.7**	**9.0**	**7.8%**
Depreciation	(10.0)	(7.4)	35.1%
Net income from investment in associates	0.3	0.1	200.0%
Income from equity interests	2.6	1.8	44.4%
Income from loans held as financial securities	0.0	0.0	NM
Other interest and similar income	1.5	1.7	-11.8%
Amortisation of financial assets and current securities	(0.5)	(1.2)	-58.3%
Interest and similar expenses	(2.9)	(2.7)	7.4%
Income taxes	(0.6)	(1.7)	-64.7%
Earnings after tax	**4.7**	**1.8**	**161.1%**
Other taxes	0.0	(0.1)	NM
Consolidated net profit	**4.7**	**1.7**	**176.5%**
Consolidated net profit attributable to non-controlling interests	(0.6)	(0.2)	200.0%
Consolidated net profit after non-controlling interests	**4.1**	**1.5**	**173.3%**

Source: Ernst Russ accounts

In its H120 financial statement, management had guided to at least a moderate increase in cash and cash equivalents at end-2020 compared with end-2019. However, its liquid resources declined by c 8% during FY20, mainly attributable to the purchase of new ships, completed shortly before the balance sheet date. ERAG has a healthy financial position with its equity ratio increasing to

49.0% at end-2020 from 46.2% 12 months earlier, despite net debt expanding to €51.5m from €44.2m amid the shift to a more asset-heavy business model.

Management guides to a significant increase in shipping segment revenue in FY21 driven by continued fleet expansion (see below), further assisted by a slight increase in its own fleet utilisation rate (95.9% in FY20) and positive developments in the charter markets. According to management's forecast, this would result in a significant y-o-y improvement in operating earnings in FY21, although no precise guidance has been provided.

Streamlining business operations to focus on shipping

At end 2020, ERAG's shipping portfolio consisted of 68 vessels, down by three compared to end-2019. These included 16 fully consolidated ships (14 at end-2019), a further 14 in which it owns a significant interest and 38 ships to which it offers mainly fund and management services. Despite the difficult global trade situation (especially in H120), driven by the pandemic outbreak, ERAG's shipping business ran almost uninterrupted, reporting only a slight decline in the utilisation rate from 97.5% in FY19 to 95.9% in FY20. This was perhaps partially attributable to increased technical downtime, sitting at 2.8% of possible operating days in FY20, compared to 0.9% in FY19.

In December 2020, ERAG acquired two container vessels with total capacity of 9.7k TEU (the total capacity of ERAG's own fleet at end-2020 amounted to c 37.2k TEU), which therefore made a limited contribution to FY20 results. In February 2021, ERAG acquired two multi-purpose vessels, expanding its own fleet to 18 ships. Entering 2021, the company also held alternative investment funds with exposure to the insurance and aircraft businesses.

Following the divestment of residential housing projects in March (ILO Park, Pinneberg) and April 2020 (Bad Oldesloe), ERAG fully exited the real estate segment in October 2020 through the sale of Assetando Real Estate and other fund and asset management companies. Together with the sale of seven fund ships, this brought ERAG's end-2020 AUM to c €0.8bn (spread across 67 funds), compared with €1.8bn (112 funds) a year earlier.

As part of ERAG's new segmental reporting, it will present the shipping activities performed by its own fleet under the **Shipping segment**. Meanwhile, all services provided by the company, including fund and asset management in both the shipping and alternative investment areas, will be reported under the **Management services segment**. Holding functions will continue to be reported in the **Other services segment**.

Robust demand for container shipping

As the global economy partly reopened in Q320, world merchandise trade rebounded by 11.6% quarter-on-quarter after a 12.7% decline in Q220, according to the World Trade Organization (WTO), which now estimates a contraction in total trade volume in 2020 of 9.2%. The United Nations Conference on Trade and Development (UNCTAD) expects this to result in a 4.1% fall in global maritime trade in 2020. However, unexpected initial negative demand has not severely affected shipping market profitability, as it was partially offset by the supply-control measures implemented by carriers. Starting from Q220, capacity has been significantly reduced through suspending services, blank sailing and re-routing vessels. With a recovery in demand for container shipping in H220 (driven by restocking amid stronger demand for consumer goods), freight rates have rallied since H120, with the New ConTex Index (covering time charter rates for container ships) expanding in euro terms from 309 on 30 June 2020 to 1,093 on 6 April 2021. Similarly, the Baltic Dry Index, which represents developments in bulker markets, increased in euro terms over the same period from 1,601.8 to 1,761.7 points. As both UNCTAD and the WTO expect a rebound in global trade volumes in 2021, this positive momentum could continue.

Valuation

As ERAG has disposed of its real estate business to focus entirely on operations in the shipping segment, we have decided to replace our previous peer group of real asset investors and managers operating in the real estate sector. The new group includes Hapag-Lloyd, the largest German company (and one of the largest in the world) focused on the container shipping business, as well as four smaller European entities. These include Danaos Corp, which charters its own container fleet, Eimskip, the oldest shipping company in Iceland also focused on container shipping, as well as SFL Corp (operating all types of ships) and Wilhelmsen Holding (shipping management) – both registered in Norway.

As there are no Refinitiv consensus estimates for ERAG, we compare P/E and EV/EBITDA multiples based on reported FY20 figures, providing consensus estimates of the peers for broad context. After a strong year to date rally, which brought ERAG's share price from €1.35 to €2.34, the company trades at a significant premium to peers based on both multiples. This may suggest that the market is expecting significant operational improvement over the next couple of years, is in line with management guidance, and that it is likely to recognise the benefits of the new focus on shipping and maritime investment funds.

Exhibit 2: Peer group comparison

	Market cap	EV/EBITDA (x)			P/E (x)		
	(m)	2020	2021e	2022e	2020	2021e	2022e
Hapag-Lloyd	€23,956	9.2	7.0	9.0	25.9	11.0	16.9
Danaos Corp	US$1,079	7.4	5.5	5.5	8.2	4.1	3.6
SFL Corp	US$1,026	9.8	9.7	10.1	N/A	13.1	12.1
Eimskip	SEK51,425	8.8	7.6	7.0	N/A*	N/A	N/A
Wilhelmsen Holding	NOK8,336	7.0	7.3	7.1	8.1	11.7	5.4
Peer group average		**8.4**	**7.4**	**7.8**	**14.0**	**10.0**	**9.5**
Ernst Russ	€76	13.1			19.5		
Premium/(discount) to peer group		**55%**			**39%**		

Source: Refinitiv consensus at 7 April 2021. Note: *Eimskip reported marginally positive EPS in FY20, translating into a P/E ratio of over 70x, which we have excluded as an outlier.

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