

## Scherzer & Co

### Upward NAV trend continues

Scherzer & Co (PZS) was able to leverage the favourable market conditions in H117, generating an EPS of €0.15 (vs €0.04/share loss in H116) and growing NAV by 13.5% to €2.55/share as at end-June. Realised capital gains, higher dividend income and a lower negative balance of value adjustments contributed to the solid result. Although there were no major favourable extra compensatory claim (ECS) rulings in H117, the company maintained an extensive ECS portfolio, which now amounts to €99m or €0.97 per share, providing potential future earnings upside. PZS's NAV stands at €2.64 as at end-August, in line with its current share price.

### H117 results well above last year

PZS reported strong H117 numbers, with EBIT improving to €4.64m from a €1.09m loss last year. The company realised net capital gains of €6.40m (compared to €0.92m in H116) and posted a 22% y-o-y increase in dividend income to €1.44m. PZS benefited from the favourable stock market environment, as the DAX gained c 7% in the first half of the year, while mid- and small-caps appreciated even more (MDAX +10%, SDAX +14% and TecDAX +20%).

### Sustained NAV growth

PZS's NAV currently stands at €2.64 (as at 31 August 2017) compared to €2.29 at end-2016. This represents ytd growth of 17.5% (adjusted for the €0.05 dividend payment made in June), which is ahead of PZS's five-year NAV CAGR of 15.6%. Performance was driven particularly by some of the current top 10 portfolio holdings, such as GK Software, Lotto24, Horus or Pfeiffer Vacuum Technology, but also Wüstenrot & Württembergische (W&W). Importantly, the company has been able to outperform the large- and mid-cap indices so far in 2017, as the DAX and MDAX increased by c 5% and 11%, respectively (the SDAX and TecDAX grew by 19% and 25%, respectively).

### Valuation: Trading in line with NAV

PZS has long traded at discounts to NAV to the tune of 15%, but following positive catalysts such as the successful sale of FIDOR Bank in 2016, PZS shares are now trading broadly in line with NAV. An additional stock driver is the recently updated valuation report on AXA, which implies a potential income from PZS's AXA shareholding of €18.8m or €0.63/PZS share. It must be noted that the NAV does not include any income from potential ECS profits.

#### Consensus estimates

Year end	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/15	12.8	5.3	0.18	0.05	14.6	1.9
12/16	7.6	4.5	0.15	0.05	17.5	1.9
12/17e	9.4	5.4	0.18	0.05	14.6	1.9
12/18e	9.8	5.8	0.17	0.05	15.5	1.9

Source: Scherzer & Co accounts, consensus estimates (ODDO, GSC, Solventis) as at 12 September 2017

#### Asset management

13 September 2017

Price €2.63

Market cap €9m

#### Share price graph



#### Share details

Code	PZS GY/PZSG
Listing	Deutsche Börse Scale
Shares in issue	29.9m
Last reported net debt as at 30 June 2017	€23.4m

#### Business description

Scherzer & Co (PZS) invests its funds mainly in domestic equities. PZS looks for companies that are unknown or unloved, and special situations. The focus is on special situations, where the downside is perceived to be limited. In addition, it acquires value stocks, mainly below book value. These stocks need to demonstrate strong business models.

#### Bull

- Strong management, well known in the market.
- 'Hidden' NAV kicker through special compensatory rights, albeit with binary outcomes.
- Well diversified portfolio with attractive risk/return pattern, built over a number of years.

#### Bear

- Dependent on market environment.
- Still relatively small.
- For the strategy, market size is limited.

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## Company description: H117 results released

PZS reported an H117 EBIT of €4.64m compared to a €1.09m loss in H116. This was supported by net realised capital gains of €6.40m (vs €0.92m in H116) and a 22% y-o-y increase in dividend income to €1.44m. Furthermore, the company recorded positive value adjustments of €0.84m (up 61% from €0.52m). This was somewhat offset by the lower result from covered writing strategies at €0.23m (H116: €0.56m). Income from ECS was negligible in H117 (€2,000). However, PZS highlighted a recent positive ruling in its September investor presentation, resulting in an ECS gain of €1.4m. As at end-August, the original value of tendered-in shares stood at approximately €89m or €2.97 per share (compared to €95m and €3.20 by end-2016 respectively). Taking into account the investments in Allerthal-Werke and the RM Rheiner Management, the compensatory claims amount to €112m.

On the expenses side, the company recorded €2.64m in write-offs of financial assets and securities held as current assets compared to €3.53m in H116. Personnel expenses doubled y-o-y to €1.2m, driven by higher bonuses (up to €0.9m from €0.3m last year). Finally, net financial expense stood at €0.07m, ahead of last year at €0.03m. Consequently, EBT reached €4.57m vs a €1.12m loss in H116 and net income came in at €4.43m (H116: -€1.12m), translating into an EPS of €0.15 (vs a loss of €0.04 in H116).

### Exhibit 1: Results highlights

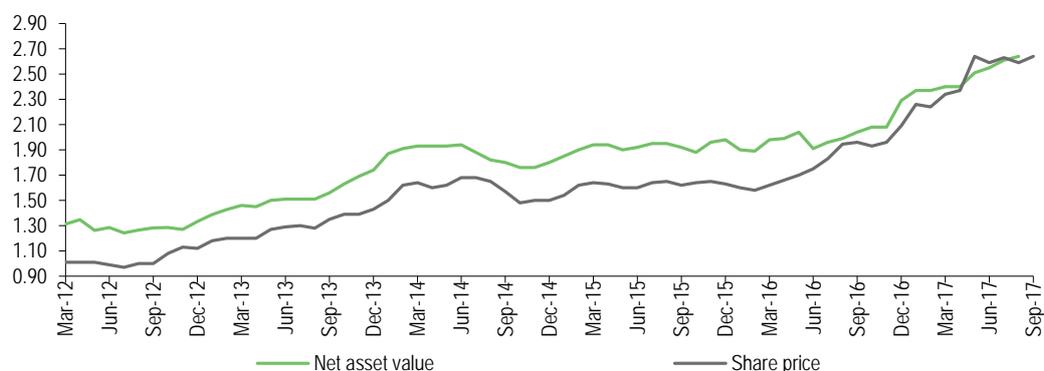
€000s	H117	H116	y-o-y
<b>Income from financial instruments</b>	<b>7,789</b>	<b>1,956</b>	<b>298%</b>
Gains on sale of non-current financial assets	2,775	213	1,203%
Gains on sale of current financial assets/securities	4,642	1142	306%
Gains on derivatives	371	563	(34%)
Extra compensatory claims (ECS)	2	37	(95%)
Expenses related to financial instruments	(1,159)	(440)	163%
Loss from sale of securities	(1,017)	(440)	131%
Loss on derivatives	(142)	0	-
Other operating income	865	672	29%
Value adjustments on non-current financial assets	362	498	(27%)
Value adjustments on investments	382	0	-
Value adjustments on current financial assets	91	21	333%
Reversal of tax provisions	0	149	(100%)
Other	30	3	900%
Personal expenses	(1,215)	(601)	102%
Other operating expenses	(432.0)	(330)	31%
Income from dividends	1,436.1	1,182	22%
Write-offs of current and non-current financial assets	(2,637.3)	(3,525)	(25%)
D&A	(3.5)	(3)	7%
<b>EBIT</b>	<b>4,642.9</b>	<b>(1,090)</b>	<b>426%</b>
EBIT margin	59.6%	N/M	N/M
Other interest and similar income	23	92	(75%)
Interest and similar expenses	(97)	(121)	(20%)
<b>EBT</b>	<b>4,569</b>	<b>(1,119)</b>	<b>N/M</b>
EBT margin	58.7%	N/M	N/M
Income tax	(142)	0	N/A
effective tax rate	3.1%	0.0%	311bp
<b>Net profit for the period</b>	<b>4,427</b>	<b>(1,119)</b>	<b>N/M</b>
Net income margin	56.8%	N/M	N/M
EPS	0.15	(0.04)	-

Source: Scherzer & Co accounts

Net debt increased to €23.4m in H117 from €18.6m by end-2016, implying a net debt/equity ratio of 41% (FY16: 34%). PZS's NAV as at end-June reached €2.55 per share, whereas last reported NAV (as at 31 August) was even higher at €2.64 per share. Adjusted for the €0.05 dividend paid in June, this represented a 17.5% increase from €2.29 at end-2016. This was ahead of PZS's five-year NAV CAGR (2011-16) of c 15.6%. Over this period, the company was able to outperform blue chips (the DAX posted a five-year CAGR at 12.3%). However, it is worth keeping in mind the fact that PZS is

more inclined towards small- and mid-caps, which generally outperform the broad market amid an upward trend. The last reported NAV level is broadly in line with the current share price of €2.63.

#### Exhibit 2: PZS's NAV and share price comparison



Source: Scherzer & Co accounts

PZS's top 10 portfolio holdings are illustrated in Exhibit 3 below. As at end-June, 59.87% of PZS's overall portfolio consisted of investments treated as 'opportunistic' (including special situations, new business orientation, restructuring/recapitalization, and sustained business models with high-growth outlook) and the remaining 40.13% represented the so-called 'safe' investments (companies with a 'natural' valuation floor, high asset quality, strong/strategic major shareholder, strong earnings quality, etc). The top 10 holdings make up 52.9% of the current portfolio (vs 53.9% at end-2016). With respect to recent major portfolio changes, the company reduced its stake in Wüstenrot & Württembergische (W&W) to cash in some of its capital gains.

#### Exhibit 3: Top 10 holdings as % of total portfolio

Company	August 2017	June 2017	December 2016	Opportunistic/safe
GK Software	13.67%	10.60%	8.72%	Opportunistic
freenet	9.66%	9.56%	7.51%	Opportunistic
Allerthal-Werke	5.00%	4.64%	5.05%	Safe
Lotto24	4.16%	4.46%	6.72%	Opportunistic
Oldenburgische Landesbank	3.90%	N/A	N/A	Safe
Audi	3.66%	3.74%	N/A	Opportunistic
Horus	3.60%	2.96%	N/A	Opportunistic
K+S	3.30%	4.19%	3.41%	Opportunistic
Mobotix	3.00%	3.99%	5.11%	Safe
Pfeiffer Vacuum Technology	2.97%	N/A	N/A	Safe
<b>Total top 10 holdings</b>	<b>52.92%</b>	<b>52.61%</b>	<b>53.91%</b>	-

Source: Scherzer & Co accounts

## Valuation

The most recently reported NAV stands at €2.64/share as at end-August 2017. In the past, PZS's shares have traded at prices below the stated NAV. This appears to be a function of the asset value minus the capitalised management costs, which were approximately 10% of revenues. As such, the average discount to NAV before 2016 was approximately 15%. Since the successful ECS transaction in 2015 and the subsequent newsflow (eg the AXA valuation case and the successful sale of the FIDOR Bank stake), the discount has declined and the stock trades close to last reported NAV of around €2.64. This suggests the improved acceptance of potential gains resulting from the ECS portfolio. However, there is no visibility of future gains.

Based on P/E, PZS has traded well below the market averages in the past five years. We believe that the main reason for this is the low visibility on potential gains from the ECS portfolio. However,

given recent successful transactions, the discount started to decline in 2016 and has continued to do so in 2017.

**Exhibit 4: Comparable market P/E ratios**

	P/E (x)						
	2012	2013	2014	2015	2016	2017e	2018e
DAX	17.3	18.4	16.6	22.0	19.0	13.7	12.9
MDAX	17.9	27.8	20.0	19.2	28.8	17.9	16.2
SDAX	N/M	54.7	30.9	28.0	23.5	21.8	19.3
Arithmetic average	17.6	33.6	22.5	23.1	23.8	17.8	16.1
PZS	Loss	7.2	11.9	9.2	13.6	15.0	15.3
PZS discount/(premium)	Loss	79%	47%	60%	43%	16%	5%

Source: Bloomberg as at 12 September 2017, Scherzer & Co reports. Note: P/E valuations based on year-end prices.

PZS's valuation is mainly based on asset value, also described by price to book (P/B) value. We have looked at the development of market P/B ratios over time, and a decline in PZS's discount to the market has been apparent since 2015.

**Exhibit 5: Comparable market P/B ratios**

	P/B (x)						
	2012	2013	2014	2015	2016	2017e	2018e
DAX	1.5	1.8	1.7	1.7	1.7	1.7	1.6
MDAX	1.8	2.3	2.1	2.3	1.9	2.0	1.8
SDAX	1.3	1.7	1.9	2.0	1.7	1.9	1.7
Arithmetic average	1.5	1.9	1.9	2.0	1.8	1.9	1.7
PZS	0.8	0.8	0.8	0.8	0.9	1.3	1.3
PZS discount/(premium)	48%	59%	58%	60%	49%	28%	27%

Source: Bloomberg as at 12 September 2017, Scherzer & Co reports. Note: P/B valuations based on year-end prices.

PZS has reported profits every year since 2012. Despite this, the stock has traded below both its own book value and German market valuations. Nevertheless, the company has achieved positive absolute returns each year, documented by the increase in NAV (even after dividend payment).

**Exhibit 6: Comparable market performance**

	DAX Index		PZS NAV
	End	Change (%)	Change (%)
2012	7,612.4	29.06	14.65
2013	9,552.2	25.48	30.83
2014	9,805.6	2.65	3.45
2015	10,743.0	9.56	12.78
2016	11,481.1	6.87	18.18
2017 (ytd)	12,524.8	9.09	17.47

Source: Bloomberg, Scherzer & Co reports. Note: Ytd DAX return is as at 12 September 2017 and ytd figure for PZS NAV is as at 31 August 2017.

In addition, the NAV progression does not fully reflect the ECS portfolio. On one hand, earnings realised from successful closings are reflected in the NAV, as the returns are partially reinvested in the portfolio. On the other hand, the outcome and the timing of the claims are uncertain.

The AXA case, however, highlights the potential; while it is unclear whether the new valuation report will be fully accepted and finally turn into payments to those shareholders who tendered in the AXA shares in 2006, a potential gain of €103 per AXA ordinary share represents a pre-tax gain for PZS of approximately €18.8m, or €0.63 per PZS share (before taxes and other costs). The €0.63/share gain is equal to a 24% increase in current NAV.

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