

German Startups Group

Expanding the business model

German Startups Group (GSG) is transforming its business model to an asset manager (through dedicated SPVs and an intended investment fund) and an online matchmaking platform for transactions in secondary shares in German start-ups and venture capital (VC) funds (scheduled for launch by the end of Q218). Management believes that this should present a completely new opportunity to create significant shareholder value at relatively low investment costs, given that similar marketplaces have reached standalone valuations beyond GSG's market cap. A successful transformation could not only allow GSG to close the valuation gap to its NAV (which stands at c 30%), but also allow it to realise additional value.

Higher revaluation and disposal gains

GSG reported an EPS of €0.14 in FY17 vs a loss of €0.29 per share in the prior year. Earnings were supported by several portfolio exits, most notably the disposal of interest in Scalable Capital. Furthermore, seven of GSG's key holdings were revalued upwards during the year, translating into a net revaluation gain of €1.1m compared with a loss of €1.9m in FY16. GSG decided to refrain from capitalising a certain amount of deferred taxes, which had a negative impact on EPS of €0.04. The company's net debt declined to €2.5m from €5.2m in the prior year, mostly due to partial repayment of the short-term subordinated debt incurred in 2016.

Addressing an untapped investor group

The developed matchmaking platform for secondary start-up or VC fund shares is aimed at channelling the outstanding sale offers while unlocking the 'closed-shop' ecosystem to allow a broader investor community into the German start-ups universe by lowering the minimum ticket size per investor to c €0.2m. This will also be done by setting up SPVs and an intended investment fund in which investors can participate. This will also constitute a source of transaction fees, management fees and carries, translating into an additional income stream for GSG.

Valuation: Discount to NAV persists

GSG's current share price of €1.71 represents a 31% discount to NAV at end-December 2017 (based on book value of equity ex-minorities). Importantly, the discount may be understated, as valuation of minority holdings is mostly based on historical transaction prices and 50.7%-owned Exozet is not revalued at all due to full consolidation.

Historical financials

Year end	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/14	0.1	1.5	0.32	0.0	5.3	N/A
12/15	5.6	3.6	0.49	0.0	3.5	N/A
12/16	10.9	(5.4)	(0.29)	0.0	N/A	N/A
12/17	9.6	1.8	0.14	0.0	12.2	N/A

Source: German Startups Group

Financials

29 May 2018

Price

€1.71

Market cap

€20m

Share price graph



Share details

Code	GSJ
Listing	Deutsche Börse Scale
Shares in issue	12.0m
Net debt at 31 December 2017	€2.5m

Business description

German Startups Group is a Berlin-based venture capital investment company primarily focused on providing investment to technology businesses in German-speaking countries. The company holds 20 active companies of major importance in its investment portfolio and a majority stake in digital agency Exozet.

Bull

- NAV likely understated.
- Success of new business model may result in narrowing/closing the valuation gap to NAV and realising additional shareholder value.
- Listed exposure to a diversified portfolio of technology start-ups in Germany.

Bear

- Low liquidity.
- VC investments are inherently high risk.
- Potentially constrained by capital.

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Financials: Results driven by portfolio exits

GSG reported of EPS at €0.14 in FY17, compared with a loss per share of €0.29 in FY16 (€0.17 loss when adjusted for the write-off associated with costs incurred for a capital increase that did not take place in 2016). Results from the investment business reached €3.4m (vs €1.9m loss) and included profit from asset sales of €2.6m, which was largely attributable to the disposal of GSG's stake in Scalable Capital in H117 (€2.4m gain vs book value). As discussed in our [update note](#) dated 28 September 2017, the company completed some other disposals in FY17, including Delivery Hero, realbest, Pyreg, CRX Markets and eWings. All these transactions (except for the disposal of the remaining 0.8% stake in CRX Markets) were concluded in the first half of the year. The net result from revaluation of holdings was €1.1m (FY16: €1.9m loss), as seven out of the remaining 20 portfolio holdings of major importance to GSG were subject to revaluation gains last year. GSG participated in follow-on funding rounds of three of its key holdings in 2017, including Book-A-Tiger, Fiagon and Remerge. In new investments, GSG has acquired an 18.14% holding in AuctionTech, which was established based on an online livestream auction technology IP spun off from the insolvent auction house Auctionata (GSG's former portfolio company). The second, small investment made last year was the convertible bond issued by Stryking, a company offering an online platform for football fans, allowing users to compile a team of actual football stars and bet on their specific success during match days. It intends to complete an Initial Coin Offering (ICO) during the 2018 World Cup. After the reporting date, GSG also made an investment in a new focus portfolio company, with the acquisition of a 2.1% stake in Chrono24, the leading online marketplace for luxury watches. In line with earlier management comments, the company's investment activity should be largely focused on follow-on investment rounds in existing holdings.

GSG's revenue declined 12% y-o-y to €9.6m, as Exozet's performance in 2017 did not fully compensate for the absence of the large project with ZDF, which assisted the top line in 2016. However, GSG announced on 14 May that it has entered into direct negotiations with an international consulting company related to the potential sale of its 50.7% stake in Exozet. Management states the offered purchase price would translate into a capital gain, vs the current book value, of c €1.0m (or €0.08 on a per share basis) and generate a low single-digit million euro cash inflow. In our view, this seems to be a fair price given the sales multiples at which similar companies are traded. The proceeds from this transaction could be used to make early repayment of GSG's loans and to perform further share buybacks.

Exhibit 1: FY17 results highlights

€000	FY17	FY16	y-o-y
Profits from financial assets valued at fair value with recognition in profit or loss	4,135	4,384	-5.7%
Losses from financial assets valued at fair value with recognition in profit or loss	(3,078)	(6,263)	-50.9%
Profits from sale of financial assets	2,643	21	N/M
Losses from sale of financial assets	(262)	0	N/M
Result from investment business	3,438	(1,857)	N/M
Revenues	9,612	10,909	-11.9%
Change in inventories	404	32	N/M
Income from own work capitalised	874	672	30.2%
Other operating income	436	200	117.8%
Cost of materials and services received	(2,111)	(2,247)	-6.1%
Personnel expenses	(6,770)	(6,756)	0.2%
D&A	(428)	(429)	-0.2%
Other operating expenses	(3,161)	(4,152)	-23.9%
Incidental acquisition costs of investments	(23)	(53)	-56.4%
Result from other components	(1,167)	(1,823)	-36.0%
Write-offs of capital acquisition costs related to planned but not executed capital increases	0	(1,503)	N/M
Interest income	71	67	6.6%
Interest expense	(586)	(255)	N/M
Financial result	(515)	(188)	N/M
EBT	1,757	(5,372)	N/M
Income taxes	(80)	2,030	N/M
Net profit (ex-minorities)	1,623	(3,466)	N/M
EPS (€)	0.14	(0.29)	N/M

Source: German Startups Group

GSG recently raised €3.0m through issuing a convertible bond, which was subscribed in full by Obotritia Capital. This investor has also purchased a block of shares representing 8% of GSG's share capital, becoming the company's lead investor. The bonds have an interest rate of 8% a year, a term of five years and are convertible into 1,198,330 shares (representing a potential 10% dilution) at a price of €2.50.

Transition to an asset manager and marketplace

GSG is undergoing an important business transformation from an asset owner to an asset manager and an online marketplace. The company is developing an online matchmaking platform for sellers and buyers of so-called secondary shares in German start-ups and VC funds within its recently established subsidiary German Startups Market, which is scheduled for launch by the end of Q218. The platform will also be open to other asset classes, such as shares in newly set up and running VC funds, convertible loans, venture debt financings, complete angel/VC portfolios, as well as pooled investments syndicated by GSG. The matchmaking will be conducted as 'invitation ad offerendum' (invitation to treat), a concept within contract law and does not cover the process involving a notarial deed and/or third-party approval, which in Germany is normally quite complex.

The main aim of this platform is to provide liquidity in the asset class, which is normally illiquid, by creating a marketplace where multiple parties active in the start-ups/VC space could execute deals, with shareholders, founders, employees, business angels and VC entrepreneurs on one side and investors (institutional, family offices, private equity funds) and M&A advisers on the other. The decision to create this market place is based on discussions GSG's CEO had with various players on the German start-ups landscape, who confirmed there is an unmet need for this kind of platform. GSG is convinced there is a stable baseload number of investment offerings in this area, which would justify the existence of a regular marketplace. The company aims to address several problems that shareholders typically experience, such as longer lead time to exit or IPO (which often forces VCs to extend their lifetime), inability to liquidate assets and the resulting pressure on management to complete exit or list prematurely, as well as block risk (ie large exposure to a single holding) in the case of founders and business angels.

Through this project GSG plans to reach an untapped group of potential investors, who until now have not been able to actively participate in the start-up market because of high capital

requirements, with ticket size for start-up shares typically €0.5-5.0m and in the case of third-party VC funds' shares €1.0-5.0m. This effectively results in a 'closed-shop' ecosystem, where only VCs and well-known business angels have access to these investment opportunities. GSG intends to cut the minimum ticket size for a single investor to around €0.2m by entering the asset management space and creating dedicated SPVs (offering their stakes to investors) as well as a so-called German Startups Tech50 Fund. The latter will be a passively managed VC fund investing only in the top 50 of the highest valued German start-ups and will be established as a joint venture (50% each) with another subsidiary in the second half of the year.

Based on the platform, GSG aims to enter the asset management business and start generating transaction fees, management fees and carries (the company estimates the commissions should be around 5% on average). This platform could also constitute a convenient exit route for GSG's own minority investments, making it less dependent on the timing of exit decisions made by larger shareholders in companies in which GSG is invested. We believe there is definitely a gap in the German market that would be met by the creation of such a marketplace. The current market outlook also seems favourable, as VC investors with investment activities in the German start-up market having set up new funds with a value of more than US\$7.9bn in 2017 (up 27% vs 2016), according to a recent EY report. That said, we acknowledge there is a potential risk associated with the complicated process of transferring ownership in private companies in Germany (including a notary deed requirement), which may influence the activity levels on the platform.

Valuation

GSG's net asset value (ex-minorities, but including goodwill and intangibles) amounted to €29.4m as at end-December 2017, translating into €2.45 on a per share basis (Edison estimates). Consequently, the current share price of €1.71 represents a 31% discount to last reported NAV. Assuming GSG is able to realize the €1.0m gain on book value from the disposal of its stake in Exozet, the discount to NAV will increase to 33%. Moreover, the current NAV and discount are likely understated, given that portfolio companies are mostly valued, where possible, by independent third parties, which reflect prices achieved in recent transactions and follow-on investment rounds. These can be out of date as at end-December (with the average time elapsed from previous valuation of 295 days). We believe that one of the reasons for the considerable discount is the limited portfolio transparency arising from the lack of financial disclosure of minority assets in GSG's portfolio.

Currently, the company refrains from any capital raise that could result in shareholder dilution at depressed price levels. In fact, GSG has recently launched a share buyback programme, planning to repurchase up to 250,000 shares with a total purchase price (excluding incidental transaction charges) of up to €0.5m between 2 May and 15 June 2018. If the full volume is repurchased, this would represent 2.1% of the issued capital. The price the company pays for the shares will remain within a +/-5% corridor vs the Xetra closing stock market price. The forfeit of one percentage point from the general partner's management fee of 2.5% per year may also contribute to a reduction of the discount to NAV. Finally, a successful launch of the German Startups Market and German Startups Asset Management could further increase shareholder value.

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