

Ernst Russ

Focus on real estate and shipping markets

Ernst Russ (ERAG) continued its efforts towards a strategic shift, with real estate (revenues grew by c five times y-o-y in FY17) and shipping (sales up 8.1% y-o-y) acting as the key drivers post acquisition. Management guided to modest revenue growth powered by ship and asset management, and real estate but flat operating earnings in FY18 vs FY17 (€3.9m). Due to the previous volatility in shipping markets and lack of immediate earnings momentum implied by current management guidance, ERAG's market cap/AUM ratio continues to lag the peer average.

FY17 results driven by real estate revenues

ERAG's net profit declined to €5.6m in FY17 from €6.2m in FY16, primarily due to increased costs related to crewing services and a decline in other operating income. Group revenues reached €44.0m, led by higher contribution from the real estate business (15.5% vs 3.5% in FY16) and an 8.1% y-o-y increase in shipping revenues, which was primarily assisted by first-time recognition of crewing activities revenues (up by €3.0m y-o-y) for the full year, partially offset by a decline in sales/profit fees, and revenue from asset management. Revenue in the real estate business grew from €1.4m to €6.8m, driven by commissions for property sales, new tenancy agreements, fund management fees and the sale of land in Leipzig.

Management guides to moderate revenue increase

Management guided to moderate revenue increases across all segments in FY18. The shipping segment is expected to rise slightly, assisted by the relatively positive outlook for container ships, bulkers and tankers. Real estate segment revenues could double in FY18 (although assisted by non-recurring effects). ERAG's corporate planning for the investor management segment assumes lower revenues y-o-y in FY18. The company expects its operating income to be near its FY17 figure of €3.9m. Several investments planned in the shipping and real estate segments are likely to reduce the cash balance moderately in 2018.

Valuation: Still trading at a discount to peers

ERAG's valuation in terms of its market cap/AUM ratio (0.7%) remains below the peer group average. If we assume flat y-o-y EPS in 2018 (as ERAG guides to flat operating earnings), the shares trade at a P/E of c 7.1x 2018e, well below the listed asset managers. This may be partly due to its focus on the challenging shipping sector and persistent litigation risk related to ERAG's legacy funds, as well as unfamiliarity with the group's significant business transition on the part of investors.

Historic 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	7.1	N/A
12/17	44.0	9.3	0.2	0.0	7.1	N/A

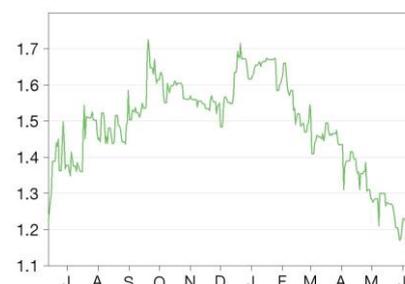
Source: Ernst Russ accounts

Diversified financials

13 June 2018

Price €1.21
Market cap €39m

Share price graph



Share details

Code	HXCK
Listing	Deutsche Börse Scale
Shares in issue	32.4m
Last reported net debt as at 31 December 2017	€8.4m

Business description

Ernst Russ (formerly HCL Group) is a listed asset and investment manager, with AUM of c €6.3bn, focused on shipping. 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

- Challenging maritime conditions.
- 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: FY17 results released

The company recorded a 10% y-o-y increase in revenues at €44.0m in FY17 bolstered by revenue growth in the real estate and shipping segments, as described above. Investor management revenues fell 18.4% y-o-y in FY17 due to a decline in the trustee business, while revenues from the alternative investments segment were flat y-o-y at €1.4m in FY17. Cost of materials and services rose by €8.8m from €6.1m in FY16 to €14.9m in FY17 due to the increase in expenses for purchased services related to crewing activities for which the company booked higher expenses (€5.7m) in FY17. The cost of repairs for two acquired container ships was €1.3m, while costs related to the sale of property in Leipzig were €1.0m. These factors contributed to the increase in the cost of materials and services. The other operating expenses were lower in FY17 vs FY16 due to a reduction in impairment losses and write-downs on receivables, as well as lower legal and advisory costs. Other operating income declined from €35.0m in FY16 to €23.6m in FY17. Net income from investment in associates reversed a loss of €4.0m in FY16 to a profit of €4.0m in FY17, assisted by the positive performance of a real estate investment fund, whose property was sold in FY17. The net effect of increased costs resulted in a lower net income after minority interests of €5.6m in FY17 compared to €6.2m in FY16. The cash balance was reduced in FY17 (€17.8m) vs FY16 (€28.3m) due to the payment of €9.0m for the purchase of a shipping investment in FY17. Net debt increased to €8.4m at end-December 2017 vs net cash of €16.1m in FY16, due to the financing of two container ships.

Exhibit 1: Results highlights

€000s	FY17	FY16	Y-o-y % change
Revenue	44,040	39,955	10.2
Increase/(decline) in unfinished products	15	(119)	N/M
Other operating income	23,578	34,969	(32.6)
Cost of materials and services	(14,923)	(6,126)	143.6
Personnel expenses	(18,777)	(20,578)	(8.8)
D&A and impairment	(12,346)	(7,862)	57.0
Other operating expenses	(16,027)	(20,619)	(22.3)
Net income from investments in associates	4,388	(3,990)	N/M
Income from equity interest	1,556	976	59.4
Income from loans held as financial investments	109	72	51.4
Other interest and similar income	1,720	2,117	(18.8)
Amortisation of financial investments and securities	(3,020)	(7,557)	(60.0)
Interest and similar expenses	(1,039)	(1,064)	(2.3)
Operating earnings	3,900	3,300	18.2
EBT	9,274	10,174	(8.8)
Income taxes	(2,929)	(3,715)	(21.2)
Earnings after tax	6,345	6,459	(1.8)
Other taxes	(108)	(76)	42.1
Net profit (including minorities)	6,237	6,383	(2.3)
Minorities	(679)	(157)	N/M
Net profit (ex-minorities)	5,558	6,226	(10.7)

Source: Ernst Russ accounts

Exhibit 2: Revenue by operating segment

€m	FY17	% of group revenues	FY16	% of group revenues	Y-o-y % change
Shipping	21.3	48.4	19.7	49.3	8.1
Investor management	12.4	28.2	15.2	38.0	(18.4)
Real estate	6.8	15.5	1.4	3.5	385.7
Alternative investments	1.4	3.2	1.4	3.5	0.0
Other services	2.1	4.8	2.3	5.8	(8.7)
Total	44.0	100	40.0	100	10.0

Source: Ernst Russ accounts

Outlook

Industry experts such as Alphaliner and Clarksons expect demand for container ship capacity to grow by 5% in 2018, with supply-side growth at 4.1% y-o-y (Clarksons) or 5.6% (Alphaliner). In the charter market, rates are expected to rise on the back of improved market conditions. According to Clarksons, growth in demand of 2.7% could exceed growth in supply of 1.8% in 2018 for bulker fleet. Moreover, growth in demand for product tankers should be roughly equal to the increase in capacity for 2018 (Clarksons). In the German real estate market, the trend of rising property prices and rentals could continue in 2018 (source: Deutsche Bank Research), and there could be a moderate increase in interest rates during the year. Moreover, management expects rents and property prices in German metropolitan areas such as Berlin, Hamburg and Frankfurt to increase rapidly in 2018, despite new house completions.

ERAG's shipping segment revenues are likely to be higher y-o-y in 2018, accounting for the largest share of total revenues. Real estate segment revenues, primarily driven by fund and asset management income, could increase significantly in 2018, as the company continues its investments in this segment (management expects sales to double on the back of non-recurring effects). With regard to the investor management segment, ERAG cautiously incorporates only contracts that have already been funded in its corporate planning, which could result in a revenue decline in 2018. It also expects further write-downs of receivables in this segment. Alternative investments sales could be higher y-o-y in 2018. Overall, the company projects its total revenues to increase modestly y-o-y in 2018 and believes that its operating income will be flat y-o-y (FY17: €3.9m).

Valuation

We compare ERAG to a broad peer group of listed asset managers in Europe and North America, including private equity, specialist and conventional asset managers. Noting management guidance of flat operating earnings in 2018, we have used the 2017 net earnings figure as a guide for the current year. We note that there could be a significant variance in the ratio of 2018 net income to operating profit vs 2017. ERAG's EPS in 2017 was €0.17, which puts the shares on a P/E of c 7.1x, substantially below the peer group median of c 12.7x and implying potential undervaluation.

ERAG's return on closing equity was c 15% in 2017, somewhat lower than the peer group median, but this seems to be more than reflected in a lower P/BV (based on last reported equity) at c 1.0x.

Exhibit 3: Peer group comparison

	PE (x)		ROE (%)		P/BV	Dividend yield (%)
	2018e	2019e	2018e	2019e	2017	2018e
Private equity (Partners Group, Blackstone, KKR, 3i Group)	10.7	9.4	27%	25%	2.4	2.8%
Specialist (Apollo, Ashmore, Man Group, Patrizia, Lloyd Fonds, MPC, Deutsche Beteiligungs)	13.2	9.8	13%	14%	1.9	4.3%
Conventional (Azimut, Janus Henderson, Jupiter, Schroders)	12.8	11.9	21%	20%	3.0	5.5%
All	12.7	9.8	16%	16%	2.3	4.3%

Source: Company accounts, Bloomberg data as at 24 May 2018

In Exhibit 4 we compare ERAG with close local peers, Lloyd Fonds, MPC and the real estate-focused manager, Patrizia. While the market cap and market cap/AUM seem to be directly related, the market cap/AUM valuation placed on ERAG is considerably lower than Lloyd Fonds, which has a lower market capitalisation and lower revenue/AUM ratio. It may just be an indication that the market is undervaluing ERAG's earnings potential.

Exhibit 4: Market cap/AUM and revenue/AUM comparison with close local peers					
	Market cap (€m)	2017 AUM (€bn)	Market cap/AUM (%)	2017 revenues (€m)	Revenues/AUM (%)
Patrizia	1,706	38.7	4.4	249.6	0.64
Lloyd Fonds	35	1.4*	2.5	9.5*	0.68
MPC	161	5.1	3.2	59.6	1.17
Ernst Russ	39	6.3	0.7	44.0	0.73

Source: Company data. Note: *Revenues and AUM for Lloyd Fonds as of FY16. Market cap as at 24 May 2018.

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.