

## Scherzer & Co

**Asset management**
**13 September 2018**

### Resisting the weaker environment

Scherzer & Co (PZS) was able to offset the impact of subdued equity markets (the MDAX declined 1.3% in H118) through its business of writing options and higher dividend streams. As a result, despite the c 26% share price decline in the case of one of its largest holdings (freenet), the company's NAV (including the dividend at €0.10 per share) rose by 4.7% in H118. However, the ytd return as at end-August was slightly lower at 2.2%. PZS's portfolio of extra compensatory claims (ECS) increased to €102.1m (€119m including Allerthal-Werke and RM Rheiner Management), mainly due to the addition of €8.4m attributable to PZS's stake in Oldenburgische Landesbank.

### Higher dividends and profits from writing options

PZS reported EPS of €0.18, which was 19% higher vs H117. EBIT improved by 17% y-o-y to €5.4m in H118 on the back of an increase in dividend income (€2.0m vs €1.4m in H117), a €1.65m profit on writing options (H117: €0.26m) and lower bonuses to management and employees. In tough market conditions in H118, PZS realised net gains of €4.9m (below the €6.4m in H117), but also had to book higher net unrealised losses at €2.0m in H118 (vs €1.8m in H117).

### NAV performance close to market year to date

Although PZS's NAV performance in H118 (+4.7%) was ahead of both the MDAX (-1.3%) and SDAX (+0.5%), the results weakened somewhat up to end-August. In the first eight months of 2018, PZS's NAV performance reached 2.2% ytd, which is close to the MDAX's total return of 2.7%, but somewhat below the growth posted by SDAX (5.3%) and TecDAX (19.1%). This was due to most of PZS's top 10 holdings recording a share price decline between June and August, including the largest position (GK Software).

### Valuation: Slight premium to 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, its shares are now trading broadly in line with NAV. An additional stock driver is the updated valuation report on AXA, which implies potential income from PZS's AXA shareholding of €18.8m or €0.63 per PZS share. This is further supported by insider purchases (both board members purchased shares worth €271k in April/May 2018). It should 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 (%)
12/16	7.6	4.5	0.15	0.05	18.5	1.8
12/17	18.8	7.9	0.26	0.10	10.7	3.6
12/18e	12.5	6.5	0.19	0.05	14.6	1.8
12/19e	12.9	6.8	0.20	0.05	13.9	1.8

Source: Scherzer & Co accounts, consensus based on two analysts at 10 September 2018.

**Price €2.77**
**Market cap €83m**

#### Share price graph



#### Share details

Code	PZS GY/PZSG
Listing	Deutsche Börse Scale
Shares in issue	29.9m
Last reported net debt at 30 June 2018	€30.3m

#### 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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## Financials: Higher earnings despite weaker markets

PZS was able to record EPS of €0.18 in H118, up 19% y-o-y vs H117, assisted in particular by higher dividend income at €2.0m (compared with €1.4m in H117), profit from writing options at €1.65m (H117: €0.26m) and a decline in personnel expenses to €0.7m (H117: €1.2m) as a result of lower bonuses to management and employees. Income from financial instruments decreased slightly by 4% y-o-y to €7.5m in H118 and included gains from disposals of both current and non-current financial assets of €5.7m (the rest being gains from writing options). This compares with €0.8m of corresponding disposal losses booked in H118 (€0.1m from writing options). However, the company reported net write-downs of financial assets (representing unrealised losses) amounting to €2.0m in H118 (vs €1.8m in H117) as a result of the relatively weak equity markets in the DACH region in the first half of this year and, in particular, as shares of freenet (one of PZS's largest holdings) fell by c 26% up to end-June 2018. Following the decline in personnel expenses and broadly stable other operating expenses, PZS's expense ratio (measured as a percentage of average NAV during the period) declined to 1.3% in H118 (not annualized) vs 2.3% in H117. As net debt rose to €30.3m from €24.0m at end-2017, the net debt to equity ratio also increased to 48% from 40% at the end of last year.

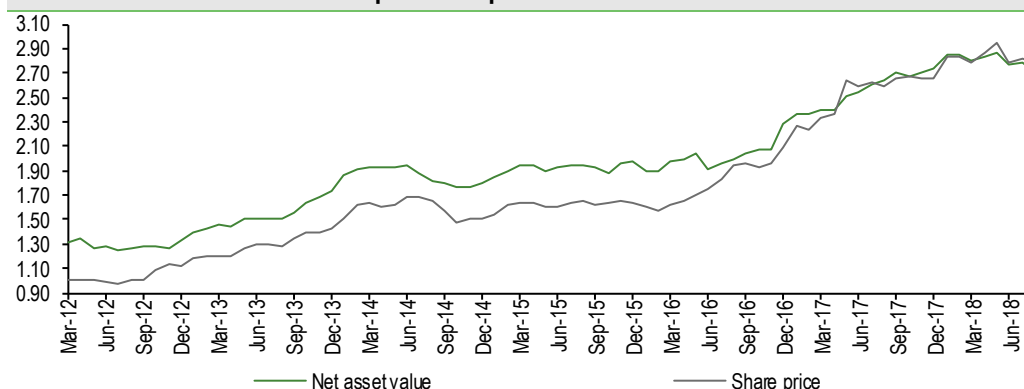
### Exhibit 1: H118 results highlights

€000s, unless otherwise stated	H118	H117	y-o-y
<b>Income from financial instruments</b>	<b>7,500</b>	<b>7,789</b>	<b>-4%</b>
Other operating income	894	865	3%
Expenses related to financial instruments	(959)	(1,159)	-17%
Personnel expenses	(706)	(1,215)	-42%
Other operating expenses	(389)	(432)	-10%
Income from dividends	1,978	1,436	38%
Write-offs on current and non-current financial assets	(2,903)	(2,637)	10%
D&A	(4)	(4)	3%
<b>EBIT</b>	<b>5,413</b>	<b>4,643</b>	<b>17%</b>
Other interest and similar income	49	23	111%
Interest and similar expenses	(150)	(97)	55%
<b>EBT</b>	<b>5,312</b>	<b>4,569</b>	<b>16%</b>
Income and other taxes	(23)	(142)	-84%
Net profit for the period	5,289	4,427	19%
<b>EPS (€)</b>	<b>0.18</b>	<b>0.15</b>	<b>19%</b>

Source: Scherzer & Co accounts, Edison Investment Research

PZS's NAV (including the €0.10 dividend paid) increased moderately by 4.7% in H118 in comparison to end-2017, which was ahead of the German small- and mid-cap spectrum, as the MDAX declined by 1.3% and the SDAX appreciated by 0.5% over the same period (although TecDAX went up by 6.4%). Scherzer's ytd NAV total return performance as at end-August 2018 reached 2.2%, broadly in line with MDAX (+2.67%), but somewhat below the growth posted by SDAX (5.32%) and TecDAX (19.13%). PZS's NAV progression (ex-dividends) is shown in Exhibit 2.

The company was able to record an increase in NAV in the first eight months of 2018 despite the considerable share price declines of two of its top 10 holdings representing around 23% of PZS's portfolio as at end-2017 (GK Software was down c 11% and freenet's shares lost c 26% ytd as at end-August). We estimate that the aggregate negative impact of these two holdings on Scherzer's returns stood at c 3-4pp. GK Software, Scherzer's largest holding, reported an 11% y-o-y increase in turnover in H118, but an EBITDA decline to €2.39m from €5.29m in H117 due to ongoing investments. Still, GK Software's management maintained its FY18 guidance of considerable sales growth and a c 15% EBIT margin in the company's core business. This is backed by a solid business pipeline (according to the company) following the successful entry into the US market. It is also important to note that GK Software's share price decline comes after a very strong performance in 2017 (share price almost doubling). The downward trend in freenet's shares seems to be a result of the fact that FY17 results did not meet the expectations of some analysts, as well as the somewhat disappointing FY18 outlook.

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


Source: Scherzer & Co accounts, Bloomberg

The company's top 10 portfolio holdings are presented in Exhibit 3. Key changes vs end-2017 include the inclusion of BUWOG (a residential real estate developer and investor), which is currently subject to a squeeze-out procedure where the cash compensation was set at €29.05 per share. Secondly, Oldenburgische Landesbank (which made up 5.78% of PZS's portfolio at end-2017) left the portfolio following the squeeze-out completion in June 2018, with Scherzer & Co being entitled to a cash compensation of €8.4m. This was added to PZS's ECS portfolio, which reached €102.1m (or €3.41 per PZS's share) at end-August 2018 (€119m including portfolios of Allerthal-Werke and RM Rheiner Management), compared with €93.3m (€110m) at end-2017.

Another important (positive) portfolio development is the recent resolution of the Higher Regional Court in Munich related to the domination and profit and loss transfer agreement (DPLTA) between Volkswagen Truck & Bus and MAN. The court set the recurring compensation payment at a gross amount of €5.50 per share (from €3.30 earlier) and the cash compensation at €90.29 vs €80.89 per share previously. PZS expects the resulting earnings contribution to reach €0.4m. Volkswagen later terminated the DPLTA and the minority shareholders now have the option to tender their MAN shares in exchange for the cash compensation.

**Exhibit 3: PZS's top 10 holdings list**

Company	% of total (Aug 18)	% of total (Jun 18)	% of total (Dec 17)	Opportunistic/safe
GK Software	12.99%	13.25%	13.72%	Opportunistic
freenet	6.61%	6.19%	9.10%	Opportunistic
BUWOG	6.10%	n/a	n/a	Safe
K+S	5.58%	5.67%	4.00%	Opportunistic
MAN	5.17%	4.24%	2.76%	Safe
Allerthal-Werke	4.76%	4.95%	4.88%	Safe
Innogy	3.99%	3.69%	n/a	Safe
Horus	3.85%	3.83%	4.02%	Opportunistic
Audi	3.60%	3.54%	3.73%	Opportunistic
Mobotix	3.32%	3.28%	2.92%	Opportunistic
<b>Total top-10 holdings</b>	<b>55.97%</b>	<b>55.83%*</b>	<b>54.17%</b>	-

Source: Scherzer & Co, Edison Investment Research. Note: \*Includes holdings not in top 10 as at August 2018.

## Valuation

The most recently reported NAV stands at €2.70 per share as at end-August 2018. In the past, PZS's shares traded at prices below the stated NAV. This appears to be a function of the asset value minus the capitalized management costs, which were c 10% of revenues. As such, the average discount to NAV before 2016 was c 15%. Since the successful ECS transaction in 2015 and subsequent newsflow (eg the AXA valuation case and successful sale of the FIDOR Bank stake), the discount has declined and the stock now trades slightly above the last reported NAV at €2.77. This suggests improved acceptance of potential gains resulting from the ECS portfolio.

There is no visibility of future gains, which may be why PZS has traded well below market averages

in the past five years based on the P/E ratio. However, the discount narrowed slightly and PZS currently trades at a 16% discount to the market on 2018e P/E.

Exhibit 4: Comparable market P/E ratios							
	P/E (x)						
	2012	2013	2014	2015	2016	2017	2018e
DAX	17.3	18.4	16.6	22.0	19.0	14.6	12.8
MDAX	17.9	27.8	20.0	19.2	28.8	17.6	18.0
SDAX	n.m.	54.7	30.9	28.0	23.5	23.4	20.4
<b>Arithmetic average</b>	<b>17.6</b>	<b>33.6</b>	<b>22.5</b>	<b>23.1</b>	<b>23.8</b>	<b>18.5</b>	<b>17.0</b>
PZS	loss	7.2	11.9	9.2	13.6	10.8	14.4
<b>PZS discount</b>	<b>loss</b>	<b>79%</b>	<b>47%</b>	<b>60%</b>	<b>43%</b>	<b>42%</b>	<b>16%</b>

Source: Bloomberg as at 10 September 2018, PZS reports. Note: P/E ratios based on year-end prices.

PZS's valuation is mainly based on asset value, also demonstrated by the price to book (P/BV) value. We have looked at the development of market P/BV ratios over time, and a decline in PZS's discount to market has been apparent since 2015. Importantly, PZS has achieved positive absolute return each year since 2012, demonstrated by the increase in NAV (even after dividend payment).

Exhibit 5: Comparable market P/BV ratios							
	P/BV (x)						
	2012	2013	2014	2015	2016	2017	2018e
DAX	1.5	1.8	1.7	1.7	1.7	1.9	1.5
MDAX	1.8	2.3	2.1	2.3	1.9	2.1	2.0
SDAX	1.3	1.7	1.9	2.0	1.7	1.8	1.6
<b>Arithmetic average</b>	<b>1.5</b>	<b>1.9</b>	<b>1.9</b>	<b>2.0</b>	<b>1.8</b>	<b>1.9</b>	<b>1.7</b>
PZS	0.8	0.8	0.8	0.8	0.9	1.3	1.3
<b>PZS discount</b>	<b>48%</b>	<b>59%</b>	<b>58%</b>	<b>60%</b>	<b>49%</b>	<b>32%</b>	<b>25%</b>

Source: Bloomberg as at 10 September 2018, PZS reports. Note P/BV ratios based on year-end prices

In addition, the NAV progression does not fully reflect the ECS portfolio. On the 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.

However, the AXA case 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 c €18.8m, or €0.63 per PZS share (before taxes and other costs). The €0.63/share gain is equal to a 23% increase in the current NAV.

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