EDISON **Scale research report - Update**

SGT German Private Equity

Financials

16 June 2021

PE fund first close expected shortly

SGT German Private Equity (SGT) reported a €0.7m net loss in FY20 compared to €3.7m loss in FY19 (excluding the deconsolidated Exozet). The company finalised its merger with SGT Capital in January 2021 and expects the first close of the PE fund in the coming weeks with c US$1.0bn in funds and subsequently to start collecting management fees. SGT expects to close several PE transactions on companies with an enterprise value of €200–800m by the end of FY21 and the asset management business should drive its results going forward. Meanwhile, the VC portfolio is gradually being sold off.

FY20 results attributable to VC business

As the merger and fund launch were not closed by the end of 2020, SGT's FY20 results are solely attributable to the VC business and some merger-related costs. The loss per share decreased to €0.05 (FY19: €0.24 excluding Exozet) on the back of a €0.9m profit from the investment business. The results were also supported by interest income from money market instruments (as proceeds from the sale of Exozet were initially allocated to securities). Moreover, over the year, SGT bought back its convertible bonds (€3.0m) and is currently virtually debt free.

SGT expects significant net profit in FY21

In April, SGT announced that it had secured more than US$1.0bn in binding commitments and non-binding declarations for its PE fund. With the launch of the fund, SGT will start collecting management fees on committed capital and estimates a monthly post-tax profit of €750k from the segment (which translates into a c €9.0m profit for a full year of operations). Additionally, SGT intends to continue fund-raising (targeting a fund volume of up to US$3.5bn) and management fees should increase proportionally with the fund's volume growth. Meanwhile, SGT expects the VC segment to deliver post-tax profit in the low single-digit million euros range in FY21 on the back of disposals – year to date, SGT announced the sale of three companies – Anacapa, Animoca and Lingoda (two of which were in the top nine holdings as at end-FY20).

Valuation: Repositioning business model

With the completion of the merger with SGT Capital, SGT's market capitalisation increased to €101.0m from €18.9m at end-FY20. As a result of the transaction, 50m new SGT shares were issued against contribution in kind from SGT Capital. We believe that once the new business model is implemented, the company may be valued based on prospective earnings rather than a discount/premium to NAV.

Historical financials

Year end	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/17	9.6	1.8	0.14	0.0	12.3	N/A
12/18	12.5	1.2	(0.05)	0.0	N/A	N/A
12/19	16.4	3.7	0.20	0.0	8.3	N/A
12/20	0.1	(0.8)	(0.05)	0.0	N/A	N/A

Source: SGT German Private Equity, Refinitiv

Price	€1.66
Market cap	€101m

Share price graph

Share details

Code	SGF
Listing	Deutsche Börse Scale
Shares in issue	60.9m
Last reported net cash as at date	€4.5m

Business description

Frankfurt-based SGT German Private Equity was renamed after the merger with SGT Capital and will become a listed private equity asset manager. The company will manage a PE fund, currently in the fund-raising phase. SGT also manages a VC portfolio of minority stakes in non-listed German companies, predominantly in the technology sector.

Bull

- PE fund's first close expected in the coming weeks.
- Secular growth trend of the PE industry.
- Solid 27.4% IRR achieved by an earlier US$1.2bn fund managed by SGT Capital team.

Bear

- High PE valuations in most sought-after sectors.
- Limited visibility on the asset making up the contribution in kind.
- Free float at only 15% (albeit with a much larger market cap after the merger).

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Financials: Still driven by legacy portfolio

SGT reported a net loss per share of €0.05 in FY20. We note that FY20 results are solely attributable to the legacy VC business, as the fully consolidated Exozet was sold in FY19 (see our update note published in December 2019 for details), and the merger with SGT Capital was closed after the FY20 reporting date. Having said that, the €0.05 loss per share compares to €0.24 loss reported in FY19 (including the results of Exozet, SGT's EPS came in at €0.20 profit in FY19). SGT did not provide any update on the development of the G│S Market.

As at end-FY20, SGT's VC portfolio consisted of minority interests in 20 companies, with a total value of €19.6m (-6% y-o-y). The portfolio is highly concentrated, as the top five holdings (Anacapa, AuctionTech, Mister Spex, Remerge and simplesurance) represented 80% of the portfolio value at end-2020. While the portfolio value decreased over the year, we note that this is in line with SGT's business reorganisation plan to gradually sell down the portfolio. Meanwhile, gains from the investment business (both realised and unrealised) amounted to €0.9m profit compared to a €2.1m loss in FY19 (excluding a €6.2m gain on the disposal of Exozet).

SGT recognizes nine of its positions as key holdings, which represented 93% of portfolio value at end-2020. Five of those were revalued upwards in 2020, and overall positive revaluations across all of SGT's existing holdings amounted to €1.9m in FY20. The negative revaluations amounted to €1.3m, mostly attributable to three full write downs and one being company written off by c 24%. SGT's holdings are valued based on third-party comparable transactions where possible, which applied to five out of the nine key portfolio holdings. The remaining four were valued based on a peer multiple method (blended with a DCF valuation in one case).

SGT's intention is to sell the businesses in the medium term, albeit without any time pressure. It may still consider follow-on investments in some of the holdings. During FY20, SGT sold its holding in Fiagon in September and performed a minor partial exit from Alphapet. Fiagon was acquired by NASDAQ-listed Intersect ENT, which resulted in a €0.4m uplift over the book value. Overall, SGT should receive €2.3m in proceeds over three years and achieve a 2.0x exit multiple, translating into an IRR of 24% per year on this transaction. The investments were scarce – a minor follow-on in AuctionTech and a €25k convertible loan granted to Junique.

Year to date in FY21, SGT announced three disposals: Anacapa, Animoca (former Stryking Entertainment), and Lingoda. Anacapa (including its holding in the Social Fashion Company) was in SGT's top five holdings at end-2020, and Lingoda was one of the key holdings (top nine). Overall, SGT announced that two disposals generated total proceeds in low-single digit million euros, with a disposal gain on both the last book value and acquisition costs.

Other net operating expenses were €2.0m compared to €1.3m in FY19. The main cost was a management fee charged by the general partner, which amounted to €0.8m in FY20 versus €0.7m in FY19. The partner resumed charging a full management fee after 18 July 2020 (which had been temporarily reduced in July 2017), which amounts to 2.5% pa of total standalone assets. SGT also bore the cost of buying back its convertible bonds (described below), which amounted to €0.4m.

The bottom line was supported by financial income (€0.4m), which was driven by interest on the money market instruments temporarily acquired with Exozet's disposal proceeds in late-2019; as well as by €0.1m in tax loss carried forward (FY19: €0.2m).

For 2021, SGT expects profit after tax at least in the low single-digit million euros range for the VC portfolio segment. Here, we note that Mister Spex (one of SGT's current top five VC holdings) is planning an IPO for Q321. In addition, SGT expects significant management fees from the PE fund (described below). Overall, SGT expects significant profit after tax for 2021.

Exhibit 1: Results highlights

€000s, unless otherwise stated	FY20	FY19*	y-o-y
Profits from financial assets valued at fair value with recognition in profit or loss	2,240	5,768	(61%)
Losses from financial assets valued at fair value with recognition in profit or loss	(1,358)	(7,846)	(83%)
Result from investment business	**882**	**(2,078)**	**N/A**
Revenues	131	88	48%
Other operating income	106	21	406%
Personnel expenses	(130)	(84)	55%
D&A	(8)	(8)	(8%)
Other operating expenses	(2,104)	(1,348)	56%
Incidental acquisition costs of investments	-	(9)	N/A
Result from other components	**(2,005)**	**(1,339)**	**50%**
EBIT	**(1,123)**	**(3,417)**	**(67%)**
Financial income	406	26	1478%
Financial expense	(111)	(455)	(76%)
Net financial income	**296**	**(430)**	**N/A**
EBT	**(827)**	**(3,847)**	**(78%)**
Income taxes	91	163	(44%)
Minorities adjustment	-	1	N/A
Net profit (ex-minorities)	**(736)**	**(3,683)**	**(80%)**
EPS, basic (€)	**(0.05)**	**(0.24)**	**(79%)**

Source: SGT accounts. Note: *FY19 figures exclude discontinued operations (Exozet).

SGT ended 2020 with €28.2m in equity capital, which translates into €2.74 per share (down 1.2% year-on-year). We note that with the conclusion of the merger with SGT Capital 50m of new SGT shares were issued after the reporting date and the current share count is 60.9m from 10.3m at end-2020. The net cash position stood at €4.5m at end-FY20 compared to €8.2m at end-FY19, including proceeds from the sale of Exozet. In FY20, SGT bought back its convertible bonds (€3.0m) and performed a share buyback of 514.7k own shares at €2 per share. Following acquisition of the convertible bonds, at end-FY20 SGT was virtually debt free (€2k bonds re-sold).

Ongoing transition to asset manager

SGT continues its business repositioning from asset owner to asset manager. The merger with SGT Capital was completed on 26 January 2021 and the company's largest and fully consolidated company, Exozet, was sold in late FY19. While the new PE fund has not been launched yet, SGT reports good progress in the capital raising process and expects to launch the fund in the coming weeks with a volume of c US$1.0bn. Meanwhile, SGT's VC portfolio is being gradually sold off and SGT does not intend to make new minority stake investments going forward.

After completion of the merger, SGT Capital holds an 82.9% stake in SGT German Private Equity. As described in our earlier note, the merger was completed by issuing SGT German Private Equity shares, which resulted in a significant (82%) dilution of former shareholders. We note that the risk of further dilution is limited, given that the convertible bonds issue initially agreed as part of the merger transaction was subsequently cancelled. Meanwhile, Christoph Gerlinger increased his stake to more than 10% of the company (mostly indirectly through SGT Capital), and currently 15% of the shares are free float.

The main driver of SGT's results, and indirectly its value, is the potentially successful launch of the PE fund, with a targeted volume of US$1.0–3.5bn. SGT expects the first close of the fund in the coming weeks and announced in April 2021 that it had already secured more than two-thirds of the planned US$1.0bn in binding commitments and more than US$350m in additional non-binding declarations. After the first close, the fund will start collecting management fees and will continue to raise further capital. The fund will look for opportunities across different industries to acquire a majority interest in the underlying companies, and the fund will, over a period of 10 years, acquire eight to 10 holdings and hold each for three to five years. SGT expects the first deals with an enterprise value of €200–800m to be closed before the end of 2021. In particular, the fund will focus on investments in sectors such as medical engineering, healthcare, business services and data analytics, as well as advanced industrials. We note that some of these have been the most sought-after sectors during the COVID-19 crisis and thus those characterised by high valuations at present. The launch was initially planned for 2020 but, due to the pandemic and travel restrictions, both the conclusion of the merger and launch of the fund were postponed.

Until the first close of the fund, the PE segment generates a loss after tax of c €250k a month, according to the company. As it starts collecting management fees on launch, SGT expects a monthly profit after tax of €750k based on the initial volume of the fund (c US$1.0bn), which would broadly imply €3.0m profit after tax for the segment in FY21 (assuming SGT starts collecting fees in July) and, consequently, some €9.0m for a full year of operations. This in turn translates into €0.05 per share in FY21 (and €0.15 per share for a full year of operations), and compares to the company's previous year guidance of €0.15–0.20 per share in FY21, which assumed an earlier launch of the fund. The calculations do not include further planned fund-raising. SGT estimates that monthly income after tax should increase by 0.1% of the increase in fund volume. We calculate that this implies an annualised EPS increase of €0.01 with every €51m additional capital raised by the fund. SGT expected profit for this segment at €0.20–0.30 per share in FY22, which we believe assumed further fund-raising.

Valuation

SGT's NAV was €28.2m at end-FY20, or €2.74 per share (based on the share count excluding treasury shares). This translated into a 42% discount based on the year-end share price. We note that after completion of the merger, SGT's market cap increased to the current €101.0m from €18.9m at end-2020.

On successful fund-raising, SGT could, to a certain extent, be compared with other listed private equity asset managers, such as KKR, Blackstone, EQT or Partners Group. These currently trade at FY21e P/E ratios in the range of around 17.7–48.6x (based on Refinitiv consensus), but we should bear in mind that these are much larger, well-established players, which also make investments on their own balance sheets. We calculate that, based on SGT's forecast of the asset management business alone, SGT currently trades at a P/E of c 11.2x based on a full year of operations (and US$1.0bn in fund volumes) with a significant discount to the abovementioned asset managers.

While the successful launch of the PE fund could act as a potential catalyst to SGT's value, we note that the company has a limited track record (although we note that the team behind SGT Capital has previously closed one US$1.2bn PE fund with a solid 27.4% IRR), and the general partner is still entitled to a preferential profit advance of 25% from the amount of earnings exceeding commercial losses. The current majority shareholder of SGT is also the majority shareholder of SGT's general partner.

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