EDISON Scale research report - Update

SGT German Private Equity

Financials

20 October 2020

New name, new business, new shareholder

SGT German Private Equity (SGT, formerly German Startups Group, GSG) reported a minor €0.2m net loss in H120, following the deconsolidation of Exozet in FY19. The company is currently in a merger process with a private equity asset manager SGT Capital. Meanwhile, as at end-June 2020, SGT's main operations covered a portfolio of 22 minority stakes in non-listed entities, which is expected to gradually wind down. Recently SGT announced the disposal of its Fiagon stake at a 2.0x exit multiple.

Rebranding following merger

On 7 August 2020, GSG's AGM approved the merger with SGT Capital as discussed in detail in our previous update note. The company was renamed SGT German Private Equity, its headquarters moved to Frankfurt from Berlin and its Deutsche Börse ticker has changed to SGF from GSJ. The new business model will be focused on managing third-party assets through a private equity fund that is currently raising funds.

Deconsolidation of Exozet

Following the disposal of Exozet in late 2019, SGT deconsolidated its Creative Technologies operating segment. At the same time, SGT did not recognise any management fees from the private equity fund, as these will be generated upon successful completion of the fund-raising and start of the fund's investment period. Meanwhile, financial results in H120 were still driven by SGT's venture capital portfolio, with the result from SGT's investment business flat year-on-year at €0.7m in H120.

Valuation: On the brink of merger

As at 19 October 2020, SGT trades at 36% discount to its end-June 2020 NAV, which is broadly in line with the levels seen in previous years. We believe that once the new business model is implemented, the company may be valued by the market based on prospective earnings rather than through the discount/premium to NAV. We note that the ongoing merger will result in significant dilution of current shareholders (up to 93%), but the NAV may be supported by the contribution in kind from SGT Capital. We understand that for the purpose of the merger the contribution has been valued by an independent firm based exclusively on the prospective fee income of the new fund, which is still in a fund-raising phase. Having said that, the above valuation implies a value of newly issued SGT shares at €2.92 in the base case and €4.04 in the best-case scenario.

Historical financials

Year end	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/16	10.9	(5.4)	(0.29)	0.0	N/A	N/A
12/17	9.6	1.8	0.14	0.0	12.9	N/A
12/18	12.5	1.2	(0.05)	0.0	N/A	N/A
12/19	16.4	3.7	0.26	0.0	6.7	N/A

Source: SGT German Private Equity, Refinitiv

Price	€1.75
Market cap	€19m

Share price graph

Share details

Code	SGF
Listing	Deutsche Börse Scale
Shares in issue	10.9m
Last reported net cash including short-term financial assets at end-H120	€7.3m

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 fundraising phase. SGT also manages a VC portfolio of minority stakes in non-listed German companies, predominantly in the technology sector.

Bull

- Potential success of new business model may result in value creation.
- Secular growth trend of the private equity industry.
- SGT's share value, implied by the compensation for the contribution in kind, is well ahead of the current share price.

Bear

- Level of capital raised for the new fund is uncertain at present.
- Limited visibility on the asset making up the contribution in kind.
- The merger will result in share dilution, up to 93% on successful launch of the PE fund.

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Focus on the investment business in H120

SGT's net loss in H120 amounted to €0.2m vs a €0.2m net profit in H119. H120 is the first financial period after deconsolidation of the majority-owned digital agency Exozet, sold back in December 2019 (which we describe in detail in our June 2020 note), which greatly affected SGT's results. Consequently, SGT became a pure investment company, except for the minor operations of the online matchmaking platform of German Startups Market.

SGT's result from investment business was flat year-on-year at €0.7m due to more limited revaluation gains and losses than in the previous year. Upward revaluations (both realised and unrealised) amounted to €1.0m and were 35% lower year-on-year and similarly SGT's losses on revaluations were 63% lower at €0.3m. Net operating expenses decreased greatly to €0.8m from €7.6m in H119 as they were mostly related to Exozet's operating business. Most notably, personnel expenses amounted to €0.1m in H120 compared to €4.4m in H119. As a result, EBIT amounted to a loss of €0.1m vs the H119 EBIT profit of €1.0m, with EBIT attributable to the investment business in H119 at €0.1m. The slightly higher net operating expenses excluding the Creative Technologies segment are likely related to legal and operational costs of the merger.

As at end-H120, GSG VC (now a subsidiary of SGT) held a portfolio consisting of 22 investments, of which eight are key holdings representing 88% of the portfolio value (of which one was subject to upward revaluation in H120). GSG VC performed two smaller partial exits in H120 from German Crypto Tech and Alphapet, and a full exit of Fiagon post-reporting date (September 2020). Fiagon is a med-tech company in which GSG VC held a 2.5% stake, acquired by Nasdaq-listed Intersect ENT. The uplift on disposal will be recognised in H220 results at €0.4m over the carrying value. Overall, SGT will receive over €2.3m proceeds over three years and should achieve a 2.0x exit multiple, translating into an internal rate of return of 24% pa. SGT also performed a follow-on investment in AuctionTech.

As at end-H120 SGT is virtually debt-free with a net cash position of €0.3m. SGT also holds €7m in short-term financial assets, which consist mostly of receivables from the sale of shares and short-term securities. Including these as near cash items, the net cash position increases to 25% of equity capital.

Exhibit 1: Results highlights

€000s, unless otherwise stated	H120	H119	y-o-y
Profits from financial assets valued at fair value with recognition in profit or loss	953	1,470	-35%
Losses from financial assets valued at fair value with recognition in profit or loss	(299)	(818)	-63%
Result from investment business	**654**	**653**	**0%**
Revenues	59	7,272	-99%
Change in inventories	-	447	N/A
Income from own work capitalised	-	233	N/A
Other operating income	89	168	-47%
Cost of materials and services received	-	(1,670)	N/A
Personnel expenses	(58)	(4,372)	-99%
D&A	(4)	(491)	-99%
Other operating expenses	(807)	(1,244)	-35%
Incidental acquisition costs of investments	(12)	(10)	20%
Result from other components	**(733)**	**333**	**N/A**
EBIT	**(79)**	**985**	**N/A**
o/w Investments	**(79)**	**59**	**N/A**
o/w Creative Technologies	**-**	**926**	**N/A**
Financial income	317	15	N/A
Financial expense	(518)	(281)	84%
Net financial income	**(201)**	**(266)**	**-24%**
EBT	**(280)**	**719**	**N/A**
Income taxes	113	(274)	N/A
Minorities adjustment	-	(260)	N/A
Net profit (ex-minorities)	**(167)**	**184**	**N/A**
EPS, basic (€)	**(0.02)**	**0.02**	**N/A**

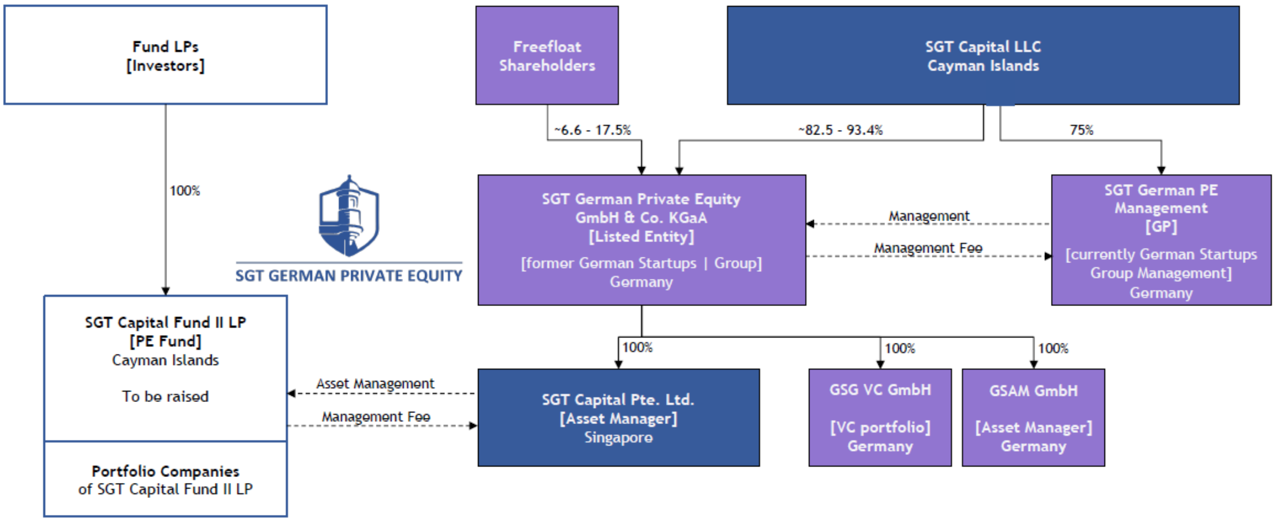
Source: SGT accounts

Merger to create a listed PE asset manager in progress

As described in detail in our report in July 2020, SGT (previously GSG) will merge with private equity asset manager SGT Capital Pte Ltd, which serves SGT Capital as a backdoor listing. SGT Capital LLC, the parent company of SGT Capital Pte Ltd, will become a majority shareholder of the listed SGT. Depending on the final terms of the convertible bond conversion, SGT Capital LLC's stake in SGT may be up to 93.4%. The new entity will maintain the legal form of a partnership limited by shares (KGaA), still managed by German Startups Group Management (to be renamed SGT German PE Management); see full organisational chart in Exhibit 2. The general partner was fully owned by GSG's CEO Christoph Gerlinger, who will retain a 25% holding in the entity and will remain managing director of the renamed entity. The general partner is entitled to a profit advance of 25% from the amount of earnings exceeding commercial losses, which would amount to €0.9m if all the assets were sold at end-H120 balance sheet value. This translates to €0.08 per share and compares to €0.09 per share at end-FY19. Having said that, the general partner has recently waived its right to receive this fee.

SGT maintains its VC operations under the new entity, with its portfolio of minority stakes in German start-ups and its secondary shares trading platform G|S Market managed by GSG VC. The entity remains fully owned by SGT. The acquired SGT Capital Pte Ltd will manage the SGT Capital Fund II (a private equity fund with a primary focus on Europe and North America), which is currently in the process of raising capital with the target volume of US$1.0–3.5bn. SGT announced back in July 2020 it had US$411m commitments already secured prior to merger. As the merger was not finalised yet, and operations of GSAM are still marginal, SGT financial results were almost solely attributable to GSG VC (as discussed above).

Exhibit 2: Organisational and ownership structure of newly formed SGT German Private Equity



Source: SGT

Valuation

SGT's NAV was €29.8m at end-H120, or €2.75 per share (based on share count excluding treasury shares, according to our estimate). This translates to a 36% discount based on the current share price of €1.75. On 13 October 2020 SGT completed a share buyback covering 542,700 shares at a price of €2.0 per share. The discount has recently remained at a similar levels to prior years despite the significant organisational changes.

In this context, we note that the merger will result in considerable dilution of the existing shareholders. GSG acquires SGT Capital Pte Ltd against the issuance of 50m new GSG shares, compared to the currently outstanding 10.9m. Additionally, the convertible bond issue will result in issuance of further up to 103m shares, which means current shareholders will be diluted up to 93%. We acknowledge that the merged entity will be significantly larger than GSG itself, which may offset the dilutive impact of the GSG share issue. Moreover, the independent valuation prepared by Ebner Stolz for the purpose of the merger implies a value per newly issued GSG share of the new entity at €2.92 and €4.04 in the base case and best case scenarios, respectively (significantly above the current NAV and share price). However, there is still limited visibility on the potential success of the new strategy, given that the fund-raising process of SGT Capital Fund II is still in progress.

Upon successful fund-raising, SGT could be, to some extent, comparable with other listed private equity asset managers, such as KKR, Blackstone, EQT or Partners Group (bearing in mind that these are much larger, well-established players). These currently trade at next 12 months P/E ratios in the range of around 19.2–38.0x (based on Refinitiv consensus), which may however be distorted by the impact of COVID-19.

We also note that, as described in the financial section, within SGT's organisational structure, the general partner is still entitled to a preferential profit advance. The current majority shareholder of SGT is also the majority shareholder of SGT's general partner.

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