EDISON **Scale research report - Update**

Lloyd Fonds

Fund management

9 April 2020

On to the next chapter

Lloyd Fonds (LF) continues its operational realignment process with Strategy 2023/2025 kicking off in FY20 – this should help complete its transformation to an active asset manager in the medium term. In 2019 (under the previous plan), LF laid the foundation for its three-pillar structure through acquisitions of Lange Assets & Consulting and SPSW Capital, as well as through the development and implementation of an algorithm, which enables the use of artificial intelligence in the investment process. Digitalisation of business operations (including its Digital Asset Platform) could help LF mitigate the impact of the coronavirus outbreak and allow it to approach the targeted €7bn AUM.

FY19 financials: One-off transformation costs

In FY19 LF reported a 3.9% y-o-y improvement in revenues, which was fully offset by increases across almost all types of operating expenditure, resulting in an EBIT loss of c €11m versus a loss of €1.8m in FY18. The company's bottom line, however, has been shaped by the financial income from investment disposals from its legacy portfolio and the positive effects of tax losses carried forward, which helped meet the management guidance of breakeven at the net profit level. In FY20 LF will continue bearing significant one-off transformation costs and plans to offset them with the positive deferred tax impact.

Profitable legacy business

LF intends to position itself as an investment and active asset manager, but due to the early stage of transformation, its business is still driven by legacy assets. On the back of positive development in the broader market, each of LF's segments reported positive earnings, which helped it cover the significant expenditures related to developing new products. It is worth noting, however, that most of the legacy assets are invested in segments that could be severely affected by the coronavirus outbreak, including shipping and aviation.

Valuation: Diminishing premium to peers

With the majority of the company's revenue still coming from real assets, we show LF's relative valuation against the peer group formed by local asset managers active in real estate and shipping sectors. Thanks to its superior earnings growth potential resulting from new business developments, LF's consensus-derived P/E premium of 4% in FY21 turns into a 23% discount based on the FY22 multiple.

Consensus estimates

Year end	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/18	7.9	(1.0)	(0.16)	0.00	N/A	N/A
12/19	8.2	(5.1)	(0.01)	0.00	N/A	N/A
12/20e	28.1	(3.4)	0.12	0.00	25.9	N/A
12/21e	36.8	2.8	0.26	0.00	11.5	N/A

Source: Refinitiv. Note: Consensus is based on the estimates of two analysts (SMC Research and Warburg Research).

Price	**€2.98**
Market cap	**€40m**

Share price graph

Share details

Code	L10A
Listing	Deutsche Börse Scale
Shares in issue	13.3m
Last reported net debt at 31 December 2019	€5.6m

Business description

Lloyd Fonds has positioned itself as an integrated asset manager and partner for private customers and institutional capital. It aims to provide added value through transparent, active asset management, forward-looking digital solutions with the secondary brand LAIC, as well as individual and institutional asset management. It has over 20 years' experience as an investor in a range of alternative real assets.

Bull

- Broad product portfolio serves all types of customers.
- Management with extensive experience and broad customer network.
- Ambitious targeted AUM growth.

Bear

- Execution risk in business repositioning.
- Markets for legacy activities remain volatile.
- Regulatory risks.

Analyst

Milosz Papst +44 (0)20 3077 5700

financials@edisongroup.com
Edison profile page

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Financials: Significant non-operating income

While LF is committed to repositioning itself as an active asset manager, for now its top line remains predominantly driven by the legacy business. In FY19, the company recorded a c 3.9% y-o-y increase in revenues to €8.2m, with funds and asset management fees down to €5.1m from €5.6m in FY18 and transaction fees up from €2.2m to €3.1m, indicating increased realisations from the real assets funds. The drop in management fees could have been more significant, but new funds (set up under Strategy 2019+) were launched for seed investors in April 2019 and offered to the public starting from the end of May, substantially affecting the end of year revenue figures. Consequently, the other assets segment's sales, which include management fees from the new funds, improved from €1.4m in FY18 to €1.9m in FY19.

While the strategic realignment has not yet been fully reflected in revenues, the company incurred considerable expenses to drive the change. Personnel costs doubled compared to 2018 due to average headcount increasing from 32 in 2018 to 54 in the last reporting period (excluding SPSW), while other operating costs increased by 34.7% y-o-y to €11.2m. The lion's share of this growth is attributable to one-off costs related to accounting, legal and advisory services, which increased from €2.5m in 2018 to €4.1m. The other key opex growth contributor was the €1.8m rise in IT and communication expenses related to the implementation of digital solutions, which is the cornerstone of the new strategy. Consequently, Lloyd Fonds reported an operating loss of €10.9m in 2019 against a €1.8m loss in 2018.

The gradual selling down of the legacy portfolio, apart from generating transaction fees, also translates (through profit-sharing agreements) into significant financial income, which in FY19 stood at €7.2m (€1.1m in FY18). It was largely attributable to successful disposals of a real estate portfolio in Köln, an office building in central Eindhoven and two hotels in Hamburg and Sylt. Together with positive effects of the tax loss carried forward, this almost completely offset the negative operating result, bringing the net loss for FY19 to just €93k compared to €1.5m in FY18. This is broadly in line with management guidance of reaching breakeven in FY19.

Exhibit 1: Financial highlights

€000s	FY19	FY18	y-o-y
Revenues	8,223	7,918	3.9%
Real estate	*3,343*	*2,989*	11.8%
Shipping	*3,024*	*3,540*	-14.6%
Other assets	*1,856*	*1,389*	33.6%
Cost of materials	(426)	(523)	-18.5%
Personnel costs	(8,732)	(4,346)	100.9%
D&A	(1,258)	(112)	NM
Other operating result	(9,603)	(5,247)	83.0%
Result from associates	858	528	62.5%
Operating earnings (EBIT)	(10,938)	(1,782)	NM
Financial income	7,179	1,101	NM
Financial costs	(1,315)	(305)	NM
Pre-tax profit	(5,074)	(986)	NM
Income tax	4,981	(548)	NM
Net profit	(93)	(1,534)	-93.9%

Source: Lloyd Fonds

As the overall impact of the coronavirus outbreak is still unknown, the company has not provided any quantifiable guidance for its FY20 results. However, as the transformation proceeds, LF expects to still bear significant one-off costs, which would be at least partially offset by the positive effects of the tax loss carried forward. As for the revenue stream, the focus that was put on the digitalisation of the business may be useful in the current environment, where online accessibility is gaining importance.

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Strategy 2023/2025: Next stage of transformation

The end of FY19 marks the successful conclusion of the company's Strategy 2019+, which helped LF partly reposition itself as an independent, active and listed fund and asset manager. The process was highlighted by the acquisitions of Lange Assets & Consulting and SPSW Capital (both concluded in Q419), which added a significant volume of managed assets, speeding up the portfolio-building process (more details in our previous update note). At end-December 2019, the acquired assets amounted to €785m in the open-ended investment fund segment (LF-Linie) and €186m in the asset management area (LF-Vermögen). Meanwhile, four new LF funds that were opened in April and December 2019 have raised €75m, which was enough to reach the €1bn overall AUM threshold in the first year of operating under the new business model. In the short term, LF plans to unify the names of all managed funds, as those acquired with the SPSW and Lange stake still hold their original titles.

The key element of the transformation process was business digitalisation, which is a cornerstone of the LF-System segment, focused on managing clients' portfolios through extensive utilisation of artificial intelligence. The algorithm responsible for optimal investment structuring has already been internally developed and successfully implemented. Depending on the level of risk acceptance of the respective clients, the algorithm designs a unique mix of instruments, selected from c 10k actively managed open-ended investment funds and c 400 ETFs, to maximise profits. The portfolios are then actively managed and adjusted to benefit from market opportunities, taking into account all the necessary transaction costs. Importantly, the strategy is largely focused on actively managed funds, with ETFs used only for cost optimisation. This part of business is operated by a new entity, LAIC Vermögensverwaltung, which obtained the necessary BaFin approvals in March 2020. LAIC's offer is aimed at wealthy private customers. The product range is to be expanded this year as LF plans to offer a pension product using the algorithm (thus addressing a broad target group) along with five digitally controlled LAIC mixed funds. Their composition cannot be compared with traditional mixed funds in the market due to different weights used in the LAIC investment universe with respect to, for example, regions and risk classes. We note that, according to Statista, digitally managed assets in Europe are expected to grow from €26.6bn in 2019 to €108.3bn in 2023.

The next stage (Strategy 2023/2025) symbolically started on 1 January 2020 with the appointment of Achim Plate, who served as a managing director of the recently acquired SPSW, the new CEO of the company. Its main objective is to transform LF further into an innovative asset manager for both retail and commercial clients, leading the market in terms of quality and innovation. It is worth noting LF's prospective emphasis on sustainability, as illustrated by its Green Dividend World fund launched in cooperation with WWF Deutschland.

The coronavirus outbreak led to a reassessment of the AUM expansion plan. The previous long-term goal of increasing the AUM volume to €7bn will be maintained, but at this stage the company expects to reach it by the end of 2024. This goal is to be achieved through organic growth and acquisitions in the area of individual asset management. Until the new business model is fully implemented and profitable, the company intends to also finance its development with the profits from the legacy portfolio of closed-end funds. In FY19, the company completed a €6.1m convertible bonds issue and a share issue with gross proceeds at €8.04m.

Several realisations in the real estate segment

The **real estate** segment benefitted from robust transaction market in Germany, which reached €91.3bn in 2019 (€79bn in 2018) across all property classes, with €34bn reported in Q419, according to JLL. The largest share was attributable to the office and residential sectors, sitting at 40% and 24% respectively. In FY19 LF concluded four disposals from its portfolio, including office building in central Eindhoven and two hotels in Hamburg and Sylt divested during the first six months of the year and a portfolio of office and education properties in Köln sold in H219. These transactions resulted in c €95.7m distributed to the clients throughout the whole portfolio and almost €7.0m financial income from investment for the company. Overall, the net income of the segment reached €6.5m, against €2.5m recorded in 2018. At end-December 2019, LF managed four funds in the segment, with c 35.5k sqm rental area spread across the office (70%) and hotel (30%) sectors, fully let to 13 tenants. Post the reporting date (March 2020), the company sold an office building in the Netherlands, yielding a 127% return to the fund investors (and itself benefiting through a profit-sharing agreement).

Shipping segment assets remained broadly stable during the year with 19 vessels, fully owned by clients, including 12 container ships (up to 8.5k TEU) and seven tankers (eight at end-December 2018). The company also manages three funds that hold shares in second-hand ships, which include 40 container ships, 22 tankers and one bulker (down two container ships and two tankers compared to 31 December 2018). However, the segment's revenue saw a 14.6% y-o-y decline while net earnings dropped by 65% to €0.9m, which was largely due to positive one-off effects in FY18. This segment (in particular related to container ships) seems particularly susceptible to the coronavirus outbreak, which will probably shape its profitability in the near term. That said, the recent increase in demand for oil storage on the back of the lower oil prices coupled with the increased VLCC chartering from Saudi Arabia have resulted in higher tanker rates and could therefore lend some indirect support to LF as well.

Within the **other assets** segment, at end-December 2019 LF managed three airplane funds, following disposal of one of the long-distance aircrafts in October 2019, one private equity fund and eight British life insurance funds. While first two sectors operated in a supportive market environment, as aviation market grew by 4.6% in 2019 and the Private Equity market approached a record high annual transaction volume, reaching €260bn on c 2500 trades, the British life insurance business suffered from all the uncertainties related to Brexit.

Valuation

With only the initial stage of the transformation into an active asset manager complete and the legacy business still contributing the majority of the LF's revenue, we have decided not to change the peer group composition and still compare LF to a group of real asset investment companies. We consider this approach justified as long as LF does not accelerate the exit process from the legacy portfolio, which may still have a significant impact on the company's earnings in the short and medium term. However, we acknowledge that LF's valuation may already capture its business repositioning to some extent, although we have not been able to identify any relevant local peers that represent a good reference point in this respect. The closest potential listed peer is PEH Wertpapier, but there are no consensus forecasts available for the company. Other comparable businesses, such as DJE Kapital, Flossbach or Scalable Capital, are not listed.

Exhibit 2: Peer group comparison

	Market cap	P/E (x)			EV/EBITDA (x)		
	(€m)	2020e	2021e	2022e	2020e	2021e	2022e
MPC Capital	39	4.7	10.7	8.4	NM	11.7	4.8
Corestate Capital	572	4.0	3.8	3.5	5.8	5.5	5.1
Patrizia	1,991	22.7	21.8	22.7	13.0	12.7	12.8
VIB Vermogen	657	10.4	9.3	NM	15.6	14.4	NM
TLG Immobilien	1,768	10.2	9.6	9.7	20.7	19.8	NM
Peer average		10.4	11.1	11.1	13.7	12.8	7.6
Lloyd Fonds	40	25.9	11.5	8.5	NM	5.1	4.8
Premium/(discount) to peers		149%	4%	(23%)	NM	(60%)	(37%)

Source: Refinitiv. Note: Consensus is based on the estimates of two analysts (SMC Research and Warburg Research). Priced at 8 April 2020.

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Australia

New Zealand

United Kingdom

United States

Frankfurt +49 (0)69 78 8076 960
Schumannstrasse 34b

London +44 (0)20 3077 5700
280 High Holborn

New York +1 646 653 7026
1,185 Avenue of the Americas

Sydney +61 (0)2 8249 8342
Level 4, Office 1205

60325 Frankfurt
Germany

London, WC1V 7EE
United Kingdom

3rd Floor, New York, NY 10036
United States of America

95 Pitt Street, Sydney
NSW 2000, Australia