

mutares AG

European restructuring expertise

mutares AG specialises in the acquisition and restructuring of unlisted companies in Europe and currently holds 13 investments. Shareholder value is created over time as profitable exits boost NAV and enable the company to pay special dividends. A successful realisation has already been achieved at the start of the year and the company intends to complete a further one or two exits this year. mutares's shares have delivered a compound annual total return of 34% since listing in 2008. Trading at a 30% discount to NAV, investors may find the stock an attractive opportunity.

Scaling up the opportunity

mutares is increasingly focused on its 'buy and build' strategy to create value in its investments beyond the turnaround phase which should result in bigger gains over time. Its target is to achieve revenues of €1.8bn by 2018 (€648m in 2016) and complete five transactions a year, supported by a strong balance sheet with over €60m cash.

Potential for higher dividends in 2017

The company posted a €5.3m earnings loss for 2016 but earnings in any single year are not a strong indicator of long-term value. Shareholder value is created over time through profitable exits which also enable the company to pay special dividends. Since the start of the year, mutares has already completed three transactions. These include the partial exit of EUPEC for €19.5m (potentially €32m including earn outs) which raises the potential for higher dividends in 2017 as the company has a policy to pay out up to 80% of exit profits. If the gain on EUPEC is €10m, this could support a dividend of over €0.50 per share, representing a yield of 3.6%. Meanwhile, the company intends to divest of one or two more this year which could raise the dividend potential further.

Supportive valuation

mutares is trading at a significant discount to NAV of 30%. Should the company continue to make further successful exits, the discount has considerable scope to narrow. mutares will also start to publish its NAV quarterly which will give investors greater transparency. The prospect of an attractive dividend yield should also support its valuation.

Historic financial data summary

Year end	Revenue (€m)	EBITDA (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/13	347.0	5.9	(0.67)	1.67	N/A	11.9
12/14	648.1	30.9	0.61	0.78	22.9	5.6
12/15	683.8	39.9	0.51	0.60	27.5	4.3
12/16	647.8	20.7	(0.35)	0.35	N/A	2.5

Source: Bloomberg

Financials

10 May 2017

Price **€14.00**
Market cap **€216m**

Share price graph



Share details

Code MUX
Listing Deutsche Börse Scale
Shares in issue 15.4m
Last reported net cash as at 31 December 2016 63.6m

Business description

Founded and listed in 2008, mutares AG acquires special situation companies that are under performing and can be turned around through financial and operational restructuring. It currently owns 13 companies across five focus industries.

Bull

- Exposure to a diversified portfolio of potentially high growth, recovery companies actively managed by experienced industry professionals
- Prospect of higher dividends following exits
- Attractive 30% discount to NAV

Bear

- Low trading liquidity
- Turnaround investments are inherently risky
- Outstanding litigation

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European restructuring specialist

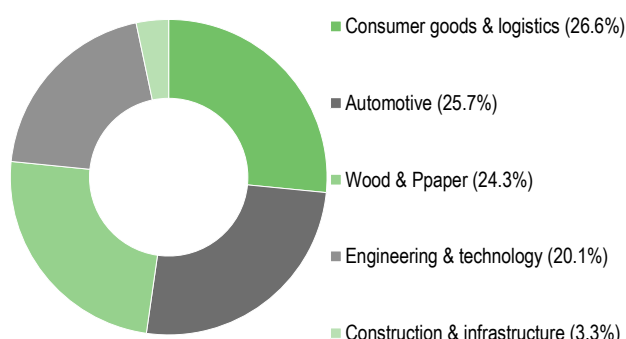
Founded and listed in 2008, mutares AG is a special situations investor which acquires and turns around unlisted companies that are financially or operationally weak, or challenged by succession issues. Its focus and expertise lie in five industry segments: automotive; consumer goods & logistics; wood & paper; construction & infrastructure; and engineering & technology. Currently, it has 13 portfolio companies and over 3,000 employees. Headquartered in Munich, mutares also has an office in Paris.

By revenues, the company is well diversified across its five industry segments though in NAV terms, the automotive segment is the most important at 34%. Geographically, mutares's exposure is Europe dominant, accounting for 94% of revenues (Exhibits 1 to 3).

The company believes its advantage is its operational and industry expertise. It directly employs 50 highly experienced staff, of which 20 are dedicated M&A specialists and 40 have operational expertise across the group's five sectors. This structure allows mutares to grow by both turning underperforming companies around as well as through acquisitions. It targets to complete five transactions per annum and to achieve revenues of €1.8bn by 2018 (€648m in 2016).

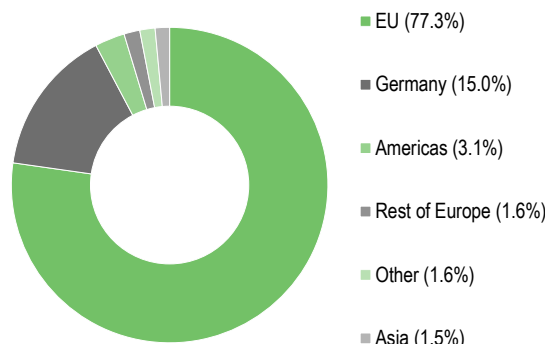
Investing in turnaround companies is inherently risky, therefore portfolio companies are held in separate limited liability legal entities and mutares AG is, in effect, a holding company. This helps mitigate risk of single company failures and losses are largely contained to the value of the individual investment. mutares's dividend policy is to pay a base dividend (and has done so in loss making years) and to pay special dividends of up to 80% of the net profits from exits.

Exhibit 1: Revenues by segment, December 2016



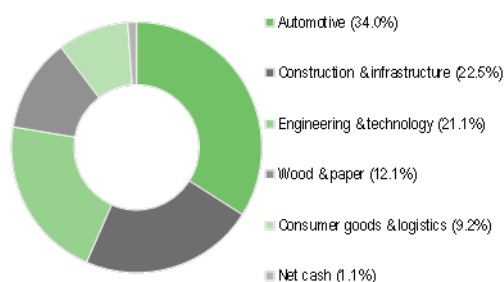
Source: mutares AG, Edison Investment Research

Exhibit 2: Revenues by geography, December 2016



Source: mutares AG, Edison Investment Research

Exhibit 3: NAV by segment, December 2016



Source: mutares AG, Edison Investment Research

Strategy

mutares's business model is to acquire companies in turnaround situations. It looks for particular characteristics in its potential investments:

- Spin-offs from larger corporates where the company is no longer regarded as a core business and the parent does not have the appetite or expertise to do its own restructuring.
- Business activity focused in Europe as this is the region of mutares's expertise.
- Companies with a strong balance sheet (able to fund its own restructuring).
- Companies with a proven business model, an established brand and customer base. Targets are likely mid-sized companies with revenues of between €50-500m.
- Companies in financially or operationally difficult positions (eg short-term liquidity problems) or with leadership succession issues.

These turnaround investments are referred to by the company as 'platform' investments to which it may also make 'add on' investments as part of its build strategy to extract synergy and value. As at the end of December 2016, mutares's portfolio consisted of 14 platform investments (Exhibit 4).

Exhibit 4: mutares's portfolio of platform investments

Automotive	Construction & Infrastructure	Wood & Paper	Engineering & Technology	Consumer Goods & Logistics
 Acquired in 2009 from Diehl Group Automotive supplier for grommets	 Acquired in 2012 from Korindo Group Provider of coatings for oil and gas pipelines	 Acquired in 2015 from Metsä Group Manufacturer of premium paper	 Acquired in 2010 from Römheld Group Manufacturer of rotary tables	 Acquired in 2011 from Huber Group Producer of metal packaging solutions
 Acquired in 2013 from autoneum Group Automotive supplier for insulations	 Acquired in 2015 from Genoyer Group Producer of pipes for the oil and gas industry	 Acquired in 2015 from Metsä Group Manufacturer of wood products	 Acquired in 2012 from Platinum Equity Manufacturer of refuse collecting vehicles	 Acquired in 2012 from ARC Group Distributor for tableware and kitchenware
		 Acquired in 2016 from Sonoco Group Manufacturer of cardboard products	 Acquired in 2014 from Oystar Group Manufacturer of packaging machines	 Acquired in 2015 from Auchan Group E-commerce retailer for consumer electronics
			 Acquired in 2016 from SPX Group Manufacturer of energy efficiency components	

Source: mutares AG

mutares is an active investor and works in close collaboration with incumbent managements to form restructuring plans and provide operational and financial resources, drawing on its pool of professionals. Once a company has returned to sustainable profitability, normally expected within 18-24 months, it can be considered for exit. In some cases, mutares may judge there is scope to create more value through further strategic development and making add-on acquisitions.

This 'buy and build' approach to its investments has become more commonplace as its reputation has grown in post-merger integration and longer-term strategic development. In some industries, automotive parts in particular, mutares is seen as a consolidator which in turn has attracted acquisition candidates.

The STS Group is an example of mutares's 'buy and build' strategy. In 2013, mutares acquired loss-making auto parts supplier STS and turned around its profitability. Instead of looking for an exit, mutares identified two strategic companies in synergistic areas and acquired the plant assets of Mecaplast Group and has nearly completed its acquisition of the trucks supply businesses of Plastic Omnium. Combined, the STS Group has become the largest European truck cabin

components manufacturer with a turnover of around €400m and 15 production facilities on three continents. It is likely to look for more add-on acquisitions to further establish STS Group's position as a leading global supplier. mutares is of the view that this will enhance value meaningfully ahead of choosing a nearer-term exit.

Recent newsflow and upcoming catalysts

In 2016, the company has completed five (nearly six) transactions. Two of which (as discussed above) were add-on acquisitions for STS Group. Two further add-on acquisitions were made in the consumer segment for homeware distributor, Artmadis which should help grow its revenues to around €100m (from €76m in 2016).

Two platform investments were also made. Balcke-Durr, a manufacturer of energy efficient components with a turnover of €142m was added to the engineering and technology segment; and Cenpa, a manufacturer of cardboard products with turnover of €32m was added to the wood and paper segment.

Since the beginning of 2017, the level of M&A activity has kept pace with a further three transactions already completed.

In February, it announced a partial sale of EUPEC consisting of its German manufacturing facility for €19.5m to Wasco Group of Malaysia (mutares retains the operating business of EUPEC). Through earn-out payments until 2019, the proceeds could increase by another €12.5m, bringing the total consideration to €32m. This sale is highly profitable for mutares as the asset was acquired for a nominal sum and, given the holding structure of the asset, a very low tax rate applies. Thus most of the proceeds should flow directly into the company as cash. Earlier this month, mutares completed the add-on acquisition of Aperam's stainless steel welded tubes business in France. This generated revenues of €64m in 2016 and complements portfolio company, BSL a French manufacturer of pipes and fittings for the oil and gas industry.

Potential catalysts

Within mutares's portfolio, there is good restructuring progress being made and several companies could be considered for exit. Subject to market conditions, further company disposals could take place this year and next. Potential candidates include:

- A+F Packaging Solutions (acquired December 2014)
- Elastomer Solutions (acquired August 2009)
- STS Group (acquired July 2013)

Although STS Group has been successfully turned around, an exit is unlikely this year as management sees significant value to be created from its strategy to establish the company as a leading global player in truck cabin parts.

Overall, it would appear that there is value to be unlocked in the mutares portfolio which is not reflected in the 2016 NAV.

Successful exits are likely to result in higher dividends given mutares's dividend policy is to pay up to 80% of exit profits to shareholders. Although management may choose to retain a larger proportion for reinvestment, the EUPEC disposal gives scope for an increased dividend payout in 2017 which could be further supported by additional exits during the year.

Market overview

In 2016, economic growth continued to recover in the euro area, the critical region for mutares' business activities, with Germany continuing to be the anchor of economic stability in the region. The ifo Institute forecasts 1.6% GDP growth in the euro area in 2017 (1.7% in 2016) and for unemployment to moderate slightly to 9.7% (10.1% in 2016).

The company observes the environment for acquiring unprofitable companies to continue to be favourable, especially in France and Italy where its expertise in workforce restructuring is attractive to business sellers (and as a result mutares opened an office in Paris in 2016 and will open an office in Milan later this year). Meanwhile, a continued economic recovery, especially in consumption, is supportive for its ongoing restructurings.

Sentiment for the German private equity sector remains optimistic. BVK's (German Private Equity and Venture Capital Association) recent 'Private Equity Forecast 2017' report finds 48% of equity investment companies expect an increase in acquisition activity and 19% anticipate an increase in divestments.

Management, organisation and corporate governance

German corporate law requires public companies to have two boards: a management board and a supervisory board. The board of management is executive and responsible for the management of the company. The supervisory board is made of non-executives whose role is to oversee the board of management and appoint its members.

The executive board is currently made up of five members, including the co-founders Robin Laik and Dr Axel Geuer. Each board member holds a senior management role and has a designated industry segment focus as follows:

- Robin Laik, CEO and founder, manages the M&A business. He has held several senior finance positions within ESCADA AG, including head of M&A of the group. He was CEO of an automotive supplier for plastic components where he first met Dr Axel Geuer. His focus areas are retail, furniture, medical engineering and electronics.
- Dr. Axel Geuer, CEO and founder has a background in mechanical engineering before becoming a consultant at Bain & Co. His focus areas are mechanical and plant engineering, automotive, information technology and telecommunications.
- Dr. Wolf Cornelius has been COO since the beginning of mutares and supervises the operations and restructuring of portfolio companies. His areas of focus are mechanical and plant engineering, chemicals industry, food and groceries.
- Dr. Kristian Schleede, CRO, joined mutares in 2010 and also supervises the operations and restructuring of portfolio companies. He is a mechanical engineer and an accountant and was a consultant at McKinsey & Company. His areas of focus are machinery and plant engineering, logistics, facility management, automotive and aerospace and electronics.
- Mark Friedrich, CFO, is responsible for finance and administration. Previously an auditor at Ernst & Young, he joined mutares in 2012 and became CFO in April 2015.

Shareholders and free float

Founders Robin Laik and Dr Axel Geuer are the largest shareholders in mutares, with each owning 27% of the company (as shown in Exhibit 5). The free float was increased in October 2015 to 46% following the placement of founders' shares. Management has expressed reluctance to reduce its stake any further given adequate capital resources, the desire to retain control of the company and their belief that the shares are deeply undervalued.

Exhibit 5: Principal shareholders

Name	Ownership (%)
Dr. Axel Geuer	27
Robin Laik	27
Free float*	46
Allianz Global Investors	5.29
Fidelity Management & Research	4.82
M&G Securities	1.62
Evermore Global Advisors	1.40
Baring Fund Managers	0.97

Source: Bloomberg. Note: *Main shareholders in free float are shown below.

Financials

Income statement

HGB accounting standards values investments at the lower of cost or mark to market accounting; accordingly, reported income is conservative.

The company recently reported 2016 revenues of €647.8m (€683.8m in 2015) and a net earnings loss of €5.3m (€6.8m in 2015). Part of the decline in revenues is due to changes in and timings of consolidations and deconsolidations. Adjusting for these, revenues unaffected by these consolidation changes fell 11%. Making the same adjustments for net income shows a loss of €19m (Exhibits 6 and 7).

The company attributes much of the weaker performance to EUPEC. A provider of coatings for oil and gas pipelines, it suffered from exceptionally weak conditions in the oil and gas industry during the year with projects being postponed or cancelled. That resulted in an extraordinary decline in revenues and the company turned loss making. An extensive restructuring plan has since been initiated, involving capacity and cost adjustments. Alongside a gradual improvement in demand, mutares expects its revenues to start to recover in the current year.

Exhibit 6: Revenues adjusted for changes in consolidation

Revenue (€m)	2015	2016	% change
Group	684	648	-5
New consolidations	0	24	
Prior year new consolidations	104	235	
Deconsolidations	142	0	
Adjusted revenues	437	389	-11

Source: mutares AG, Edison Investment Research

Exhibit 7: Attributable profits adjusted for changes in consolidation

Net attributable (€m)	2015	2016
Group	8	-5
New consolidations	0	0
Prior year new consolidations	0	13
Deconsolidations	4	0
Adj attributable profits	4	-19

Source: mutares AG, Edison Investment Research. Note: Figures subject to rounding.

Balance sheet and cash flow

Total assets of the company grew to €473m (€415m in 2015) reflecting its acquisitive pace. Shareholders' equity declined to €57m (€73m in 2015) due to dividend payments of €9.3m and a net loss of €5.3m.

Nevertheless, the balance sheet remains strong with cash and near cash of over €60m which is ample to support its existing and foreseeable investments. The balance sheet was bolstered by a

successful capital increase in October 2015, raising €24.5m at €17.50 per share). Post results, the company concluded the partial sale of EUPEC which will further boost its cash position as most of the €19.5m proceeds are expected to flow directly to the company. A further €12.5m from earn-outs may also accrue through to 2019.

Exhibit 8: Financial summary

	€'m	2012	2013	2014	2015	2016
Year end 31 December		HGB	HGB	HGB	HGB	HGB
Income statement						
Revenue		301	347	648	684	648
Profit before tax (as reported)		12	(6)	13	12	(2)
Net income (as reported)		9	(8)	9	7	(5)
EPS (as reported) (€)		0.78	(0.67)	0.61	0.51	(0.63)
Dividend per share (€)		0.12	1.67	0.78	0.60	0.35
Balance sheet						
Total non current assets		53	35	56	88	118
Total current assets		248	299	347	325	351
Total assets		301	334	403	415	473
Provisions		100	88	108	141	162
Liabilities		119	186	212	148	197
Deferred income		3	2	1	1	1
Shareholders' equity		50	38	51	73	57
Equity and liabilities		301	334	403	415	473
Cash flow						
Net cash from operating activities		1	(23)	(54)	(45)	(39)
Net cash from investing activities		6	13	73	35	24
Net cash from financing activities		1	4	7	13	2
Net cash Flow		7	(6)	25	2	(13)
Cash & cash equivalent end of year		52	43	70	70	63

Source: mutares AG, Edison Investment Research

Valuation

As at end December 2016, the NAV was €307.9m. The company uses a discounted cash flow approach to the valuation and applies annual growth rates of between 0.5% and 1.5% over three years to each company, using WACCs that reflect industry and country specific rates which lie between 5.7% and 11.2%.

During the year, the NAV fell by €44m against the reported €351.9m for end 2015. In addition to the payment of dividends and earnings losses of €9.3m and €5.3m respectively, the decline in NAV was caused by significant downward adjustments to investment valuations. This was mostly attributable to EUPEC which, as discussed above, suffered from a very weak industry environment and turned loss making. Smaller impacts came from the write down of Grosbill and a downward adjustment to valuation for GeersinkNorba which has faced a challenging operating environment for several years. Significant valuation mark ups, however, were applied to A+F and to STS Group.

At the current share price, mutares is trading at a significant 30% discount to NAV. The €0.35 per share dividend (€0.60 in 2015) represents a respectable yield of 2.5%. Prospects for a higher pay out in 2017 are good following the recent partial sale of EUPEC for €19.5m (potentially rising to €32m by 2019 through earn outs). Management indicated the acquisition cost was nominal. For illustrative purposes, if the net profit of the sale amounts to €10m, the company could pay over €0.50 per share if it applies the maximum policy ratio of 80%. This more than covers the €5.4m cost of the recently declared dividend while the possibility of one or two more exits this year could

provide further scope to raise dividends. These prospects may prompt a narrowing of the wide discount. Furthermore, the company will increase the frequency of its NAV publication from six monthly to quarterly to improve transparency for investors.

Sensitivities

- **Market conditions.** mutares's business model is dependent on acquiring and disposing of companies to realise value. If market conditions are unfavourable, mutares may not be able to dispose of companies at reasonable valuations or may delay disposals. In turn, this would have implications for its own valuation and cash flow.
- **Risk management.** By their nature, the companies that mutares typically acquires are in some way vulnerable in a high risk execution phase (eg loss making, undergoing leadership change, restructuring). The failure of a company may have a meaningful impact on the NAV and share price of the company.
- **Economic environment.** mutares's portfolio companies are heavily dependent upon sales within the EU. An economic downturn would have an adverse impact given the predominantly industrial and consumer nature of their businesses. Sector exposures will also have an impact eg the oil industry and weak activity weighed on EUPEC's business in 2016.
- **Litigation and fines.** The company has an outstanding litigation with Diehl for which only legal costs have been set aside. Should mutares be defeated in the legal dispute, it may have to pay substantial claims. Furthermore, common within the M&A industry, mutares has issued guarantees and letters of comfort to third parties. Should any of the above issues result in additional and substantial costs, the impact would be negative for the company. Management believes it has assessed these risks conservatively and comprehensively.

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