

Ernst Russ

Catching the tailwinds

In H121, Ernst Russ (ERAG) continued its fleet expansion with the acquisition of two multipurpose vessels, bringing the number of majority owned ships to 18. It also sold the Bremen Fund management subsegment, decreasing its assets under management (AUM) in the management services segment, by €0.2bn to €0.6bn at end-June 2021. On the back of robust market environment for container shipping and healthy operational performance, management introduced the FY21 guidance with targeted revenues ranging from €85m to €90m and EBIT between €24m and €26m (compared to €55.6m and €2.3m in FY20, respectively).

140% y-o-y increase in net profit ex-minorities

In H121, ERAG reported a 37% y-o-y increase in revenue to €39.6m, as the 77% y-o-y improvement in shipping operations of fully consolidated fleet was partially offset by lower asset management income related to maritime assets and divestments of non-shipping assets. Net profit before minority (€2.4m; mainly related to the Elbfeeder JV in which ERAG holds a c 52% stake) reached €6.8m in H121 (vs €1.7m in H120). Net profit ex-minorities was €4.4m, still significantly up versus €1.8m in H120.

Securing sustainable income on robust charter rates

ERAG's own fleet includes 15 container ships, one bulker and two multipurpose vessels. As the company is focused on securing a long-term stable revenue stream, the chartering of only three of its ships is directly linked to short-term rate movements as they participate in charter income pools. However, in H121 the company renewed charter agreements for eight vessels, benefiting from the favourable market environment, with a further four contracts expiring by the end of the year. The average daily charter rate in H121 increased 49.6% y-o-y to US\$12,930 and is currently c US\$16,000.

Valuation: P/E implies diminishing premium to peers

Based on consensus P/E multiple (excluding minorities), ERAG trades at a diminishing premium to peers for 2021e–22e, which moves to a 37% discount for 2023e, as market expects earnings growth to outpace the peer group. Based on a EV/EBITDA multiple, which is not adjusted for non-controlling interest, the company trades at an expanding discount to peers in 2021e–23e, amounting to 30% for 2021e and 39% for 2022e.

Consensus estimates

Year end	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/20	55.6	5.4	0.12	0.00	34.3	N/A
12/21e	89.0	24.0	0.36	0.00	11.4	N/A
12/22e	96.0	28.0	0.43	0.00	9.6	N/A
12/23e	97.0	29.0	0.47	0.00	8.8	N/A

Source: Refinitiv. Note: The data are based on the estimates of one company.

Diversified financials

17 September 2021

Price €4.12
Market cap €134m

Share price graph



Share details

Code HXCK
Listing Deutsche Börse Scale
Shares in issue 32.4m
Last reported net debt at 30 June 2021 €42.7m

Business description

Ernst Russ is a ship owner and maritime investment manager with a fleet of 18 vessels at end-June 2021. It is also active as asset manager within shipping and alternative investments segments, with AUM amounting to €0.6bn, spread across 22 investment funds at 30 June 2021. The company is headquartered in Hamburg.

Bull

- Repositioned to focus on maritime segment.
- Highly experienced team from the maritime and financial sectors.
- Revival in global trade drives demand for shipping services.

Bear

- Higher risk aversion could weigh on asset values.
- Exposure to the impact of any potential global trade disruptions.
- Increasing ship prices in the secondary market.

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Shipping segment drives top-line expansion

ERAG continues to expand its own fleet with the acquisition of two multipurpose vessels in February 2021, which brought the number of majority-owned ships to 18 at end-June 2021, with further 12 in which the company holds significant interest. We note, however, that increasing prices for second-hand ships could potentially negatively affect expansion. To better reflect ERAG's strategic realignment to a maritime investor, it introduced a new segmental reporting structure in 2021. The shipping segment covers the results on chartering ERAG's 18 fully consolidated vessels, while all ship, asset and fund management operations are recorded as part of the management services segment. We note the latter includes income on services delivered to both client- and ERAG group-owned assets, hence the consolidation adjustment. The other services segment covers ERAG's holding functions.

In H121, ERAG reported €39.6m in revenues (vs €28.9m in H120), with €33.7m attributable to the shipping segment, which increased by 77.4% y-o-y on the back of expanding the fully consolidated fleet (from 14 vessels at end-June 2020) and favourable charter rates developments (see details below). In contrast, income from management services segment declined 40.4% y-o-y to €6.1m, due to a lower income in maritime assets (€2.5m y-o-y decline) and divestment of the real estate segment (€1.5m). The decrease within the shipping asset class was attributable to low crewing, chartering and management fees, and lower transaction fees on sales of ships. As part of streamlining its business model, ERAG fully exited its real estate segment operations in October 2020 (see our [previous note](#) for details) and in April 2021 sold the Bremen Fund management subsegment, with c €0.2bn AUM spread across over 40 investment vehicles holding shipping assets. Consequently, the AUM of the management services segment declined from €1.9bn at end-June 2020 to €0.6bn at end-H121 in 22 investment funds, including assets in shipping (six fund ships remaining) and alternative investments areas.

Exhibit 1: Financial highlights

in €000	H121	H120	y-o-y
Revenue	39,577	28,929	36.8%
Shipping	33,668	18,979	77.4%
Management services	6,094	10,226	(40.4%)
Other services	263	153	71.9%
Consolidation	(448)	(429)	4.4%
Decrease/increase in unfinished products	0	(1)	NM
Other operating income	2,107	2,221	(5.1%)
Cost of materials and services	(23,997)	(18,329)	30.9%
Personnel expenses	(2,699)	(3,779)	(28.6%)
Other operating expenses	(3,517)	(2,377)	48.0%
EBITDA* (excluding non-operating result)	11,471	6,664	72.1%
Depreciation and amortisation	(4,476)	(5,490)	(18.5%)
Net income from investment in associates	92	0	NM
Income from equity interests	815	1,958	(58.4%)
Income from loans held as financial securities	0	16	NM
Other interest and similar income	709	764	(7.2%)
Amortisation of financial assets and current securities	(136)	(351)	(61.3%)
Interest and similar expenses	(1,424)	(1,630)	(12.6%)
Earnings before tax	7,051	1,931	265.1%
Income and other taxes	(288)	(281)	2.5%
Consolidated net profit	6,763	1,650	309.9%
Consolidated net profit attributable to non-controlling interests	(2,384)	173	NM
Consolidated net profit after non-controlling interests	4,379	1,823	140.2%
EPS (in €)	0.14	0.05	140.2%

Source: Ernst Russ. Note: *Edison calculations.

The higher volume of shipping operations resulted in a 30.9% y-o-y growth in costs of materials and services to €24.0m in H121, including €19.2m of ship operating costs and €3.4m third-party crewing services (vs €13.2m and €3.4m, respectively, in H120). Meanwhile, the company reduced the average employee capacity (full-time equivalents) in H121 to 46 from 66 in the corresponding

period in 2020, which resulted in a 28.6% y-o-y decline in personnel expenses to €2.7m. Although ERAG is focusing on the asset-heavy business operations, its D&A expense declined in H121 to €4.5m from €5.5m, due to lower scheduled amortisation of intangible assets (€0.4m vs €1.7m in H120). Consequently, ERAG's reported €6.8m consolidated net profit in H121 (vs €1.7m in H120) with significant minorities (€2.4m) related mainly to the Elbfeeder JV (including seven container ships) in which ER holds a c 52% stake. The net profit after non-controlling interest improved year-on-year from €1.8m in H120 to €4.4m.

On the back of improved results, the company's cashflow from operating activities reached €12.1m in H121 (€3.1m in H120), bringing cash and cash equivalents to €19.5m at 30 June 2021, compared to €9.2m at end-2020. This helped reduce the net debt to €42.7m from €51.5m at end-December 2020. Meanwhile, equity expanded to €89.2m (from €80.1m) on the back of the healthy net income and €5.3m increase in non-controlling interest due to consolidation of new ships. This brought the equity ratio to 51.3% at 30 June 2021 from 49.0% at end-December 2020.

Because ERAG's management expects development of the charter markets to be stable in H221 versus H121 and for technical availability of its fleet to be sustained at 98% of possible operating days, it introduced FY21 guidance for revenues of €85–90m (implying a 53–62% increase vs FY20) and EBIT of €24–26m (vs €2.3m in FY20). We note that H121 figures represent 46% of guided sales and 36% of the operating result, with H121 EBIT of €8.6m, implying an acceleration of growth in the second half of the year.

Charter rates reaching record-high levels

ERAG's own fleet consists of 15 container ships, one bulker and two newly acquired multi-purpose vessels. The container shipping market is a beneficiary of the post COVID-19-pandemic rebound in world trade and limited transport capacities in the market. According to the OECD, the international merchandise trade of G20 countries reached new heights in Q221, exceeding the previous record level posted in Q121. The sequential growth in exports and imports of G20 countries was 4.1% and 6.4% in Q221, respectively, bringing both figures above US\$4.2tn. Increased demand led to a significant increase in both freight and charter rates. The new Contex index (covering time charter rates for container ships) in US dollar terms increased over the year ending 14 September 2021 (the last reported figure) by over 600%.

That said, we note ERAG's earnings are somewhat lagging the positive market developments, as the company's strategy is focused on securing long-term sustainable income. With six out of 18 vessels chartered over the medium to long term, another nine for periods of up to 12 months and just three ships operating in charter income pools (time charter with a floating charter rate), the short-term rates movements have limited impact on company's revenue. However, in H121 ERAG secured new charter agreements on more favourable terms for eight ships, with further four due for renewal by the end of the year.

The average daily charter rate for ERAG's fleet improved from US\$10,500 in December 2020 to US\$14,300 in June 2021 and to the current level of around US\$16,000. The H121 average rate increased by 49.6% y-o-y to US\$12,930 through 3,131 operating days out of 3,196 possible days. This translates into a 98.0% fleet capacity utilisation (up from 95.1% in H120) with no demurrage periods (when containers are left at the port longer than their allotted free time) and 2.0% technical downtime (mainly attributable to shipyard stay of one vessel).

Valuation

For valuation purposes we continue to compare ERAG with a peer group that includes international investors and asset managers in the maritime segment, with a focus on container ships. Although

ERAG's market cap has increased by over 220% ytd, it is still a relatively small player compared to its peers. Based on EV/EBITDA multiples for 2021e–23e implied by Refinitiv consensus, the company trades at an expanding discount to peers, which we believe may in part be attributable to the smaller size of its shipping operations, translating into a higher expansion rate due to the lower base effect. This growth may not yet be fully reflected in its market valuation. Meanwhile, based on P/E multiples for 2021e–22e, the company's shares trade at diminishing premium to peers, which turns into a 37% discount on 2023e figures, as earnings growth is expected to outpace the peer group. We believe the difference in valuations based on both multiples could be related to the significant minority interest attributable to the Elbfeeder JV, which is reflected in the net profit but not in EBITDA or EV.

Exhibit 2: Peer group comparison							
	Market cap	EV/EBITDA (x)			P/E (x)		
	(m)	2021e	2022e	2023e	2021e	2022e	2023e
Hapag-Lloyd	€40,390	5.6	8.7	12.2	8.1	18.0	27.8
Danaos Corp	US\$1,713	6.7	5.1	4.9	6.0	4.3	4.1
SFL Corp	US\$1,114	8.9	8.8	8.3	8.5	9.2	9.8
Eimskip	ISK 75,366	7.8	8.2	7.9	N/A	N/A	N/A
Wilhelmsen Holding	NOK 8,192	9.1	9.1	N/A	6.9	4.1	N/A
Peer group average		7.6	8.0	8.3	7.4	8.9	13.9
Ernst Russ	€134	5.3	4.9	4.6	11.4	9.6	8.8
Premium/(discount) to peers		(30%)	(39%)	(44%)	55%	8%	(37%)

Source: Refinitiv. Note: Priced at 17 September 2021; the data are based on the estimates of one company.

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