EDISON **Scale research report - Initiation**

Scherzer & Co

Asset management

11 April 2017

Investing in special situations

Scherzer & Co (PZS) is a listed asset holding company, focusing on equity investments. PZS invests in special situations, small and micro caps and value stocks, chiefly in Germany. PZS has a dual investment approach: it acquires stocks that are in takeover situations, buy-outs or similar capital restructuring situations and 'mispriced' value stocks with a perceived valuation floor due to high asset values, net cash positions or strong major shareholders. This approach has been successful in the past five years.

Value for shareholders

PZS invests in special situations, where it can offer its holdings to potential acquirers. Extracting value involves a long-term strategy. We suggest that the current market environment supports such a strategy, as M&A activities benefit from robust earnings and low interest rates. PZS aims to boost capital appreciation and uses leverage when deemed appropriate. The group has achieved a 14% CAGR of NAV/share in the past five years. In addition, PZS has paid a dividend of €0.05 since 2014.

Potential NAV kicker

Over the years, PZS has built up a portfolio of so-called extra compensatory claims (ECS), representing potential additional payments to shareholders, based on court claims following squeeze-outs and other actions such as inter-company agreements. These additional claims are based on an original tender value of approximately €95m. While the outcome of such claims is uncertain, this tendered value could be a base for a potentially strong 'equity kicker' to PZS shareholders.

Valuation: FIDOR sale leads to strong 2016 results

PZS has long traded at discounts to NAV to the tune of 15%, but following events in 2016 and the successful sale of FIDOR Bank in 2016, this discount almost vanished (NAV at 31 March 2017: €2.40). It must be noted that the NAV does not include any income from potential ECS profits. Net profit came in at €4.45m, which was about 23% above consensus estimates, chiefly based on the successful FIDOR sale on 19 December 2016 that contributed pre-tax income of €2.9m. PZS proposes a €0.05 dividend for FY16, in line with estimates. In 2016 the share price moved from a discount to premium to NAV, which may have been a reflection of the FIDOR sale and an updated valuation report on AXA (based on that report, PZS ECS could be worth €18.8m from its holding in AXA ordinary shares).

Consensus estimates

Year end	Revenue (€m)	Net profit (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/13	9.8	6.0	0.20	0.00	11.9	N/A
12/14	11.0	3.8	0.13	0.05	18.3	2.1
12/15	12.8	5.3	0.18	0.05	13.2	2.1
12/16	7.6	4.5	0.15	0.05	15.9	2.1
12/17e	7.8	4.2	0.14	0.06	17.0	2.5

Source: Scherzer & Co reports, consensus estimates (ODDO, GSC, Solventis)

Price	€2.38
Market cap	€71m

Share price graph

Share details

Code	PZS GY/PZSG
Listing	Deutsche Börse Scale
Shares in issue	29.9m
Last reported net debt as at 12/2015	€17m

Business description

Scherzer & Co (PZS) invests its funds mainly in domestic equities. PZS looks for companies that are unknown or unloved, and special situations. The focus is on special situations, where the downside is perceived to be limited. In addition, it acquires value stocks, mainly below book value. These stocks need to demonstrate strong business models.

Bull

- Strong management, well known in the market.
- 'Hidden' NAV kicker through special compensatory rights, albeit with binary outcomes
- Well diversified portfolio with attractive risk/return pattern, built over a number of years.

Bear

- Dependent on market environment.
- Still relatively small.
- For the strategy, market size is limited.

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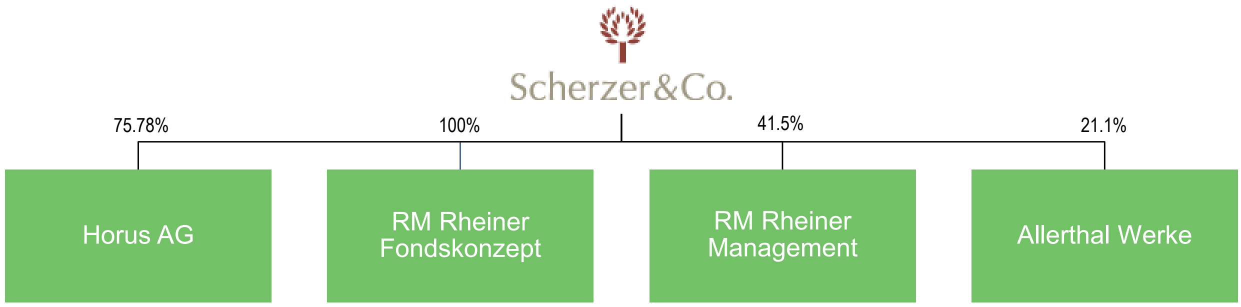
Company description

Scherzer & Co (PZS) is an asset holding company, based in Cologne, which invests its funds in listed securities, mainly shares, but also bonds and other securitized assets. In addition, PZS holds significant stakes in a number of smaller companies – foremost Allerthal-Werke, RM Rheiner Management and RM Rheiner Fondskonzept (see corporate structure below), with similar or adjacent business models. RM Rheiner Fondskonzept is advisor to the listed investment fund 'Do-RM Special Situations Total Return I', which follows a similar investment concept to PZS (AUM at March 2017 approximately €7m).

Exhibit 1: Organisation of Scherzer & Co – long-term holdings of companies



Source: Scherzer & Co report 2015, Edison Investment Research

PZS's investment philosophy could be best described as value orientated: its primary goal is to achieve a sustained value appreciation. It has established itself as one of the leading investment companies for corporate action and special situations. PZS aims to build a portfolio comprising €100m equity (currently approximately €50m). The company describes its mission, in its 2015 Annual Report, as targeting long-term wealth accumulation through a combination of both safety-oriented and opportunistic investments.

PZS mainly invests in companies and stocks that are either lesser known or unloved, or are in special situations, reflecting specific corporate issues or market misconceptions or a combination of these, with a focus on Germany:

- **Lesser known** companies include about 500-1,000 companies without research coverage, mainly micro caps with low or no interest in investor relation activities.
- **Unloved** companies have difficult or not well understood business models, earnings potential, perhaps operating in a sector that is perceived to be problematic and/or in a restructuring phase.
- Finally, **special situations** are focused on corporate action: possible squeeze-outs[1], M&A activities, takeovers or looming re-orientation of a business.

PZS has been using these criteria since its inception.

A further – potentially very profitable – investment is in so-called extra compensatory claims (ECS). The bases for these types of activities are closed squeeze-outs, corporate contractual agreements – or inter-company agreements – and similar structures, which – in the past – have resulted in minority shareholders being compensated for tendering in their shares. However, where the minority shareholders are not satisfied with the level of the tender offers many of these transactions

[1] Squeeze out is defined as the compulsory sale of the shares of minority shareholders of a joint-stock company for which they receive a fair cash compensation.

are challenged in court or in front of arbitration committees. Most claims are accompanied by new compensation assessments issued by auditors engaged by shareholders.

PZS has participated in such tender offerings, which implies that it is entitled to further potential compensation. The original value of tendered-in shares was approximately €95m by the end of 2016. PZS actively pursues these claims. However, as the validity and timing of payments of these claims cannot be specified, they do not form part of the NAV calculation for PZS nor are they accounted for in PZS's accounts.

A new auditor's opinion in an ongoing AXA 2006 squeeze-out suggested that the squeeze-out price was €103/share too low. This indicates that PZS's 176,471 AXA AG (ordinary) claims could be worth €18.8m or €0.60/PZS share, should the ruling end successfully.

In 2015, PZS acquired claims based on the tender value of €11.6m and closed claims of a tender value of €13.4m.

An example of a successful, extra compensatory claim
PZS owned shares in Schering when the company was bought by Bayer. In September 2006, Bayer announced it had acquired more than 95% of Schering's shares and entered into the legally possible squeeze-out procedure. This resulted in a 'loss' of €234,000 for PZS, which was the difference between the market price at the time and the price offered by Bayer in the tender offer – hence an opportunity loss. But through this procedure, PZS remained entitled to a potential ECS since it expected a higher price following the arbitration ruling. At the end of this process in 2015, PZS cashed in €2.9m (including 5% interest pa) as extra compensation, representing around 12 times the initial investment (ie the opportunity loss on the transaction in 2006).

Exhibit 2: PZS's portfolio of tendered shares (base for ECS)

Stock	Structure	Value, €m
AXA ordinary	Squeeze-out	18.8
AXA pref.	Squeeze-out	6.8
HVB	Squeeze-out	17.2
Generali (D)	Squeeze-out	9.0
Bank Austria	Squeeze-out	8.8
MIBA	Squeeze-out	4.9
Cologne Re	Squeeze-out	3.8
Dte.Postbank	Squeeze-out	2.6
SKY (D)	Squeeze-out	2.6
Vattenfall	Squeeze-out	2.5
Other		19.3
Total		**96.3**

Source: Scherzer & Co report 2015. Note: Current value approximately €95m.

This part of PZS's business model was challenged by the so-called 'FROSTA' ruling by the highest German court (BGH) in 2013, which decided that companies that plan a delisting are no longer obliged to offer compensation to minority investors.

Investment process and business model

The portfolio is built using a strict investment process. PZS starts by screening the potential investment universe using official news flow, potential research coming out of its established network, its own proprietary data bank (which contains historical evidence, stored news and records of company visits, conferences and meetings) and company visits. Based on these, PZS forms potential investment ideas, which are then vetted using:

- **Qualitative factors** (management, market entry barriers, corporate philosophy, market segment growth factors, competitive situation);
- **Quantitative factors** (healthy balance sheet ratios, margin development, cash flow, P/E and P/B ratios); and

- **Opportunities/restructuring** (shareholder structure according to official WpHG (German capital market law) shareholder register, level of vertical integration, quality of main shareholder, evaluation of external corporate valuation, potential success in compensation claim suits).

As a result of these analyses, a successful investment would be classified as a 'safety' or 'opportunistic' investment.

Exhibit 3: Selection of investments

'Safety' investments	'Opportunistic' investments
▪ Companies with 'natural' valuation floor. ▪ Companies with high asset quality (net cash position, shares trading well below book value). ▪ Strong/strategic major shareholder. ▪ Strong earnings quality (sustained positive results; stable dividend payments; sustained CF, low cyclicality).	▪ Special situations. ▪ Investments in sustained business models with high growth outlook. ▪ Participation following new business orientation. ▪ Realisation of potential through capital measures (restructuring, re-capitalisation, growth finance).

Source: Scherzer & Co presentation 2017

PZS then structures a diversified portfolio of safe and opportunistic investments. This portfolio is not held in a 'trust' but is actually part of the corporate balance sheet, which also includes the long-term holdings, as mentioned above. The current top 10 holdings of the actual portfolio (as at 28 February 2017) are:

Exhibit 4: Current portfolio

'Safe' investments	% holding	€m	% of total	'Opportunistic' investments	% holding	€m	% of total
Allerthal-Werke	24.9%	4.7	4.94%	GK Software AG	6.81%	8.3	8.70%
MAN SE		3.0	3.18%	K+S AG		3.8	3.94%
Mobotix AG	2.4%	4.7	4.90%	Lotto 24 AG	1.80%	4.0	4.21%
Pfeiffer Vacuum AG		3.5	3.67%	W&W AG	0.33%	5.7	6.04%
Horus AG		2.7	2.83%	freenet AG	0.16%	5.8	8.58%
Total		18.7	20%			27.6	31%

Source: Scherzer & Co presentation 2017. Note: As at 31 March 2017.

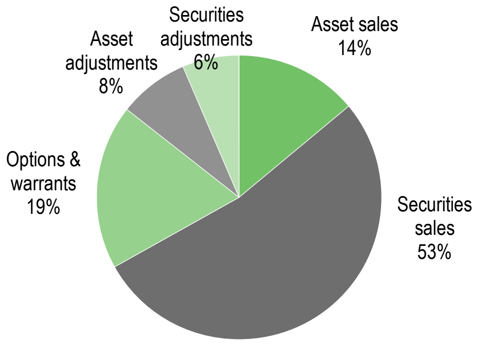
The value of these investments is approximately €46m as of March 2017, implying a total investment value of approximately €91m as of the end of March 2017.

PZS's business model is based on realising capital appreciation from its investments through active management. The main proportion of the earnings – capital gains, dividends, fees from option writing – is re-invested, but PZS also pays dividends (€0.05/share in 2015 and proposed for 2016). Unlike typical fund management companies, PZS has not formed a special investment vehicle (investment fund) in which investors invest; it invests its own corporate funds. This implies that no 'new money' is raised through selling 'units'. The way to increase the assets under management (AUM) – or invested capital – is either by increasing debt, raising capital in the form of a capital increase in PZS or realising capital gains, and reinvesting into value creating investments.

The advantage for shareholders is that the company, as owner and manager, will carefully select these opportunities: currently, the focus is on increasing the portfolio through reinvesting capital gains, while maintaining some leverage (net debt: €17m at end of 2015).

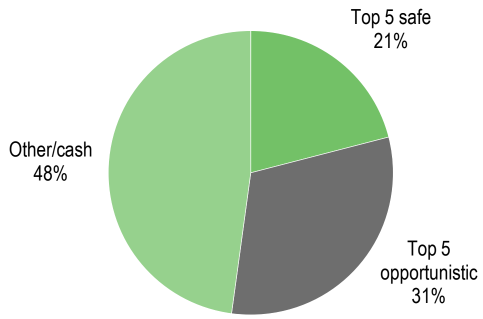
As an investment firm, PZS is also dependent on the development of the capital markets, in particular the German stock market and specifically, the small- and micro-cap segment. Nevertheless, the performance of its special investment philosophy implies that company-specific issues are outpacing overall market sentiment. However, market volatility can have an impact on PZS's net asset value in the short term.

Exhibit 5: Revenues by segment 2015



Source: Edison Investment Research

Exhibit 6: Investment structure, February 2017



Source: Edison Investment Research

Revenues from selling securities (53% of 2015 revenues)

Securities are short-term assets, ie investments with potential for shorter-term realisation of profits. These investments are more dependent on market developments and the investments are more actively traded than the long-term assets. Hence, the revenues from this business segment typically outpace the remaining segments in terms of size. PZS acts faster on any price movements of its investments in this category.

Revenues from selling assets (14% of 2015 revenues)

Assets are long-term investments, as they mostly include the participations as mentioned in Exhibit 1. Hence, the average turnover of these investments is low. Nevertheless, if certain price targets are reached or the valuation becomes stretched based on PZS's valuation system, these assets are sold.

Value adjustments (on securities – short term – 6%of 2015 revenues; on assets – long term – 8% of 2015 revenues)

Following German GAAP (HGB), the company is obliged to revalue the assets (§ 253 Abs. 5 HGB). These valuation adjustments reflect the difference between the book value and the share price as of 31 December of each business year. As such, these value adjustments are non-cash revenues and could change rapidly. However, they indicate potential cash generating sales volume as of the end of a business year.

Options and warrants and other income (19% of 2015 revenues)

This revenue item was particularly high in 2015. Typically, it is PZS policy to write options on certain securities positions. The revenues from such activities typically represent 3-5% of annual revenues. However, PZS also includes revenues from successful extra compensatory claims in this revenue position. These are lumpy and non-predictable. In 2015, PZS successfully ended an arbitration with a €2.1m gain, which is part of the 2015 revenue figure. Essentially, the 2015 result reinforces the earnings potential of this business segment.

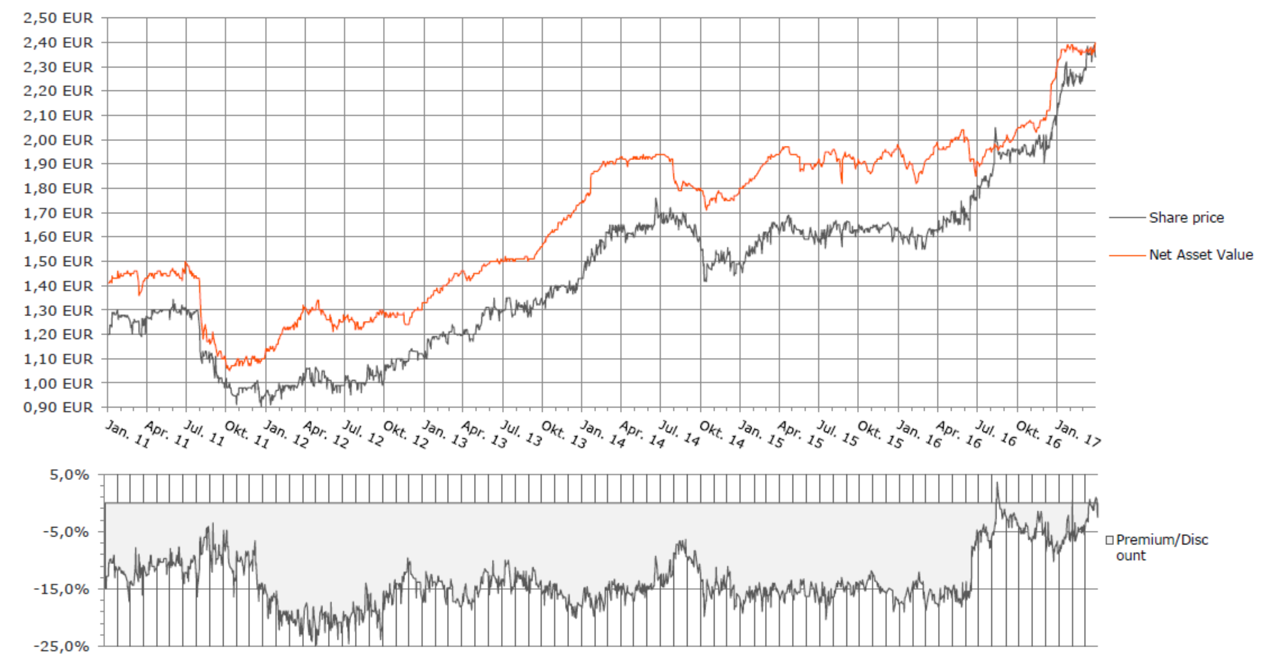
PZS also receives dividends from its investments. Given the value and safety orientated investment policy, many of its investments pay dividends. These are booked in financial income and are therefore part of the net financial result in the P&L and therefore not part of the revenue line. In 2015, dividend income was almost €1.6m, similar to that of 2014.

Recent news flow and upcoming catalysts

The company reports monthly on the development of its NAV. This was recently reported as €2.40/share as at 31 March 2017. In addition, the most relevant news flow in the past few months was the successful FIDOR Bank transaction: PZS owned a stake in the no-longer listed FIDOR Bank, which was founded in 2003 as an innovative online banking company. The bank was listed between March 2007 and June 2015. In July 2016, FIDOR was bought by the French BPCE financial group. Although the purchase price was not mentioned, market sources reported a transaction value of more than €100m. FIDOR did not offer a purchase programme to minority shareholders, as there was no 'major shareholder' in the firm at that time, which is required to trigger such a squeeze-out price. PZS remained a shareholder and was rewarded in December 2016 by the sale of its FIDOR Bank participation for €2.9m.

On 31 March 2017, PZS announced key 2016 results: net profit: €4.46m; EPS: €0.15; DPS (proposal): €0.05. Full results will be presented at the latest at the AGM on 29 May 2017. The company's shares will trade ex-dividend three days after the AGM (law change in Germany, starting in 2017; according to §58.4 of the German share law, the earliest dividend payment is three days after the AGM).

Exhibit 7: Share price and NAV (top) and discount/premium progression (bottom)



Source: Scherzer & Co news, April 2017

Market overview

PZS operates chiefly as an investor in the German stock market, with a strong focus on the small- and micro-cap market segment. These segments are typically out of the scope of the majority of institutional investors, given the typically low liquidity of the shares and very low external coverage by research houses. That said, the typical investment of PZS is based on company-specific, rather than market considerations. The impact of company-specific issues and developments on the share price are more relevant than macroeconomic issues and developments.

However, overall market sentiment is nevertheless of certain influence. The OECD expects German GDP to grow by 1.7% in 2017 and beyond, supported by healthy domestic demand, as unemployment is low (2017: 4.2%, same as in 2016) and real wages are expected to rise (2017: +2.8% after +2.2% in 2016) (source: www.oecd.org/eco/outlook/economic-forecast-summary-germany-oecd-economic-outlook-november-2016.pdf). Based on this positive outlook, the DAX Index has reached record highs at the end of the quarter. However, there are concerns that political uncertainty – such as the federal election in September 2017 – could dampen sentiment. DAX Index forecasts indicate a decline from current levels of 12.250 to 11.700 by the end of the year (source: www.tradingeconomics.com/germany/forecast).

Management

Management board, supervisory board and advisory boards

PZS is run by Dr Georg Issels and Hans Peter Neuroth. The managers are well known for their special investment approach and are frequent participants at investment conferences. The business model requires constant input from networks and own analysis to identify successful investment opportunities. Issels is an economist by education and worked between 1995 and 2001 at the Sparkasse Köln/Bonn, before joining PZS in 2001. Neuroth joined Issels as board member on 1 January 2013. Neuroth was a capital market expert at Sal. Oppenheim Bank until 2010 and joined the PZS group in 2010, before moving into the board in 2013.

The supervisory board consists of three members, namely Dr Stephan Göckeler, lawyer; Rolf Hauschildt, investor; and Dr Dirk Rüttgers, wealth manager. Göckeler works at a law firm that specializes in financial market law, M&A and private equity. Hauschildt is an established investor who also owns via A&B Vermögensverwaltung a substantial stake in Allerthal-Werke. Rüttgers is a former bank manager who runs a family office in Munich and Do Investment. The supervisory board therefore offers substantial additional expertise and networks to support PZS's business model.

Shareholders and free float

The company has issued 29.94m ordinary shares. The latest capital increase was a private placement of 2,720,501 new ordinary shares in October 2012, issued at €1.15/share to institutional investors at a price above the share price at that time. The company has no details on its current shareholder structure, but claims that the majority of shares are held by institutional investors and that approximately 400 individual investors hold PZS shares. Based on the presence of shareholders at the last two AGMs, it could be assumed that institutional shareholders close to the supervisory board hold about 40% of PZS.

Financials

PZS is essentially an asset holding company, with the assets reflected in the accounts. Therefore, unlike typical investment management companies, it is not an asset light operation. Nevertheless, the pure operational costs are similar. Based on 2015 revenues, personnel costs account for just 5% and other operational costs for 4.5%. On the balance sheet, non-investment assets (ie long- and short-term investment assets) are negligible (<2% of the balance sheet total). The balance sheet total has hovered around €70m since 2013, with total equity rising constantly. Bank loans are used to lever up the investment portfolio, rather than to increase the equity base. This has created value for shareholders, as the share price in the past traded below NAV. Management assumes that any capital increase at discounts to stated NAV is value destructive and even at NAV, it would not reflect the potential arising from the ECS portfolio.

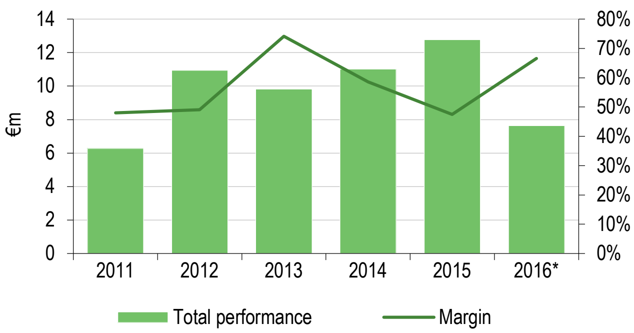
Exhibit 8: Financial summary

	€m	2011	2012	2013	2014	2015	2016
Year end 31 December				HGB*			
Income statement							
Revenue		6	11	10	11	13	8**
Profit before tax (as reported)		(3)	4	7	4	7	5
Net income (as reported)		(3)	4	6	4	5	4
EPS (as reported) – (€)		(0.10)	0.13	0.20	0.13	0.18	0.15
Dividend per pref share (€)		-	-	-	0.05	0.05	0.05
Balance sheet							
Total non-current assets		16	16	21	24	32	43
Total current assets		29	34	49	48	38	33
Total assets		44	50	70	72	70	76
Total non-current liabilities		0	0	2	2	2	0
Total current liabilities		14	12	24	23	17	21
Total liabilities		14	12	26	25	19	22
Net assets		31	38	44	47	51	54
Shareholders' equity		31	38	44	47	51	54

Source: Scherzer & Co accounts. Note: *HGB = German GAAP. **FY16 revenue is consensus estimate.

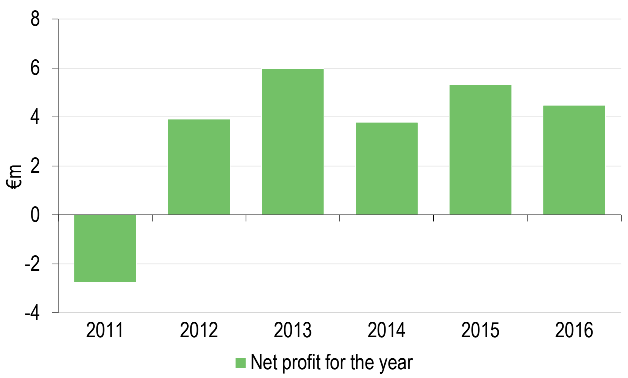
Income statement

Exhibit 9: Revenue and margin progression



Source: Scherzer & Co accounts. Note: *FY16 revenue is consensus estimate.

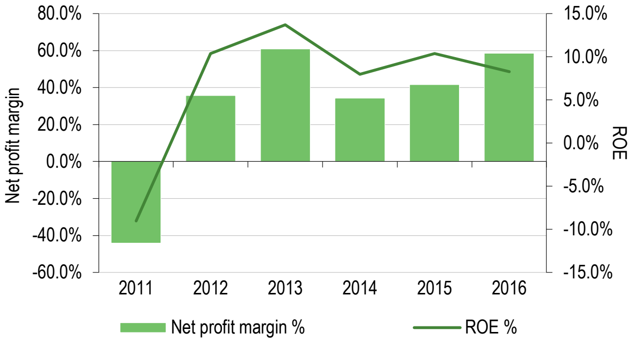
Exhibit 10: Net profit progression



Source: Source: Scherzer & Co accounts

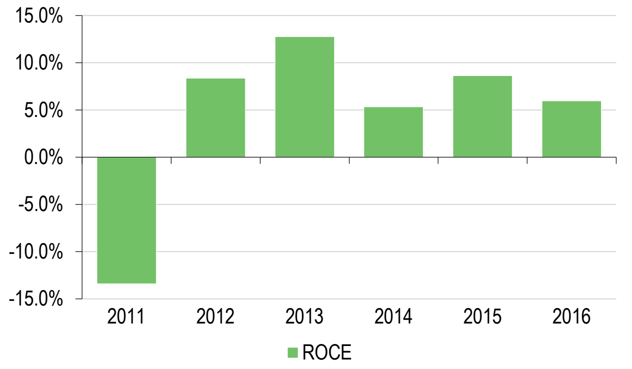
PZS's business model is based on value generation. The company aims to achieve sustained income from its operations and acts swiftly to avoid losses. As a result, it has increased profitability strongly. The key drivers for profits in 2015 and 2016 were the successful cashing in of ECS and special factors: €2.1m of ECS in 2015 and €2.9m from the sale of FIDOR Bank in 2016. Excluding these effects, net profits would have been approximately €1.5m lower in 2015 and €2.2m lower in 2016. However, in both years, PZS would have earned a positive result, sufficient to pay the dividend of €0.05 and to retain profits for further expansion of the investment portfolio. The impact would likely have led to a smaller debt reduction. On 31 March 2017, PZS reported key 2016 results, which are included in our figures and graphs (net profit: €4.46m; EPS: €0.15; DPS proposal: €0.05).

Exhibit 9: Profitability – net profit margins



Source: Scherzer & Co, Edison Investment Research

Exhibit 10: Profitability – return on capital employed



Source: Scherzer & Co, Edison Investment Research

Balance sheet

PZS's net debt position (long-term and short-term liabilities minus year-end cash) fell sharply in 2015 to €17m, from €24m the year before. Net debt is a function of management's decision to expand the portfolio without asking shareholders for fresh funds. This was opportune in the past, when share prices were trading below NAV. Given the recent share price developments – which we suggest are a reflection of successful ECS and FIDOR Bank transactions – management might be inclined to consider capital measures in the future, if share prices were to hover well above NAV. However, balance sheet ratios are considered to be very healthy (equity ratio: 73% in 2015).

Valuation

The most recently reported NAV stands at €2.40/share as of March 2017. PZS's shares have traded in the past at prices below stated NAV. This appears to be a function of the asset value minus the capitalised management costs, which were approximately 10% of revenues. As such, the average discount to NAV before 2016 was approximately 15%. Since the successful ECS transaction in 2015 and the subsequent news flow (AXA valuation case, the successful sale of FIDOR Bank stake), the discount has declined and the stock trades around the NAV of €2.40. This suggests the improved acceptance of potential gains resulting from the ECS portfolio. However, there is no visibility on future gains.

Exhibit 11: Valuation

	2011	2012	2013	2014	2015	2016
Cash dividend (€)	-	-	0.05	0.05	0.05	0.05
Dividend yield (%)	0.00%	0.0%	3.50%	3.33%	3.07%	2.39%
10-year average SDAX yield (%)	2.39%	2.39%	2.39%	2.39%	2.39%	2.39%
EPS (€)	(0.10)	0.13	0.20	0.13	0.18	0.15
P/E year + 1*	9.11	4.86	11.33	35.18	10.87	N/A
Share price average (€)	**1.19**	**0.97**	**1.43**	**6.25**	**1.63**	**2.09**

Source: Scherzer & Co, Bloomberg. Note: *Using year-end share price.

Based on P/E, PZS traded well below the market averages in the past five years. We believe that the main reason behind this is the non-visibility of potential gains of the ECS portfolio. However, given recent successful transactions, the discount started to decline in 2016 and has continued to do so far in 2017.

Exhibit 12: Comparable market P/E ratios

	2012	2013	2014	2015	2016	2017e
	P/E	P/E	P/E	P/E	P/E	P/E
DAX	17.3	18.4	16.6	22.0	19.0	20.2
MDAX	17.9	27.8	20.0	19.2	28.8	30.2
SDAX	n.m.	54.7	30.9	28.0	23.5	23.8
Arithmetic average	**17.6**	**33.6**	**22.5**	**23.1**	**23.7**	**24.7**
PZS	loss	7.2	11.9	9.2	13.6	16.8
PZS discount	loss	79%	47%	60%	43%	32%

Source: Bloomberg as at 4 April 2017, Scherzer & Co reports. Note: P/E valuations based on year-end prices.

PZS's valuation is mainly based on the asset value, also described by the price to book (P/B) value. We have looked at the development of market P/B ratios over time, and a decline in PZS's discount to market is apparent since 2015.

Exhibit 13: Comparable market P/B ratios

Year	2012	2013	2014	2015	2016	2017e
	P/B	P/B	P/B	P/B	P/B	P/B
DAX	1.5	1.8	1.7	1.7	1.7	1.8
MDAX	1.8	2.3	2.1	2.3	1.9	2.0
SDAX	1.3	1.7	1.9	2.0	1.7	1.8
Arithmetic average	**1.7**	**1.9**	**1.9**	**2.0**	**1.8**	**1.9**
PZS	0.8	0.8	0.8	0.8	0.9	1.0
PZS discount	51%	57%	56%	58%	48%	48%

Source: Bloomberg as at 4 April 2017, Scherzer & Co reports. Note: P/B valuations based on year-end prices.

PZS has reported profits every year since 2012. Despite this, the stock has traded both below its own book value and below German market valuations. Nevertheless, PZS achieved positive absolute returns each year, documented by the increase in NAV (even after payment of dividend).

Exhibit 16: Comparable market performance

Year	DAX Index		NAV PZS
	End	Change %	Change %
2012	7,612.39	29.06%	14.65%
2013	9,552.16	25.48%	30.86%
2014	9,805.55	2.65%	3.82%
2015	10,743.01	9.56%	9.84%
2016	11,481.06	6.87%	15.59%

Source: www.1stock1.com/1stock1_758.htm, Scherzer & Co reports

In addition, the NAV progression does not fully reflect the ECS portfolio. On the one hand, earnings realised from successful closings are reflected in the NAV, as the returns are partially re-invested in the portfolio. On the other hand, the outcome and the timing of the claims are uncertain.

The AXA case, however, highlights the potential: while it is unclear whether the new valuation report will be fully accepted and finally turn into payments to those shareholders, who tendered in the AXA shares in 2006, a potential gain of €103/AXA ordinary share represents a pre-tax gain for PZS of approximately €18.8m, or €0.63/PZS share (before taxes and other costs). €0.63/share would be equal to a 26% increase in current NAV.

Sensitivities

PZS is essentially a fund management company with a special investment approach and additional NAV and earning potential arising from its ECS portfolio.

A major factor in PZS's business is income from the 'opportunistic' portfolio. Here, PZS speculates on corporate action and other company-specific events. On the 'safe' portfolio side, investment should perform more closely according to projections. In any case, PZS is dependent on the fact that the underlying performance of its assets is reflected in respective share prices.

An additional income stream – probably best described as possible icing on the cake –is achieved from the ECS portfolio. Here, there is possibly very little impact from capital market developments other than risk premium and interest rates in DCF models. However, as all of the cases are historical, these parameters are likely to have a minimal impact on the ECS pricing. More relevant are potential changes in the legislative environment, which are impossible to qualify.

Macro issues

Economic downturns affect overall market sentiment. While it is less likely that the business models of the investments, which are characterised as maintaining a 'natural floor', are directly and significantly affected, overall sentiment could reduce risk appetite and lead PZS's share price lower towards an increased discount to NAV. This might limit PZS management's ability to grow the investment portfolio. Higher interest rates and a more conservative lending policy from banks could be another business dampening factor, as PZS is dependent on easy and swift loans.

Regulatory issues

PZS's business model is partly based on the ability to cash in compensatory payments. Changes in legislation could impair the possibility to achieve positive results from the portfolio of ECS. This could lead to a lower value for the ECS portfolio. Although the portfolio is not part of the current NAV calculation, the potential value appears to have some influence on the discount to NAV. Changes could therefore lead to a decline of PZS's share price below NAV, limiting the market options for PZS management.

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