Agenda

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INTRO

Summary: In this marketing message, I describe how I look at small holding companies and serial acquirers. For informational purposes only, readers will learn about the historical developments at GESCO SE – a listed German holding company with 10 subsidiaries in the industrial space which has just reported two consecutive years of record earnings.

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Holding disclosure: At the time of writing, Covesto Patient Capital holds a position in GESCO SE since 2023 at an average cost of €25.1 per share.

GESCO SE SOME HISTORICAL NUMBERS	
net revenue 2022	582.2m EUR (+19.3% yoy)
EBIT 2022	49.4m EUR (+10.9% yoy)
EBIT margin reported	*8.5%*
EBITA 2022 add back: PPA	49.4m EUR + 3.2m EUR = 52.6m EUR (+10.3% yoy)
EBITA margin (PPA adjusted)	*9.0%*
NI 2022 (post minorities)	33.8m EUR (+25.9% yoy)
NI margin	*5.8%*
Share count	10.8m shares out
Share price	24 EUR
Market cap	259m EUR
Net debt (excl. leasing)	50m EUR
EV	309m EUR
EV/EBITA 22	5.9x
Fwd. P/E 23e (Consensus)	7.7x (13.0% Earnings Yield)
EV/UFCF 23e	8.6x (11.6% Unlevered FCF-Yield)
ROE 22	12.8%
ROIC 22	10.3%

THE ELEPHANT IN THE ROOM: "WHY CAN'T YOU BE MORE SCANDINAVIAN?"

The first time I met the management team of GESCO was nine years ago, at an investor conference in Dusseldorf, Germany. The company presented itself as **a small holding company for German industrial SMEs** (sometimes referred to as "hidden champions"). It engages in 100% takeovers of private companies with average profitability and an intention to hold them forever (i. e. no restructurings, no exit strategy).

At the time of our first meeting, the most recent financial results of GESCO looked like this:

in m EUR, unless otherwise stated	GESCO FY13
Revenue	453.3
EBITA	32.6
EBITA margin	*7.2%*
NI (control. interest)	18.1
Equity	164.2
ROE	11%
Share price (adj. for stock splits)	23.4 EUR
Market Cap	233
Net Debt	73
EV	306
Net Debt/EBITDA	1.5x
P/E	12.9x
EV/EBITA	9.4x
# of operating companies	17
avg. revenue per company	26.7

Comparing GESCO to Swedish peer industrial holding Lagercrantz at the time, **the starting bases for both companies weren't all that different. In FY13, Lagercrantz generated a slightly smaller EBITA than GESCO (27.3m EUR for Lagercrantz vs. 32.6m EUR for GESCO)**, was levered at 1.2x net debt/EBITDA (vs. GESCO: 1.5x) and had a market cap of 299m EUR (vs. GESCO: 233m EUR, see table on the next page).

in m EUR, unless otherwise stated	Lagercrantz FY13
Revenue	287.7
EBITA	27.3
EBITA margin	*9.2%*
NI (control. interest)	20.0
Equity	91.0
RoE	22%
Share price (adj. for stock splits)	13.0 SEK
Market Cap	299
Net Debt	39
EV	338
Net Debt/EBITDA	1.2x
P/E	14.9x
EV/EBITA	12.4x
# of operating companies	33
avg. revenue per company	8.7

A few meaningful differences catch the investor's eye though:

- At comparable levels of indebtedness, Lagercrantz reported returns on capital *twice as high* as GESCO (ROE: 22% vs. 11%), driven by lower capital intensity and higher margins (EBITA margin: 9.2% vs. 7.2%)
- Lagercrantz was also focused on smaller companies (avg. revenue per company 8.7m EUR vs. 26.7m EUR for GESCO) and owned 33 industrial SMEs at the time vs. GESCO 17 subsidiaries

Since their listing in 1998 (GESCO) and 2001 (Lagercrantz), both companies shared an **identical vision that their industrial subsidiaries should be #1 or #2 in niche markets**. Banking on the merits of decentralization, each subsidiary was supposed to conduct its operations with a great degree of freedom, but subject to accountability vis-à-vis the holding. However, **that's pretty much where all similarities between GESCO and Lagercrantz end**.

Striking differences lay in the way how clearly both companies laid out their financial goals towards investors in FY13:

- Lagercrantz stated they planned to achieve 1) long-term earnings growth of 15% per year, 2) a ROE of no less than 25% (internally managed as net income/working capital of >45%) and that they 3) wanted to close 3-5 acquisitions per year
- On the other hand, GESCO did not provide any precise goals in terms of 1) how fast they thought they could grow earnings or 2) what ROE they targeted. In terms of 3) acquisitions, they loosely deemed 1-2 acquisitions per year realistic

After our meeting, I followed them loosely over the years. On the other hand, I followed Lagercrantz intensively and **the Covesto Patient Capital fund held shares in Lagercrantz for the**

past three years 2020 to 2022 (*Holding disclosure: At the time of writing, Covesto Patient Capital does no longer hold shares in Lagercrantz. At the time of writing, Covesto Patient Capital does hold shares in GESCO since 2023 at an average cost of €25.1 per share*).

Almost a decade from when I first became aware of both companies and with the recent release of their FY22 annual reports, it seems like an opportune time to dissect their operating progress since then and take a look at their achieved shareholder returns.

GESCO vs. Lagercrantz over the past nine years

Below one can see the progress of both industrial holding companies between FY13-22.

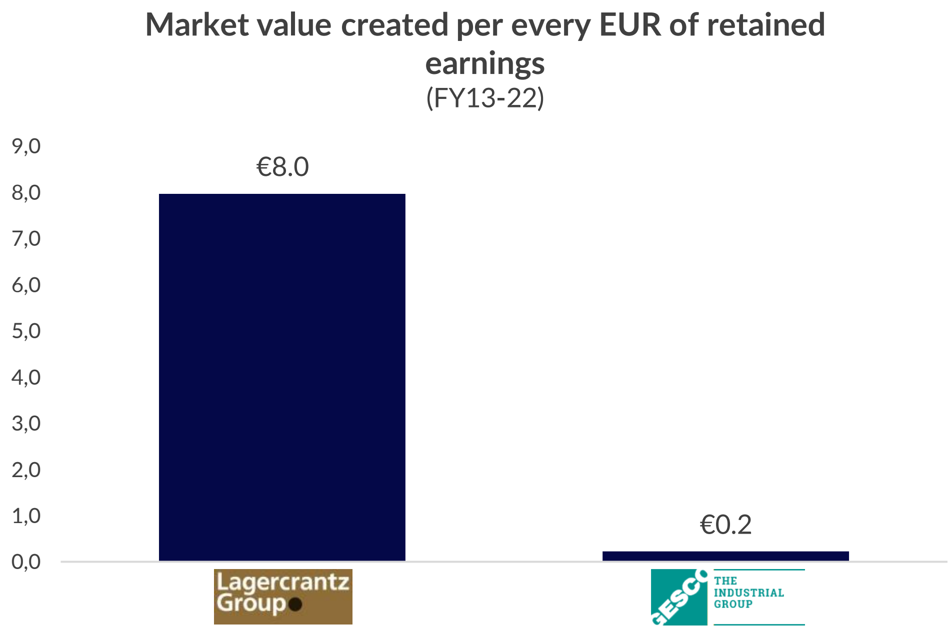
	GESCO			Lagercrantz		
in m EUR, unless o. s.	FY13	FY22	*CAGR*	FY13	FY22	*CAGR*
Revenue	453.3	582.3	*3%*	287.7	649.3	*9%*
EBITA	32.6	52.7	*5%*	27.3	108.0	*17%*
EBITA margin	*7.2%*	*9.0%*	*+180bps*	*9.2%*	*16.6%*	*+740bps*
NI (control. interest)	18.1	33.8	*7%*	20.0	67.9	*15%*
Equity	164.2	264.6	*5%*	91.0	269.6	*13%*
ROE	11%	13%		22%	25%	
Share price	23.4 EUR	24.1 EUR	*1.0x*	13,0 SEK	103 SEK	*7.9x*
Market Cap	233	261	*1%*	299	1,894	*23%*
Net Debt	73	50		39	209	
EV	306	311	*0%*	338	2,103	*23%*
Net Debt/EBITDA	1.5x	0.7x		1.2x	1.6x	
P/E	12.9x	7.7x	*0.6x*	14.9x	27.9x	*1.9x*
EV/EBITA	9.4x	5.9x		12.4x	19.5x	
# of companies	17	10		33	69	
avg. rev per company	26.7	58.2		8.7	9.4	

The result of the comparison is interesting. Both firms a) started off on a comparable profit base and b) wanted to create shareholder value through a mix of organic growth and M&A. However, they produced *vastly different* outcomes over the years. Based on a starting FY13 EBITA of 27.3m EUR for Lagercrantz compared to 32.6m EUR for GESCO, **just nine years later Lagercrantz managed to produce more than *double* the EBITA of GESCO.**

On average, Lagercrantz conducted 4 small acquisitions per year (<10m EUR in revenue per company) from FY13-22 while GESCO shrank its net number of subsidiaries from 17 to 10. Buying additional subsidiaries at accretive margins allowed Lagercrantz to increase its companywide EBITA margin by +740bps vs. only +180bps for GESCO from FY13-22.

During that timeframe, I estimate Lagercrantz paid out 40% of its total net earnings of 336m EUR and retained the remaining 200m EUR. Meanwhile, its market cap increased by 1,595m EUR which implies that **for every EUR of retained earnings, Lagercrantz created 8.0 EUR in**

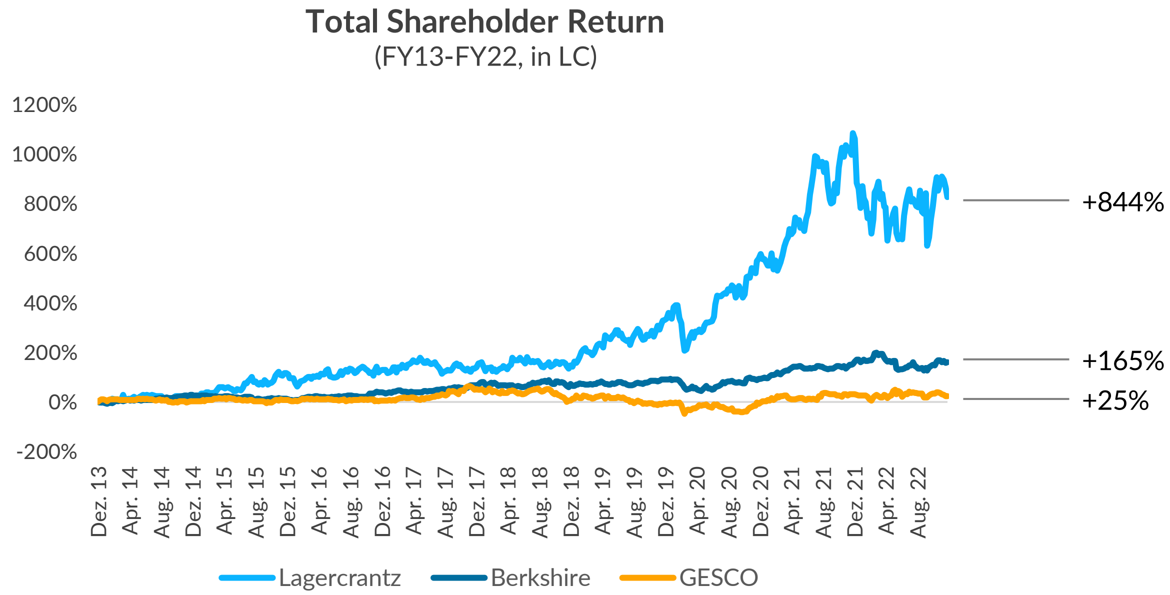
market value. Over the same period, GESCO generated 156m EUR in net earnings of which it paid out 53m EUR or 34%. It retained 103m EUR and had an equity inflow (capital raise) of ~20m EUR in FY16. Its market cap increased by 28m EUR which implies that **for every EUR of retained earnings, GESCO created only 0.2 EUR in market value**.



Translating the KPI development above into shareholder returns, an investment in Lagercrantz would have yielded a share price gain of ~700% vs. GESCO having stayed flat for nine years. While in the *really* long run, the change in cash earnings per share will determine the vast majority of returns, the table below shows how multiple expansion or compression can play a noticeable role during mid-term periods.

TSR breakdown in local currency	Lagercrantz FY13-22	GESCO FY13-22
I change in net income (local currency)	4.3x	1.9x
II change in multiple	1.9x	0.6x
I x II = III change in share price	7.9x	1.0x
IV price return in %	+695%	+3%
V add: dividend return in %	+149%	+22%
IV + V = VI TSR in %	+844%	+25%
annualized TSR in % (9 years)	+28%	+3%

A part of the performance gap stems from a multiple tailwind at Lagercrantz (1.9x) vs. compression at GESCO (0.6x). Nonetheless, **one can safely assume that returns for Lagercrantz solely based on its 18% earnings CAGR in local currency over nine years would have been great no matter what** while GESCO's earnings CAGR of +7% wouldn't have turned a dog into a star even with a less detrimental change in multiple. An interim take-away is that Lagercrantz outcompeted GESCO based on the merits. It built a well-oiled M&A machine and owns higher margin/less capital-intensive subsidiaries. To put its stellar performance into perspective, I added Berkshire to the chart on the next page.



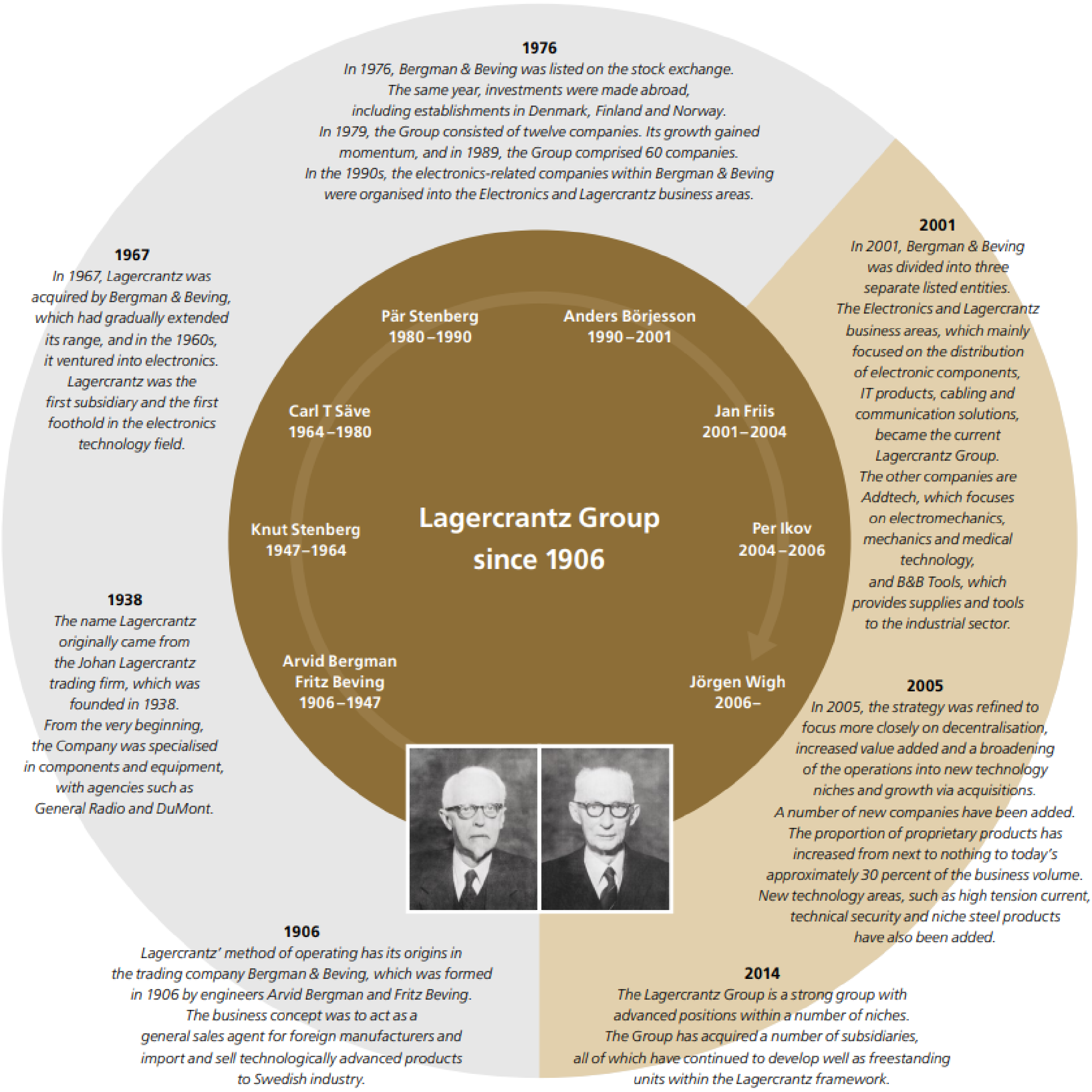
Bergman & Beving created Lagercrantz and more wildly successful spin-offs

Lagercrantz has its origin as a spin-off from Bergman & Beving and was listed on Nasdaq Stockholm in 2001. Bergman & Beving was itself a Scandinavian holding company that grew rapidly over the past decades through serial acquisitions. Lagercrantz' financial targets have remained unchanged since 2001 (see below). The only difference from FY13 to today is that **Lagercrantz back then wanted to close 3-5 acquisitions per year vs. 5-8 going forward. 10% inorganic growth from now on would mean ~65m EUR acquired revenues per year or 8-13m EUR per acquisition vs. less than 10m EUR historically.** Lagercrantz usually acquires small subsidiaries for 4 to 7x EBITA and today can run 3 to 5 M&A processes simultaneously.

It's likely these financial goals from a Swedish industrial holding company will ring a bell at many investors. Peers **AddLife** and **Addtech** pursue the *exact* same targets, namely:

- average earnings growth of at least 15% per year over a business cycle
- profitability (P/WC) of more than 45%

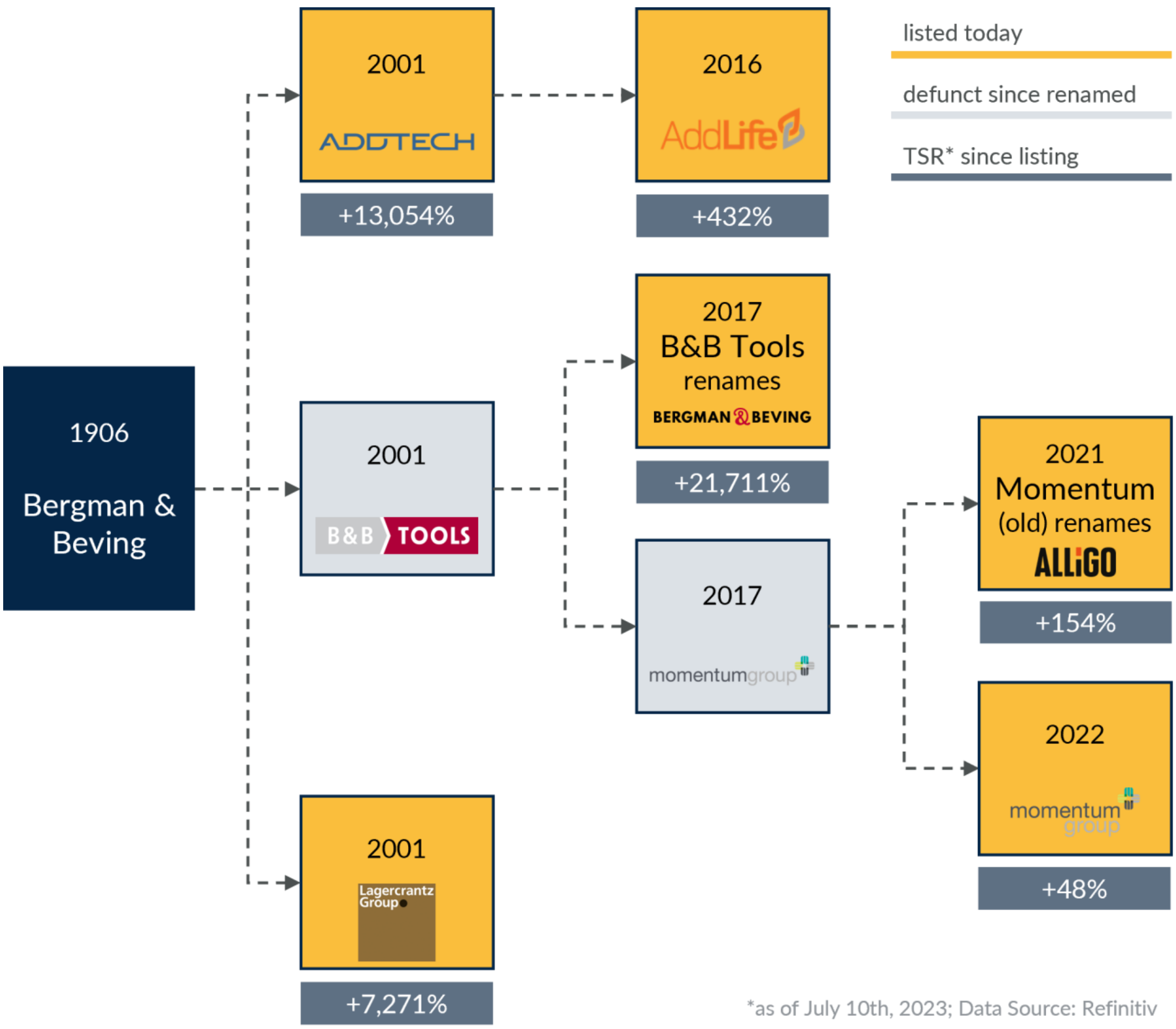
This is no coincidence at all since all three companies share a common origin in the original Bergman & Beving trading company founded in 1906. Bergman & Beving was listed in 1976 and split into the three separate listed entities Lagercrantz, B&B Tools and Addtech in 2001 (see below).



Until today, Bergman & Beving created six separate listed holding companies:

1) Addtech, ~5bn EUR market cap
2) Lagercrantz, ~2bn EUR market cap
3) AddLife, ~1bn EUR market cap
4) Bergman & Beving, ~0.5bn EUR market cap
5) Alligo, ~0.5bn EUR market cap
6) Momentum Group, ~0.5bn EUR market cap

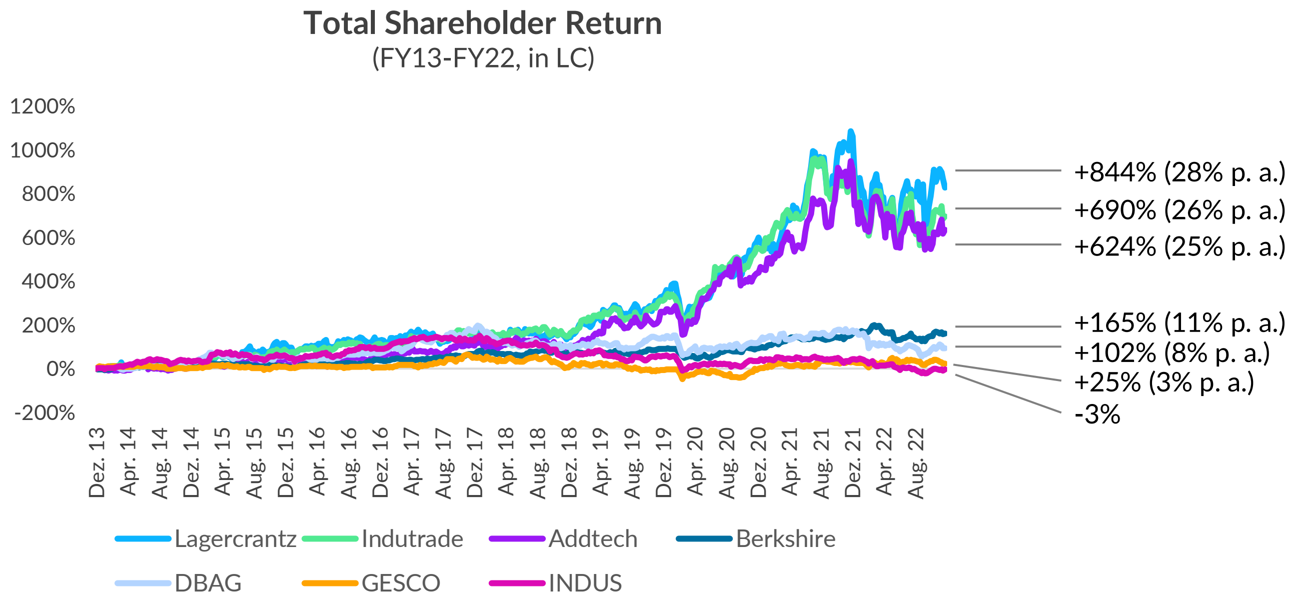
While the quality of the subsidiaries varies *significantly* between each spin-off, multiple of them have turned out to be wildly successful investments. Below one can see that according to Refinitiv, **Lagercrantz has been a 70-bagger, Addtech a 130-bagger and Bergman & Beving a 200-bagger.**[1]



[1] Bergman & Being traded under the name B&B Tools from 2001 to 2017.

An inconvenient question arises

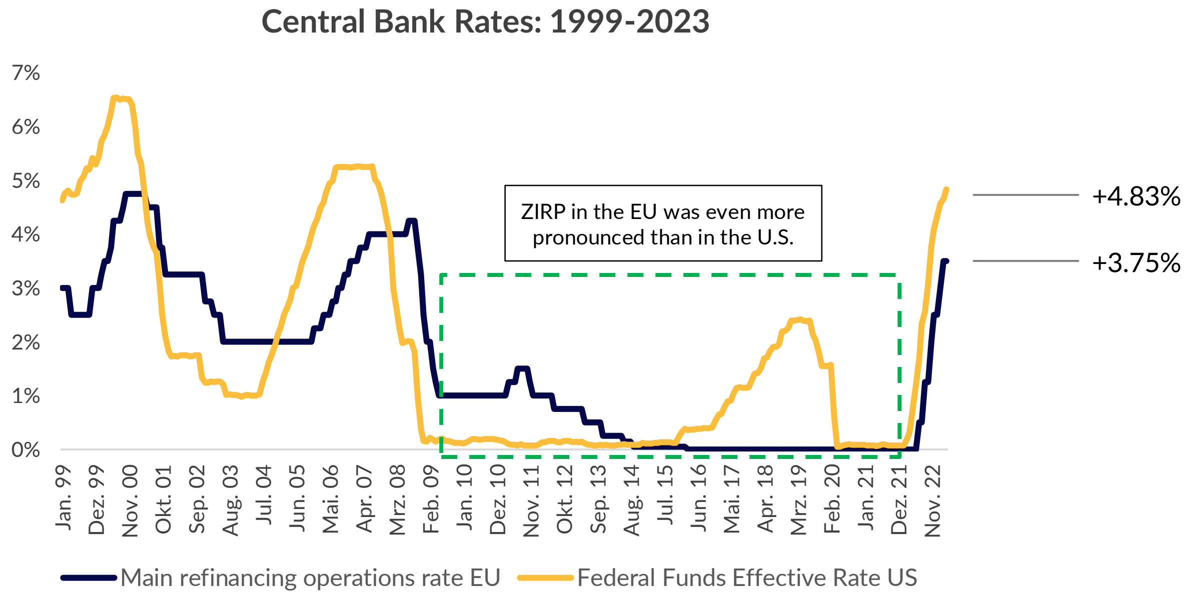
Benchmarking the historical returns of the aforementioned Scandinavian holding companies against their German peers GESCO, INDUS and DBAG raises an inconvenient question. While several of the former (e. g. Lagercrantz and Addtech) have produced annualized shareholder returns of >25% for the past decade, the German pack has been a complete disappointment (except for acceptable returns of DBAG). The chart below shows the returns of all mentioned companies from FY13-22. Once again, I added Berkshire as a vastly more sized constrained conglomerate to give readers a point of reference.



From a domestic perspective, the chart is disappointing and surprising. Neither GESCO nor INDUS or DBAG achieved above average returns despite an *unprecedented* environment of low interest rates. Ex ante one could (and should) have assumed that if your business model is to be a holding company and acquire SMEs partly funded with debt, the prolonged zero-interest-rate-policy (ZIRP) would have been a *massive boon* to what you're doing (see quote below and chart on the following page).

"Declining interest rates have a number of very strong impacts. They stimulate the economy, they make it easier for companies to make money. They make assets worth more, and of course, they reduce the cost of borrowing. […] And it's not a coincidence that this is when private equity in particular had its great success, because that's what it does. ***You borrow money to buy assets. The assets as it happened, turned out to be worth more than you thought they would, and the cost of borrowing to buy them turned out to be less than you thought it would be. That is a great combination****. And so I believe there's a couple things worth noting. Number one, I think that* ***this decline in interest rates was the biggest single event of the last 45 years in the financial world****."*

- Howard Marks, Co-Chairman Oaktree Capital Management



Despite the more pronounced ZIRP in the EU vs. the U.S., *none* of the three German industrial holding companies even matched the returns of the vastly more size constrained Berkshire conglomerate (which itself marginally *underperformed* the S&P 500 over the past decade).

To conclude our FY13-22 performance comparison between Lagercrantz and GESCO, we must acknowledge that on the one hand, Lagercrantz was heading from strength to strength and grew its number of subsidiaries from 33 to 69. On the other hand, GESCO's net number of subsidiaries shrank from 17 to 10 and it had to undergo a major portfolio restructuring in 2020. It also had to change its CEO twice (2016 and 2018) and its share price stayed essentially flat for a decade.

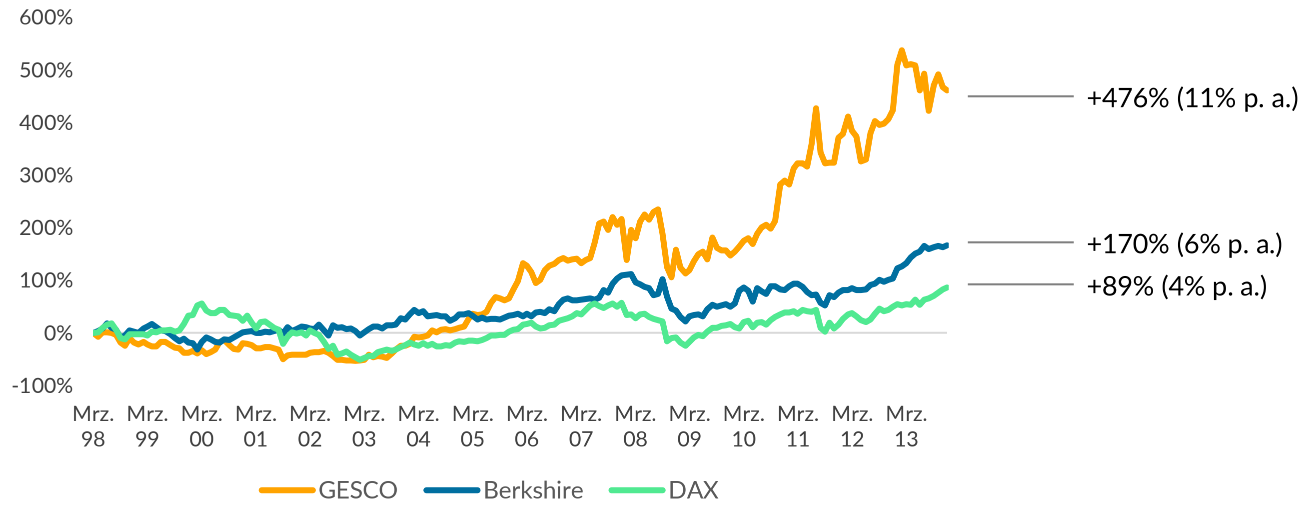
GESCO is an acronym which stands for: "German and Scandinavian organization". The company was founded in 1989 by three German and two Swedish investors but regarding the subpar performance vs. many of its Scandinavian peers over what should have been a *blowout decade* for its business model leaves an inconvenient question that arises…

…dear GESCO: "Why can't you be more Scandinavian?"

WHAT WENT WRONG?

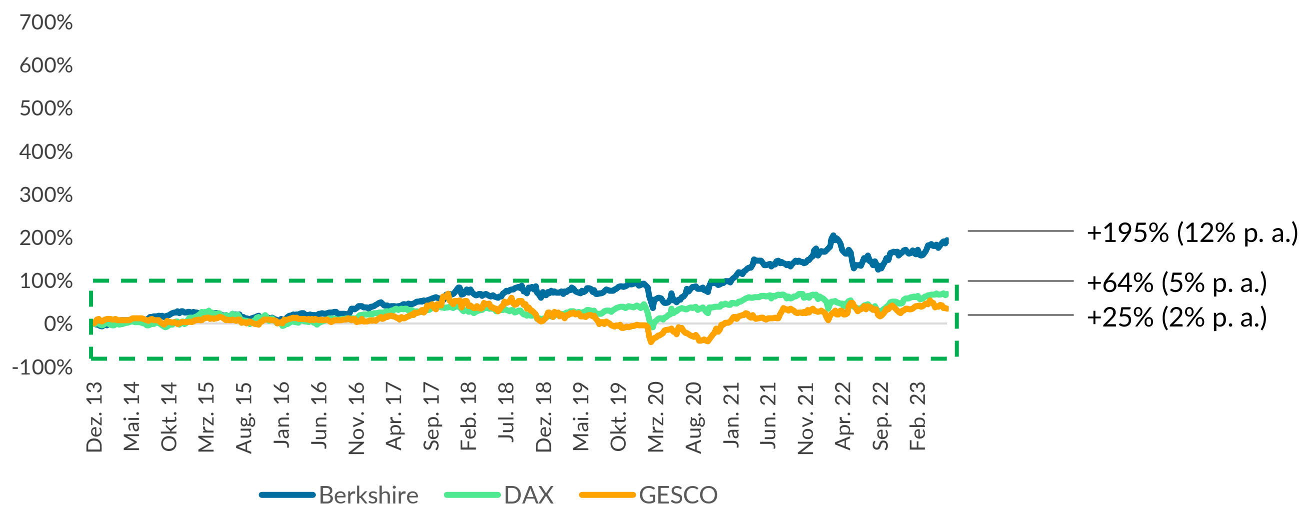
So, what went wrong? If one stopped reading this marketing message after its long opening paragraph, one can be left with the impression that GESCO has always been a chronic underperformer on the public market. **However, this is not true at all, quite the contrary!** For its first 15 years as a listed company from 1998 until the end of 2013, GESCO delivered an annualized total return of 11%, which meaningfully *beat* both the German stock index DAX (4% p. a.) and also Berkshire (6% p. a.).

Total Shareholder Return
(IPO-2013, in LC)



It's only the past decade that must be considered a lost decade for GESCO's investors. The situation lends itself **to ask some further questions about why and when GESCO got off track**.

Total Shareholder Return
(2013-today, in LC)



GESCO's genesis story: it all went well, until it didn't

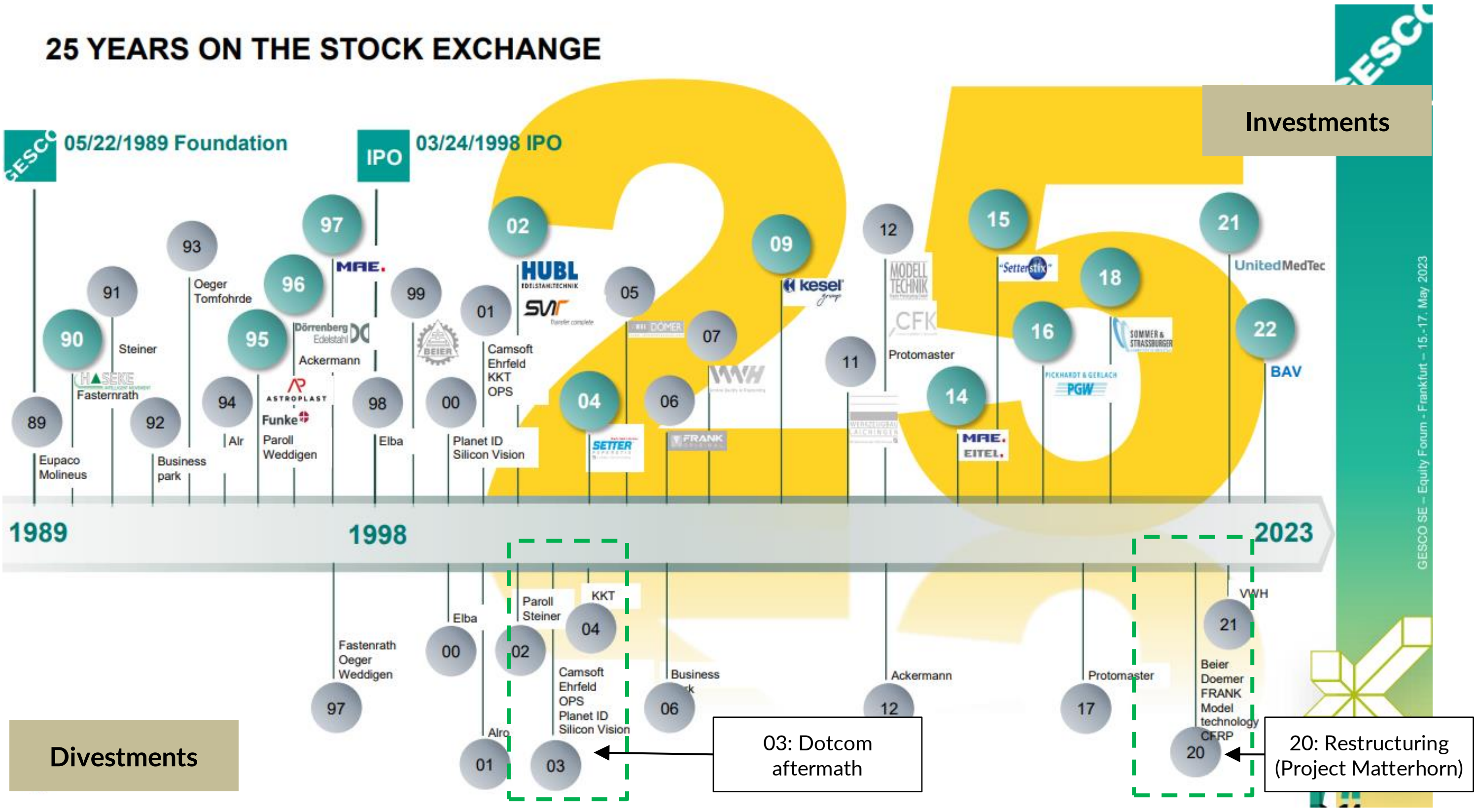
1989 marks the year when GESCO was founded by five men, one of them its longtime Chairman of the supervisory board, **Klaus Möllerfriedrich**, an auditor and tax advisor born in 1947. Klaus recently stepped down as Chairman but will continue to serve as a normal board member going forward.

From its auditing work, **Klaus knew many industrial SMEs in Germany that had mounting unresolved succession issues**. Together with four co-investors, Klaus financed GESCO's firsts acquisition using private money. Their first significant subsidiary was HASEKE, a manufacturer of pendant systems used in medical technology and heavy-duty pendant systems for industrial clients. HASEKE is still part of GESCO today and was merged in 2022 with W. Krömker to form the newly established AMTRION subsidiary with ~23m EUR in revenue and 100+ employees.

To scale GESCO's business model and raise additional capital, the five founders opted for an IPO in March 1998. Below one can find a table with GESCO's revenue, EBITA and share price development from its IPO until FY13 and then again from FY13 to FY22.

GESCO	FY97	FY13	FY22
Revenue in €m	128.9	453.3 (+252%)	582.3 (+28%)
EBITA in €m	8.7	32.6 (+274%)	52.7 (+62%)
# of companies	12	17 (+5)	10 (-7)
Share price in €	6.2	23.4 (+277%)	24.1 (+3%)

GESCO went from achieving low DD annualized returns between its IPO and 2013 to unsatisfactory LSD returns from 2013-2022. Until FY13, GESCO was in expansion mode with EBITA compounding at +9% CAGR and the net number of subsidiaries growing from 12 to 17. Although GESCO has no exit strategy, divestments happened sporadically whenever subsidiaries seemed to be in structural decline. The timeline on the next page shows two group divestments in 2003 and in 2020. The latter was conducted to sell GESCO's struggling automotive segment (Project Matterhorn), while the former (including Camsoft, Ehrfeld, OPS, Planet ID and Silicon Vision) **can at best be described as the aftermath of the Dotcom craze**.



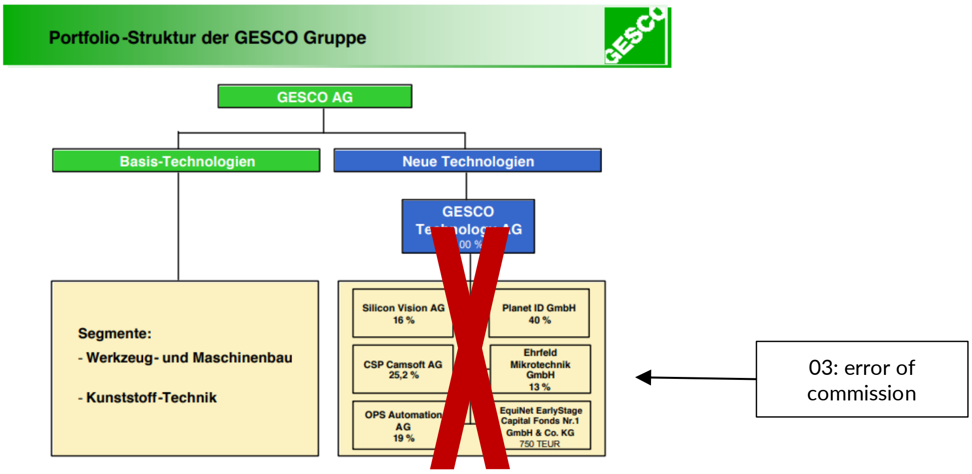
Around the year 2000, GESCO's management deemed it a good idea to start reinvesting profits from its "boring" industrial SME businesses (called "Basis Technologies") into a second, more sexy business unit (called "New Technologies"). In its new business unit, GESCO wanted to take minority stakes and sell them again after some quick gains (I know, what could possibly go wrong here, right?). The first "New Technologies" investment was the acquisition of a 16% stake in Silicon Vision AG. GESCO's CEO in 2000 made the following remarks on this:

"One of the "pearls" mentioned is Silicon Vision AG in Siegen, our first investment. Together with Agfa Gevaert, Bankhaus Julius Baer and stockbroker Schnigge, we invested in this company, because ***we see a groundbreaking product development with enormous market opportunities****. Silicon Vision has developed image sensors that are technologically far superior to conventional chips and also offer cost advantages. In Dresden, a new factory is being built, which will go into operation in two years and will generate a sales volume of DM 70 to 80 million in the following years."*

Readers probably already see it coming. **Two years later, Silicon Vision didn't generate a sales volume of DM 70 to 80m but instead, it filed for bankruptcy**. Soon after, GESCO's management divested *everything* left in the "New technologies" business unit and commented:

"The "New Technologies" business area contrasts sharply with the overall positive development (in "Basis Technologies"). It is true that the companies in this business area were able to interest potential customers in their innovative products and generate a thoroughly positive response. ***However, this fundamental interest was not sufficiently reflected in orders****. In view of the stagnating economy, potential customers were under severe economic pressure and showed a marked reluctance to invest.* ***At the Annual General Meeting on September 5, 2002, I reported to you in detail about the development of Silicon Vision AG, which had to file for insolvency last August****. [...] For this reason, the Executive Board and Supervisory Board of our company decided at the end of March 2003 to*

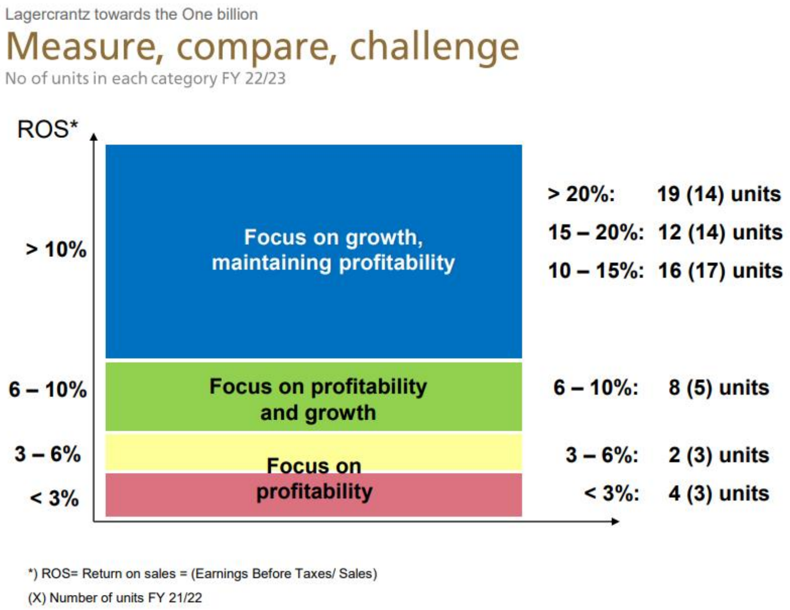
draw a firm line under our involvement in new technologies. On March 31, 2003, we sold GESCO Technology AG with its investments and thus discontinued this business area completely."



This entire episode can be judged as an easily avoidable investment misbehavior in GESCO's history. It was an *error of commission*, albeit one with limited damage after all. **A second error and most likely a much larger one didn't arise from *commission* but from *omission*.** In my opinion, the latter error explains a large part of GESCO's subpar performance since FY13.

What went wrong after FY13? Errors of omission!

Over the past decade, GESCO's executives stayed away from shaky minority investments **but it simultaneously became clear that some legacy subsidiaries (especially those in its automotive segment) less frequently produced sufficient profits**. Additionally, some had issues with ageing and less competitive management. While GESCO's Scandinavian peers share a strong belief in decentralization, **they have historically been stricter in terms of holding their subsidiaries accountable as soon as margins fall below critical thresholds**. At Lagercrantz for example, all subsidiaries are benchmarked against each other and as soon as EBITA margins fall below 6%, the sole agenda for that subsidiary becomes to improve profitability instead of discussing any growth plans or other projects (see graphic below).



Some market participants got the impression that the c-suite and supervisory board at GESCO became a bit complacent in terms of holding its subsidiaries to the same rigid performance standards after 15 years of success. **Overall, GESCO's EBITA CAGR halved from 9% between FY98-13 to 5% between FY13-22**.

Two CEO changes

In 2016 a new CEO was installed to turn the company around (former McKinsey, Plastic Omnium). However, my impression was that not much changed at GESCO at all. In 2017 this CEO shared three goals for GESCO with investors, which all lacked ambition in my opinion:

1) 8% EBIT margin by 2022 (vs. 7% in FY13)
2) Operating subsidiaries should return to organic growth
3) M&A: up to three acquisitions per year

Completing a strategic review of GESCO's entire portfolio, the new CEO saw no need for divestments, despite an evident downward trend in the automotive business. His public targets also didn't instill any new lifeblood into the M&A team and it doesn't come as a surprise that while Lagercrantz closed an average of 4 acquisitions per year from 2018 until today (against their target of 3-5), GESCO closed only Ø 0.8 acquisitions per year against their target of up to 3 (a clear miss).

The CEO was hired in 2016 but lasted for only ~2 years until 2018 and **it was this episode, which made some investors discount their expectations even further in terms of how GESCO would develop going forward**. In Germany, GESCO is considered "dead money" by some market participants and they don't see any catalysts to improve its flat share price. But for every downside risk on the stock market there's a corresponding upside risk. In the next chapter, I brainstorm about things that *theoretically* could change for the better at GESCO.

Disclaimer: I take no stance on the likelihood of any future downside risk or upside risk materializing. This document is a marketing message. It is no investment advice and no financial analysis. Please refer to the disclaimer on page 2.

COULD THINGS ALSO GET BETTER?

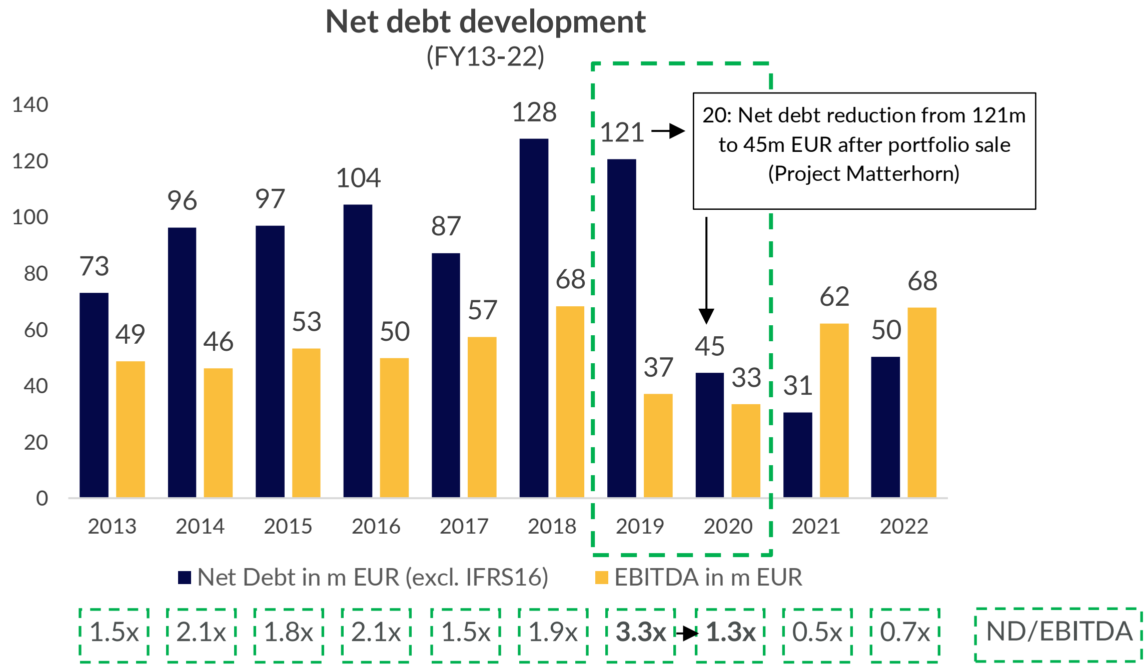
The historical facts I wrote down about GESCO so far may not sound particularly cheerful. While Lagercrantz earned itself a reputation as a beloved “compounder”, GESCO shattered many investors’ hopes. In investing it goes without saying that **past performance is no guarantee of future results**. On the one hand, this means a company like Lagercrantz might do less spectacular in the future, but the corollary is also true: GESCO might do less bad in the future. So, what could market participants imagine as things that might get better in the future?

Portfolio simplification in 2020 (Project Matterhorn)

In mid-2018, Ralph Rumberg took over as CEO from his predecessor, who didn’t achieve any quick wins. **Ralph’s strategic portfolio review led to a different conclusion. He deemed action was urgently needed and the automotive segment shall be divested.** From 2018 until 2020 GESCO prepared a group divestment (internally called: “Project Matterhorn”), which in the end led to the sale of the following six companies:

- Paul Beier GmbH & Co. KG
- Dömer GmbH & Co. KG Stanz- und Umformtechnologie
- C.F.K. CNC-Fertigungstechnik Kriftel GmbH
- Werkzeugbau-Laichingen-Group
- Frank-Group
- Modell Technik Formenbau GmbH

In sum, this group generated 90m EUR in revenue and a negative EBIT of -1.3m EUR. **They were sold for a price of 27m EUR and carried net debt of 19m EUR (EV: 46m EUR).** Project Matterhorn was the largest transaction in GESCO’s history and allowed the management to focus more intensively on the remaining 10 subsidiaries afterwards. When it comes to holding the subsidiaries accountable, **Ralph advocates for a significantly more active approach than before**. Overall, Project Matterhorn – supported by improvements in working capital – resulted in a sizable net debt reduction, which could be beneficial for GESCO’s future M&A ambitions (see chart on the next page). **FY22 showed a record EBITDA of 68m EUR (the same level as in the previous record year 2018) but now with only 10 subsidiaries left in the holding and an improved leverage ratio of 0.7x vs. 1.9x in 2018.**



New management team

Ralph Rumberg is CEO since 2018. Andrea Holzbaur became CFO in 2022.

KEY PEOPLE YOU SHOULD KNOW AT THE COMPANY

RALPH RUMBERG

CEO since July 18

Born 1969, age 54, studied Mechanical Engineering, and started his career in motorsports as a team manager and vehicle manager for BMW Motorsport, later AMG Mercedes. Went into the industrial sector by joining Bosch Rexroth. Oversaw 2 major restructurings with successful track record.

ANDREA HOLZBAUR

CFO since September 22

Born 1971, age 52, studied business administration and started her career as a financial analyst and auditor at Honeywell. Went to air and dry coolers manufacturer Güntner as CFO Europe in 2013 and rose to the role of Managing Director Europe in 2018 with a focus on digitalization.

STEFAN HEIMÖLLER

Member of Supervisory Board since July 13

Born 1963, Age 60, is GESCO's second largest shareholder (14.2% ownership). Studied business administration. Bought a steel company out of insolvency in 1993 (Platestahl), leads it with 200 employees ever since. Has deep knowledge of GESCO's subsidiaries trading or processing steel.

JENS GROßE-ALLERMANN

Member of Supervisory Board since August 17

Born 1967, Age 56, represents GESCO's largest shareholder Inv AG (18.5% ownership). Started his career at Deutsche Bank, followed by 5 years of consultancy, 3 years as CFO of Condomi AG. Since 2003, Jens serves as MD of a large family office in Bonn focused on value investing.

STEFFEN GRASSE

Managing Director, Setter subsidiary

Born 1967, Steffen is responsible for GESCO's most important growth engine Setter. The company manufactures paper sticks and grew from to 35m to 81m EUR revenue from FY18-22. It plans to double again over the next four years and could surpass 100m EUR revenue by 2024.

MARC BREIDENBACH

Managing Director, Dörrenberg subsidiary

Born 1983, Marc is responsible for GESCO's largest cash cow Dörrenberg, which I expect contributed 27.1m EUR to group EBITA last year or 46% pre holding costs. After a record year 2022, I expect Dörrenberg's EBIT will decline y-o-y and masquerade a bit the ongoing progress at Setter et al.

Out of the six persons above, the first two work at the executive level, the next two at the supervisory board level and the latter two lead GESCO's two largest subsidiaries. **Given GESCO's small size, whoever is CEO can assert a significant influence on investment decisions at the subsidiary level but also on the holding's M&A strategy**.

In my opinion Ralph wants to embody a *culture change* at GESCO, where the holding takes a more active approach in managing its subsidiaries vs. the laissez-faire approach of the past. In terms of M&A, Ralph sees his skillset more as an optimizer of acquired targets instead of "just" a passive owner. He will most likely look out for targets with *below average* profitability at first (say 3-5% margin) and try to improve from there. This strategy can lower the effective purchase price but adds implementation risks and Ralph still needs to deliver evidence his strategy works.

If one looks for clues *ex ante* if he might be able to deliver against several of his promises, some questions jump to mind:

1) *Q: Can he identify margin levers on the operations side, has he shown commitment before to spend a lot of time on the road and set foot on the ground at the subsidiary level instead of just staying at the headquarters?*

   A: It seems so.

   The back story of Ralph's career is that he studied Mechanical Engineering in Bochum, Germany and was fascinated with the construction of automotive engines. Post graduation, he joined BMW Motorsport as a team manager and vehicle manager. For 3 years he headed constructor teams next to all global racetracks. **His job came with the requirement of 200+ travel days per year and he was often away from home for the sake of his career**. After his tenure at BMW, he served a similar role at AMG Mercedes-Benz and describes this as his most insightful learning experience when it comes to team collaboration. Serving nine years as a leading technical director in racing, Ralph likes to mention an anecdote capturing the essence of what constitutes high-performance teams in his regard: in order to conduct a Formula 1 pit stop as fast as possible, 18 mechanics have to work in perfect sync. If responsibilities are clearly defined and the team trusts each other, a pit stop can be done in less than two seconds. Five seconds is a failure. At GESCO, Ralph wants to put together optimal leadership teams, spend significant time on the road (4+ round trips to all subsidiaries per year) and dedicate a large part of his time working with the managing directors of the subsidiaries instead of just staying at the headquarter.

   "Ultimately, the path to being a hidden champion starts with the will to be a hidden champion. ***As so often in life, it's a question of mindset and attitude, which makes the path to becoming a hidden champion a leadership task.*** *This kind of corporate culture also attracts talents. Who doesn't want to work at a successful company with a strong team spirit?"*

   \- Ralph Rumberg, CEO of GESCO

   After 9 years in motorsports, Ralph spent another 15 years in the industrial sector. Initially, the plan was to stay only briefly inside the large German corporation Bosch

Rexroth (a manufacturer of drive and control technology with product offerings in gearboxes and hydraulic pumps) but it turned out to be Ralph's longest tenure with over 10 years. At Bosch Rexroth, he started in sales but served many different roles afterwards. Near the end of his stay, he oversaw his first large acquisition and gained M&A experience apart from his work on the operations side.

2) *Q: Has he once before increased margins meaningfully at a below average M&A target?*

   A: Yes.

   Before Ralph joined GESCO, he worked as the CEO of AVICEM KOKI GmbH from 2014 to 2018, a turnaround project under private equity ownership which was later sold to a Chinese SOE. AVICEM KOKI manufactures gear shifting systems and **Ralph's initial focus lay on improving margins which he achieved in due time. Afterwards he focused on the company's internationalization.** At Rexroth he oversaw another significant turnaround project of a loss-making subsidiary with ~200m EUR in revenue, which he led to break-even 18 months into the job and into positive margin territory thereafter. Ralph would describe his leadership style as a CEO who likes to drive change. His M&A strategy for GESCO will be built upon improving efficiency at the subsidiaries over a 18-24 months period post closing (a change from the historically passive role of the holding).

3) *Q: Will he lapse into actionism if he doesn't find suitable targets and overspend on M&A only to get closer to his 2025 outlook?*

   A: This can't be ruled out, but so far it doesn't sound that way.

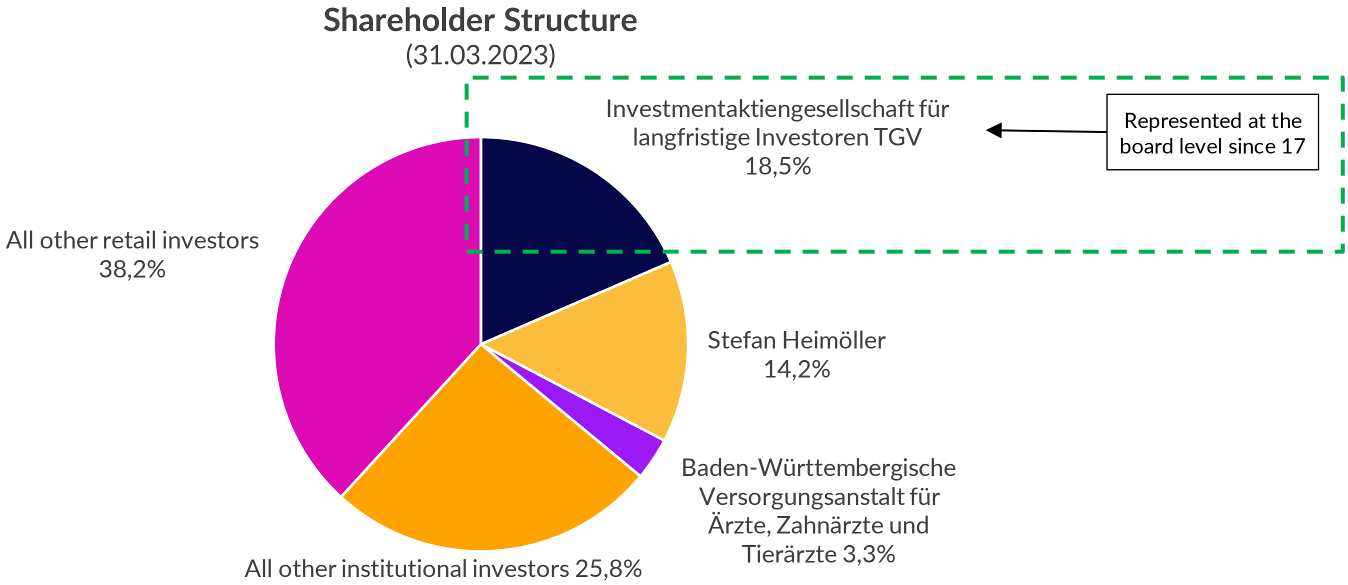
   Looking back at the past year, reading a bit between the lines, it seems GESCO has been far into a structured process to acquire a large company and backed away from it in the final stage as the asking price no longer fully met their requirements. So far, Ralph stayed clear of bad deals and rather kept GESCO's gross cash on the balance sheet.

   "We are on the lookout for future hidden champions. What does that mean in concrete terms? ***We do not want to acquire the perfect company. With our methodological expertise, we will lead the companies to that point – that they become hidden champions with us****. […] Our search profile remains unchanged at between € 20 and 100 million turnover in attractive, future-oriented sectors. Strategic add-ons are also very important to us. I am sure we will see one or two in the near future to take our existing companies further […] Yet the following applies:* ***On the way to € 1 billion in turnover - keep calm****. We take a close look at the companies. We analyze the medium and long-term potential in detail. Then we decide.* ***As always, we do not make bad deals."***

   \- Ralph Rumberg, CEO of GESCO

Largest shareholder is getting more active

Another thing that could potentially change for the better is that GESCO's largest shareholder seems to be losing some patience and is getting more actively involved since 2017.



The "Investmentaktiengesellschaft für langfristige Investoren TGV" sent its highest-ranking managing director, Jens Große-Allermann, to the supervisory board in 2017.

I have never discussed anything GESCO-related with Jens, but I once worked as an intern at the family office he represents. I generally hold him in high regard when it comes to respecting interests of minority shareholders in public companies. Especially in German small caps this can otherwise often be a problem. My educated guess would be that Jens has little involvement in day-to-day operations of GESCO, but I imagine he will take a critical stance on key personnel decisions and capital allocation topics. It's also likely he'd be a strong opponent in case the c-suite would ever propose an overpriced deal only for the sake of acquiring or getting closer to the 2025 targets.

GESCO's two largest shareholders Inv AG (Jens Große-Allermann) and Stefan Heimöller represent a combined ~33% ownership in the company. While Jens' strengths lie more in the field of capital allocation, Stefan has deep first-hand knowledge regarding all topics related to processing or trading steel (which are crucial for subsidiaries like Dörrenberg, SVT, PGW or INEX solutions).[2] Both men supported a new bonus system last year to incentivize the c-suite through 1) a variable cash-based STI tied to GESCO's future increases in net income and 2) a variable LTI (virtual shares) tied to the increase in share price over four years. The system design

[2] For the sake of completeness, I'd like to mention here that GESCO undertakes some transactions with related third parties albeit at a small scale: Stefan Heimöller's company Platestahl Umformtechnik buys and sells steel products to Dörrenberg and SVT.

is “okay” but it could also be better.[3] Oversimplified, the new incentive system works in the following way: based on a fixed remuneration for the CEO of 495k EUR, his variable remuneration (LTI + STI) depends on the latest net income and is capped at 100% of his fixed remuneration. **<50% of the variable remuneration then gets paid out as a cash bonus and >50% of the variable remuneration is invested into virtual shares for four years and then gets paid out as a cash payment.** Prior to the application of the new LTI system, Ralph earned a total of 823k EUR in 2022 (see table below):

	Ralph Rumberg	
	01/01/2022 – 12/31/2022	
T€	**Absolutely**	**Relatively**
Remuneration independent of performance	**495.0**	**60.2 %**
Annual fixed salary	388.0	47.2 %
Ancillary services	29.4	3.6 %
Retirement benefits	77.6	9.4 %
Variable remuneration	**327.7**	**39.8 %**
STI	327.7	39.8 %
LTI	0.0	0.0 %
Total 2022	**822.7**	**100.0 %**

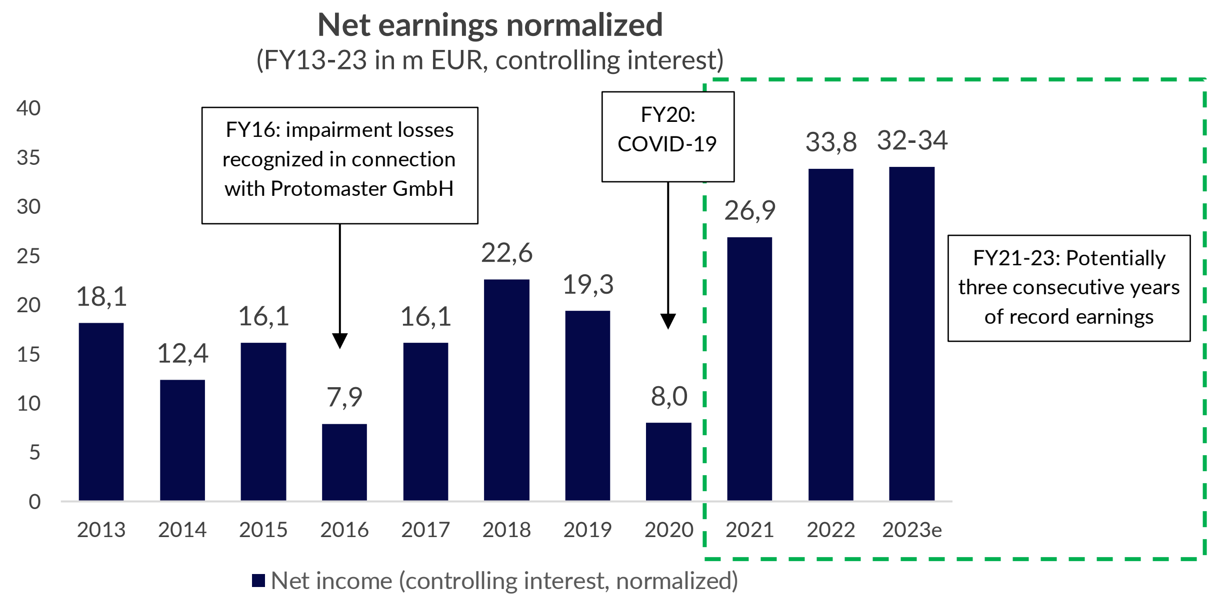
[3] Without delving too deep into incentive system designs, it often makes sense to let the management directly *feel* the consequences to their net worth whenever the share price suffers (i. e. real ownership instead of virtual ownership). Additionally, it’s often smart to tie STI to ROIC progression and LTI to TSR progression vs. a strong peer group.

(Possibly) three consecutive years of record profits

Besides some qualitative factors, there might also be some quantitative factors getting better. **In 2021 and 2022, GESCO reported two consecutive years of record net earnings and the management outlook for 2023 could imply a third consecutive record year**. The company has set the following targets for its current fiscal year:

- Net revenue: 600-620m EUR
- Net income (post minorities): 32-34m EUR

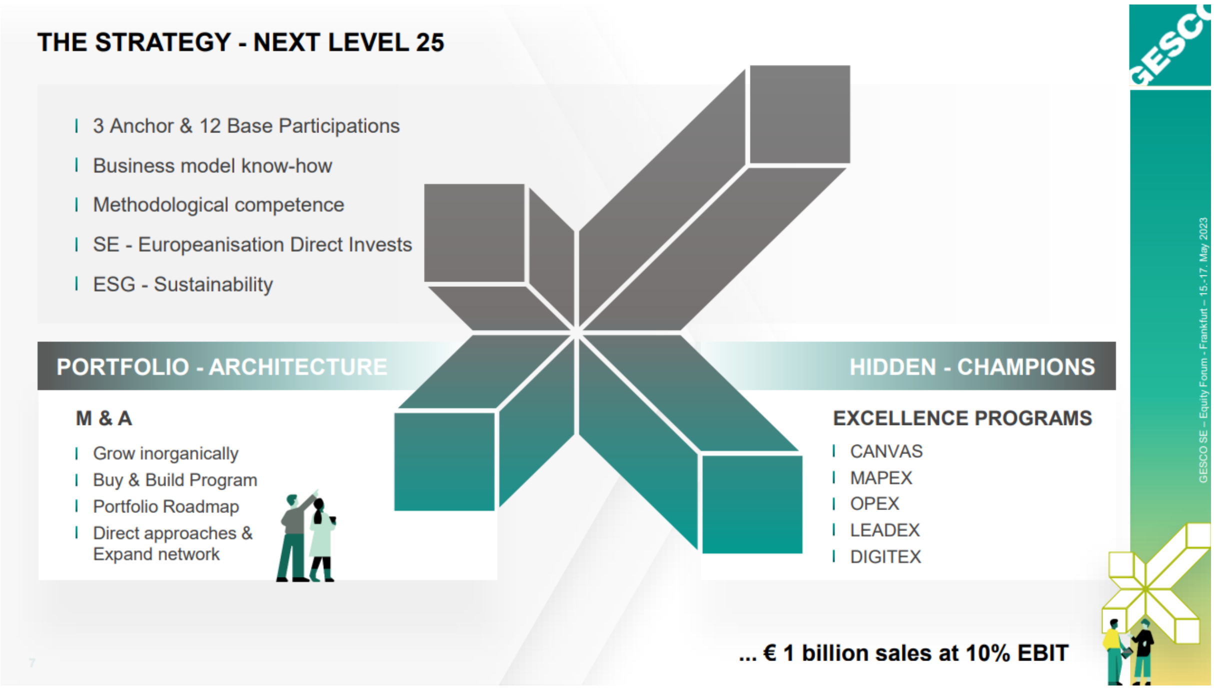
The CEO approaches the topic of giving guidance conservatively. At a recent investor conference, he confirmed the outlook but also stated that FY23 results could *slightly exceed* the upper range. Should the company reach 34m EUR in net earnings, it would constitute the third consecutive year of record earnings which is something investors haven't seen from GESCO in a long time (see below, any adjustments are mine):



Disclaimer: Please note that I take no stance on the likelihood of GESCO reaching or missing their FY23 outlook. This document is a marketing message. It is no investment advice and no financial analysis.

THE CEO'S MID-TERM AMBITION

Different from his predecessors, Ralph put out some specific mid-term targets he wants to achieve by the end of 2025 titled **"NEXT LEVEL 25". The NL25 strategy aims for 1bn EUR in sales and 100m EUR in EBIT** (see below).



Starting off on GESCO's FY23 expectations, management hitting these targets would imply the following developments:

- **Number of subsidiaries**: today's 1 anchor and 9 base subsidiaries grow organically and inorganically to 3 anchor and 12 base subsidiaries. This means GESCO needs to close 5 transactions over the next 2 years
- **Revenues**: FY23 rev of 600-620m EUR grow to 1.000m EUR until FY25 (28% CAGR)
- **EBIT**: FY23 EBIT grows from 50m+ EUR to 100m EUR until FY25 (37% CAGR)
- **FCF**: At 60%+ cash conversion, FCF grows from 34m EUR to 60m EUR until FY25 (33% CAGR)

In my opinion, ambitious mid-term targets with fancy names fail on a regular basis. GESCO's targets contain closing 5 acquisitions over the next 2 years vs. 0.8 per year achieved from 2018 to today. From my experience, missing a company's mid-term targets can lead to hiccups in its share price if doubts emerge whether the targets will be met in time.

The prerequisite for hiccups though, is that market participants price in management's targets *ex ante* and buy into the vision early. In the case of GESCO, it's debatable how much value investors ascribe today to "Next Level 25". **It's easy to come up with scenarios where GESCO doesn't reach its profit targets until 2025**. What happens to its share price in such scenarios is a different topic for debate. It will depend on any potential gap between achieved progress until then and consensus expectations. Some investors argue the latter are not overly lofty today.

Next Level 25 and its building blocks

In the paragraph below, the CEO describes the building blocks for the company to get closer to its 2025 targets over the upcoming two years:

"*The core of the NEXT LEVEL 25 strategy is to* ***expand the portfolio to three anchor investments and twelve basic investments by 2025, to make the portfolio more balanced and resilient****. To this end, we want to implement two further anchor investments in addition to the Dörrenberg Group. Their target markets should have as little correlation as possible with Dörrenberg's typical market cycles. The anchor investments can either be acquired or developed on the basis of an existing subsidiary through organic growth and strategic acquisitions. We round off the portfolio with twelve basic holdings with substantial sales and earnings contributions in various target markets. Within the framework of the NEXT LEVEL 25 strategy, we focus our acquisitions on companies with sales of between € 20 million and € 120 million. Strategically motivated supplementary acquisitions for the subsidiaries can also be made in lower sales sizes.*

With the portfolio restructuring at the end of 2020 with the sale of six subsidiaries and the management buy-out of a seventh company at the beginning of 2021, we have positioned ourselves well for the NEXT LEVEL 25 strategy. The dependency on the direct automotive business has been reduced*. In return, we strengthened our base in the medical technology sector through the acquisition of the United MedTec Group with the operating company Krömker in June 2021.*"

The first building block will be closing 5 acquisitions until 2025 vs. only 0.8 per year achieved since 2018 (see below).

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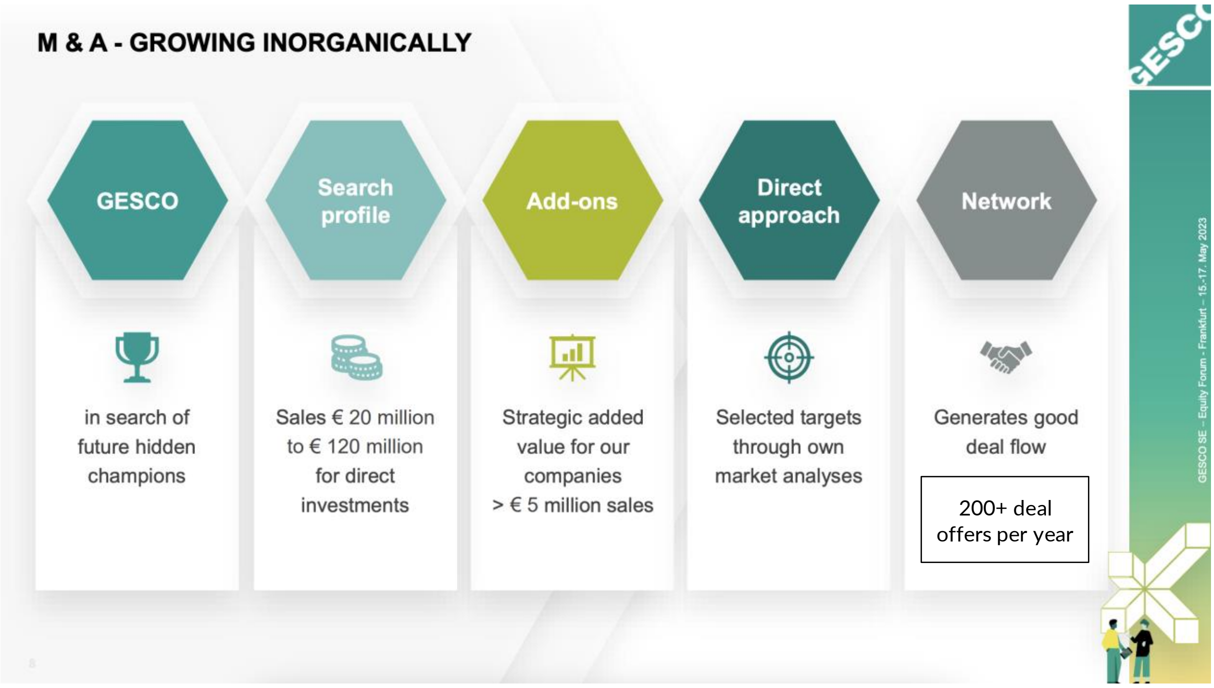


The second building block is the continuation of GESCO's new path as a more active owner of its subsidiaries. Ralph runs several programs for operational excellence titled CANVAS, OPEX, MAPEX, LEADEX and DIGITEX. Here's what's behind these acronyms:

"***The CANVAS business model analyses, which were carried out for the first time in 2019, have now become an established part of the annual strategy review at the subsidiaries and serve to jointly***

***target our activities**. Depending on the specific needs and status of the respective subsidiary, we launched or continued a number of MAPEX and OPEX programs in the past financial year. MAPEX serves to analyze and develop target markets and product portfolios with the focus on expanding the sales volume and gaining market shares. **OPEX serves to optimize processes in all corporate functions and thus to increase efficiency**. DIGITEX aims to digitalize work processes and business models."*

In the end, MAPEX shall result in every subsidiary outgrowing their market by 3% p. a. and OPEX in a 3% annual growth in revenue per employee. The margin target is 8-10% throughout the cycle. After all, the program names won't be important, execution will be.

MAPEX goal:
(12 – 24 months to efficiency)
Annual sales growth
above the market of

3 %

The CANVAS workshop and our OPEX, MAPEX and LEADEX Excellence Programmes are the stepping stones to sustainable performance, growth and dynamic adaptability. We are strengthening the Group from the inside out by building strong individual subsidiaries regardless of the economic cycle.

MAPEX – Market and Product Excellence
Analysis of customer segments, product offerings, customer channels and relationships. Further development of the product portfolio and market position.
Goal:
expanding business volumes

CANVAS – business model analysis
Introductory workshop for a holistic analysis of the respective business model.
Goal:
to instil common understanding in the managing team and identify potential for development within the company

LEADEX – Leadership Excellence
Workshops for sharpening leadership skills in a dynamic environment.
Goal:
promote and develop executives, strengthen corporate culture

OPEX – Operational Excellence
Analysis of value creation processes, particularly quality, lead time and delivery performance, as well as cost structures.
Goal:
increasing efficiency and margins

Target EBIT margin
(throughout the whole cycle)
p.a.

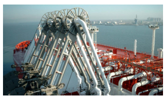
8 – 10 %

OPEX goal:
(9–12 months to efficiency)
Annual growth of
sales per employee

3 %

BUSINESS MODEL AND SUBSIDIARIES

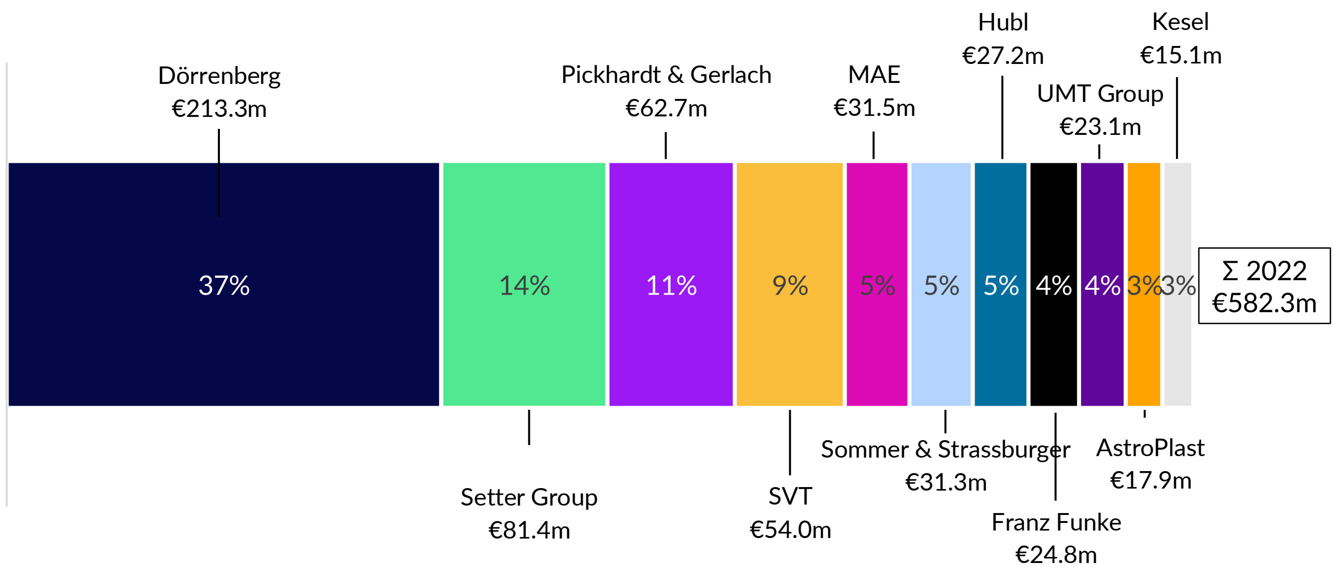
Below one finds a brief description of what each of GESCO's subsidiaries does and their contribution to group sales.[4]

	Subsidiay	Business description		sales FY22 €m	% of total
1	Dörrenberg	Tool steel supplier to SMEs		213.3	37%
2	Setter Group	manufacturer of paper ear sticks and paper lollipop sticks		81.4	14%
3	Pickhardt & Gerlach	Strip steel finishing with brass, copper, nickel or zinc coatings		62.7	11%
4	SVT	manufacturer of loading arms for liquids and gaseous media		54.0	9%
5	MAE	manufacturer of straightening machines and wheel set presses for trains		31.5	5%
6	Sommer & Strassburger	processor of stainless steel for process tanks, filter and membrane housings		31.3	5%
7	Hubl	processor of stainless steel sheets for machine coverings, housings and biotech containers		27.2	5%
8	Franz Funke	producer of machined metal turning parts		24.8	4%
9	UMT Group	pendant systems used in medical technology, heavy duty industrial pendant systems		23.1	4%
10	AstroPlast	manufacturer of injection-moulded plastic spools (for wires or cables), transparent plastic components		17.9	3%
11	Kesel	manufacturer of milling machines for bandsaws and grinding machines for gear racks		15.1	3%
	Total	-		*582.3*	*100%*

[4] I list 11 holdings instead of 10 since INEX solutions can be split into Hubl and Sommer & Strassburger.

GESCO discloses revenues by subsidiary. In FY22 the revenue mix looked like this:

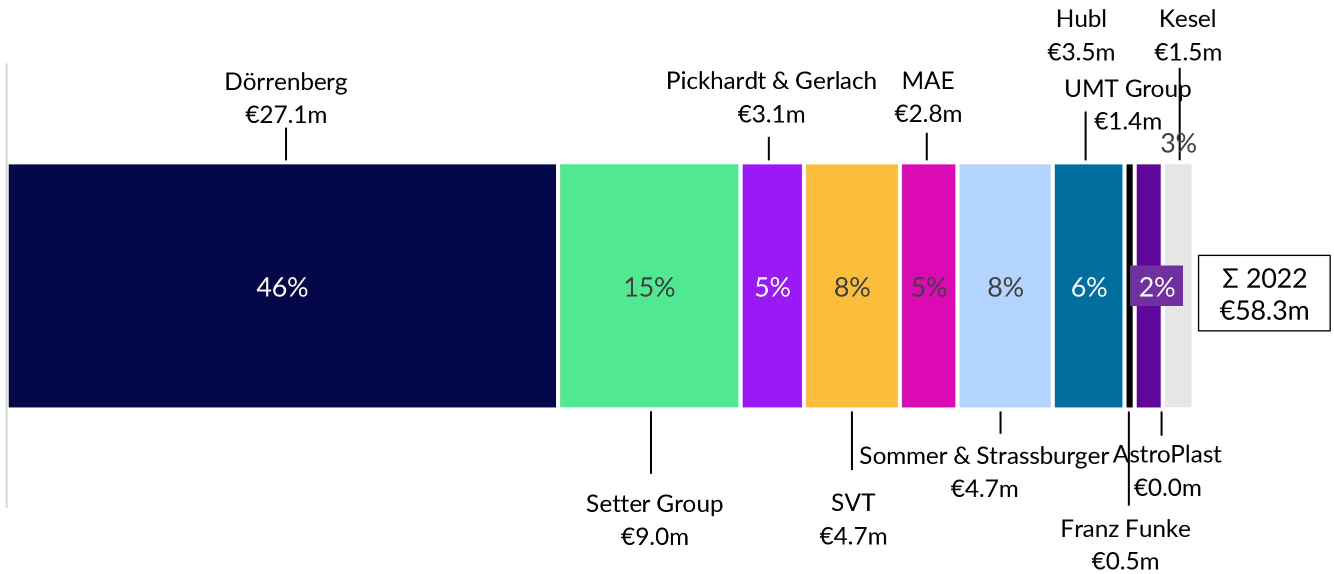
FY22 revenue by subsidiary



GESCO does *not* break out earnings by subsidiary.

The percentages below are own estimates and could *diverge significantly* from actual earnings. I expect GESCO's total EBIT pre holding costs was €58.3m in FY22 (10.0% margin) and €49.4m (8.5% margin) after €8.9m holding costs.[5] **I assume Dörrenberg achieved an above average margin of 12.7% and contributed 46% to group EBIT**, which makes it GESCO's biggest cash cow.

FY22 EBIT by subsidiary (own assumptions)



[5] Around 20 people work at the holding level, thereof 4 investment managers and 3 M&A specialists.

GESCO divides its 10 subsidiaries into 3 reporting segments:

1) Process technology: The three companies in this segment are **machinery manufacturers like MAE and Kesel** who sell their products to large manufacturing companies.

   Q: What's the most important subsidiary in this segment?

   A: It's INEX solutions, a high margin stainless steel processor for membrane housings and biotech containers.

2) Resource technology: The three companies in this segment are **value-added resellers of primary materials like Dörrenberg and PGW** who ship their materials to manufacturers of steel-made products.

   Q: What's the most important subsidiary in this segment?

   A: It's Dörrenberg, the supplier of tool steel to SMEs, which is by far GESCO's largest profit driver with an estimated 46% share of group EBIT.

3) Health & Infrastructure technology: The four companies in this segment are **component suppliers to companies close to the end consumer in the fields of medical technology, F&B or hygiene like Setter and AMTRION**.

   Q: What's the most important subsidiary in this segment?

   A: It's Setter Group, the manufacturer of paper sticks for ear buds and paper lollipop sticks. It's GESCO's fastest growing subsidiary with a 20% revenue CAGR over the past decade.

Process Technology

18% of revenue
22% of EBIT
542 employees
€194k rev/employee
12% margin

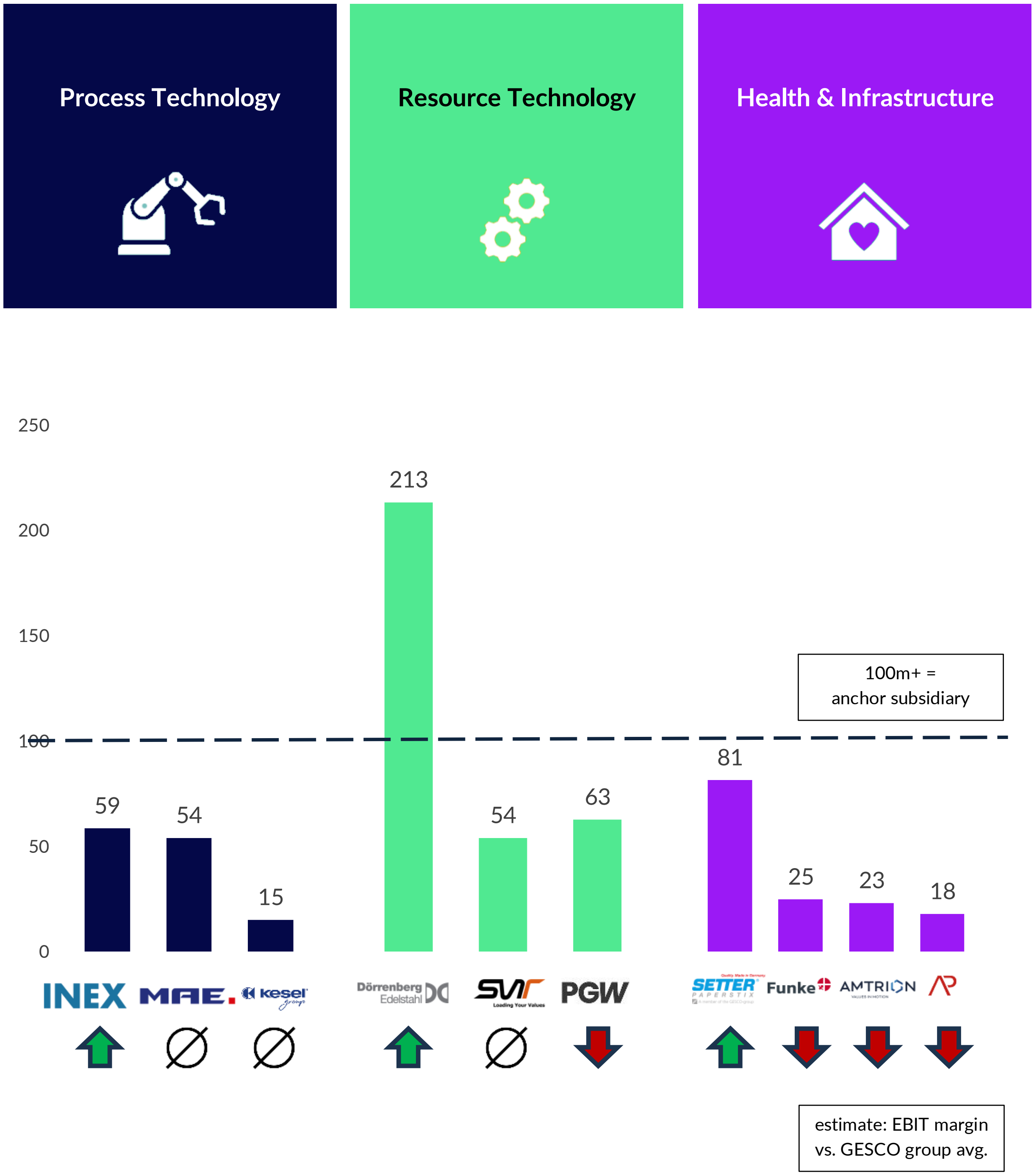
Resource Technology

57% of revenue
58% of EBIT
739 employees
€447k rev/employee
10% margin

Health & Infrastructure

25% of revenue
20% of EBIT
539 employees
€237k rev/employee
8% margin

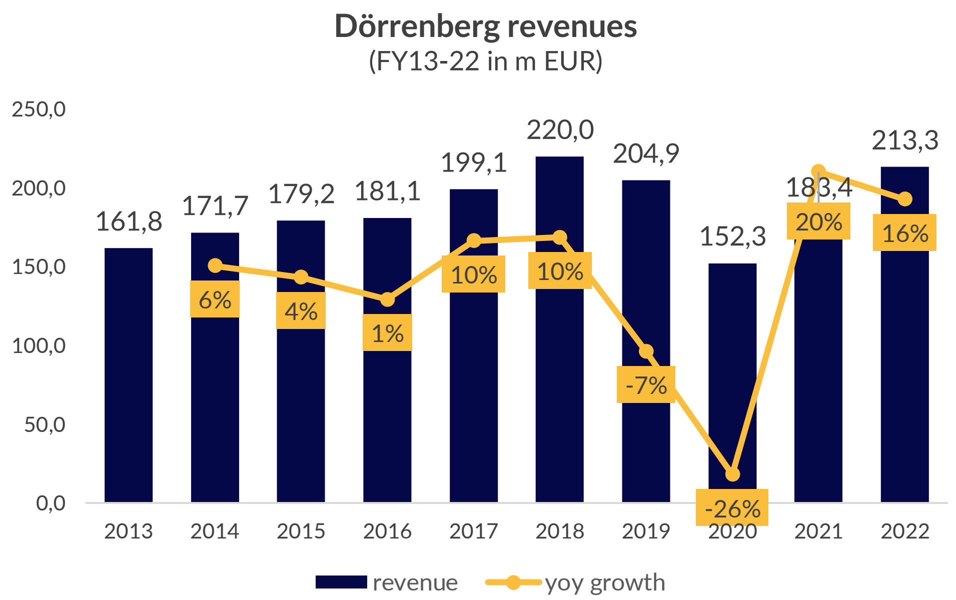
So far, Dörrenberg is GESCO's only anchor subsidiary with >100m EUR in revenue. Setter should organically grow into the second one by 2024. In terms of margins, it's reasonable to assume Dörrenberg, Setter and INEX are all operating above group average (see below).



Dörrenberg (37% of revenues)

Dörrenberg is a **tool steel supplier** with a 37% share of group revenues. It has grown top line at a **CAGR of 3.1% from FY13-22**. With 200m+ EUR in revenue, Dörrenberg is currently GESCO'S only anchor subsidiary (defined as 100m+ EUR in revenue).

It sees itself as Europe's #1 tool steel supplier that's independent from a manufacturer.



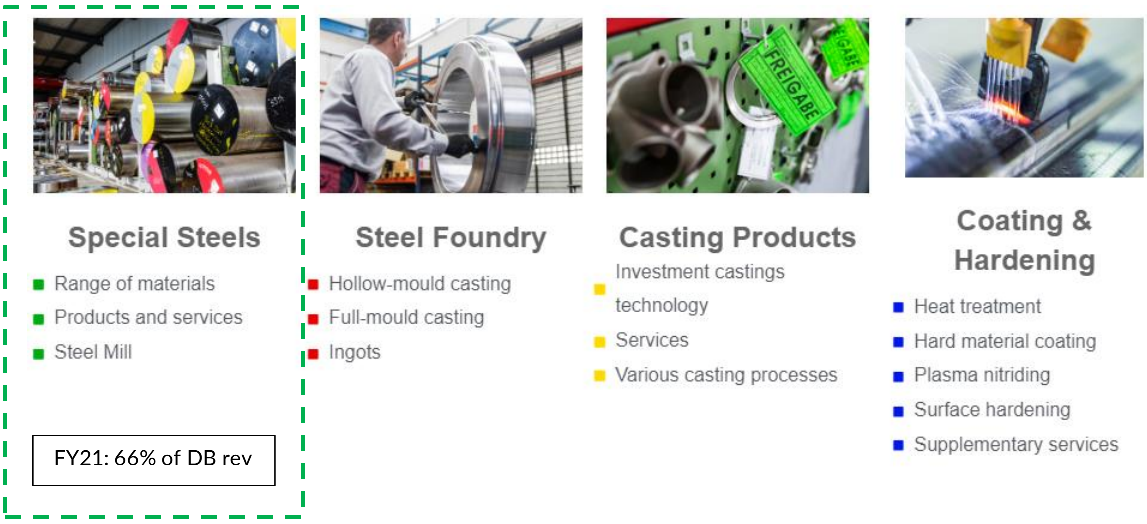
Different from other subsidiaries, several historical EBIT figures for Dörrenberg are in the public domain and for its most recent fiscal year, one can come up with a good estimate. Below readers find a table with estimates for Dörrenberg's EBIT from FY13-22.

Dörrenberg	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
EBIT in €m	13.7	17.7	16.8	16.8	14.7	25.8	16.5	4.6	21.7	27.1
EBIT margin	*8.5%*	*10.3%*	*9.4%*	*9.3%*	*7.4%*	*11.7%*	*8.1%*	*3.0%*	*11.8%*	*12.7%*

FY22 has been a record year for Dörrenberg. With 27.1m EUR in EBIT, I estimate Dörrenberg represented 46% of GESCO's group EBIT (pre holding costs of 8.9m EUR). The relatively high margin of Dörrenberg is a bit surprising for a commodity trading business. Comparing it e. g. to Salzgitter's trading segment or Klöckner & Co., one can see that outside of the high steel price environment of the past two years, these businesses usually achieved only LSD margins.

margin % of sales	**2013**	2014	2015	2016	2017	2018	2019	2020	2021	2022
Salzgitter Trading (EBT)	*0.9%*	*1.8%*	*1.0%*	*1.6%*	*2.1%*	*1.5%*	*-1.1%*	*1.1%*	*9.6%*	*5.2%*
Klöckner & Co. (EBIT)	*0.2%*	*1.3%*	*-0.8%*	*1.4%*	*1.8%*	*1.9%*	*-0,2%*	*-0.6%*	*10.2%*	*3.8%*

To sustainably generate profits above that level, Dörrenberg tries to stay in its profitable niche of supplying all variations of tool steel in small volumes to clients, agnostic of who the manufacturer is. The latter helps to differentiate from producer-owned resellers who must sell the assortment their parent company supplies them. Additionally, selling small volumes to SMEs is not the main focus of the large steel companies. Dörrenberg's distribution business "Special Steels" represented 66% of its revenue in FY21 (see below).



Dörrenberg can be described as a working capital-intensive business which strives to deliver to customers within 48 hours. In FY22, Dörrenberg significantly increased its inventories (reducing GESCO's cash flow), partly driven by opportunistic stock-buying at low prices but also by entering a new product category. The company operates one of the largest warehouses for tool steel in Europe and keeps more than 24,000 tons of stock. **Tool steel is mainly supplied to SMEs active in the manufacturing of stamping dies (Stanzwerkzeuge) and cutting and molding machinery (Schneide- und Umformwerkzeuge).** 70% of revenues are generated in Germany.

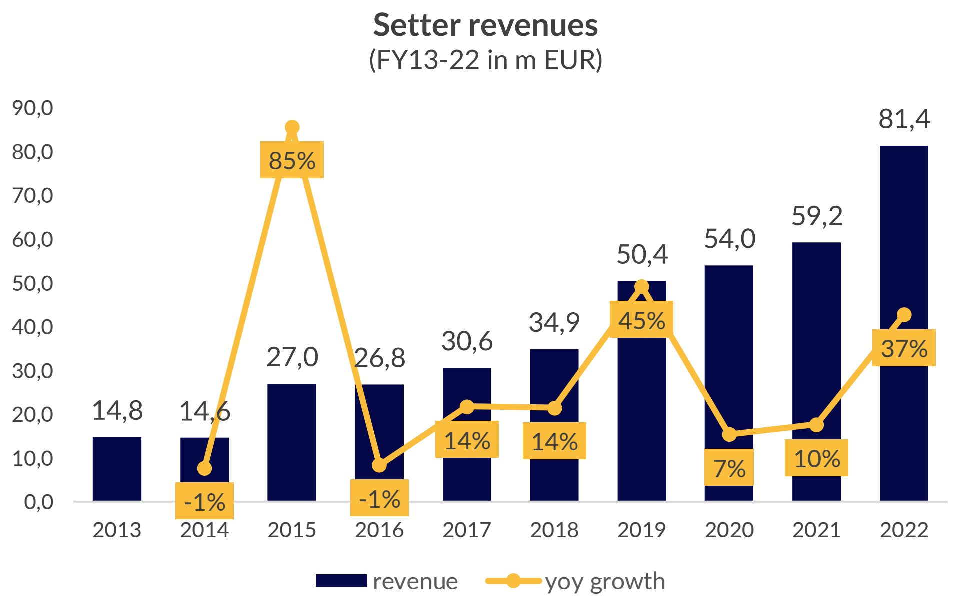
Summary: Dörrenberg is a highly profitable niche supplier of tool steel. No different from Salzgitter's trading segment or Klöckner & Co., Dörrenberg was a clear beneficiary of rapidly rising steel prices in 2021 and 2022. **Steel prices have fallen significantly this year and in the short run it is imaginable the company is running against tough comps. Therefore, Dörrenberg's FY23 earnings could likely decline vs. an extremely strong FY22.**

Setter Group (14% of revenues)

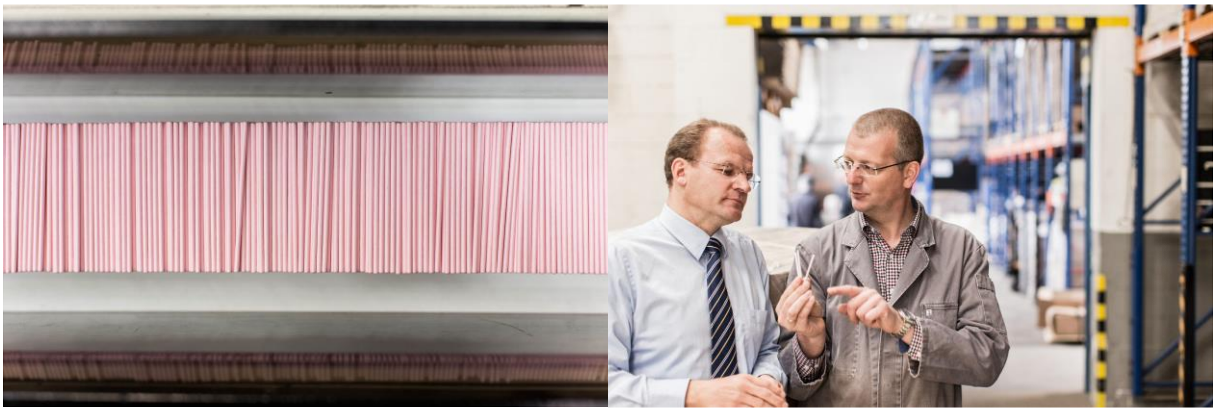
Setter is a producer of paper sticks for cotton buds and lollipops. It's GESCO's second largest subsidiary with a 14% share of group revenues. It grew its top line at a **CAGR of 20.9% from FY13-22.**

Setter is GESCO's most important growth engine and has more than doubled in size over the past four years. **It plans to do so again over the next four years and could surpass 100m EUR in revenue by 2024, which would make it the #2 anchor subsidiary inside of GESCO.** This leaves one more anchor subsidiary to be acquired by 2025 if management wants to hit its targets.

Setter sees itself as the undisputed #1 global supplier of paper sticks in its product categories.



Setter is a beneficiary of banning single use plastics in many product categories around the globe. Setter's paper sticks can be purchased in lengths from 55-360mm and diameters from 2.5-5.7mm. In terms of dimensions, there's only room for a small margin of error as the sticks have to fit exactly into the customer's high-speed machines. Setter's manufacturing plants are mostly developed and constructed inhouse, which constitutes a barrier to entry. **While some of Setter's customers – e. g. firms applying cotton to paper sticks to sell the finished cotton buds – have historically tried to internalize the paper stick production, they later often faced output and unit price disadvantages vs. Setter**. With India banning plastic sticks for cotton buds a year ago, the ongoing roll-out may become another growth driver for Setter.



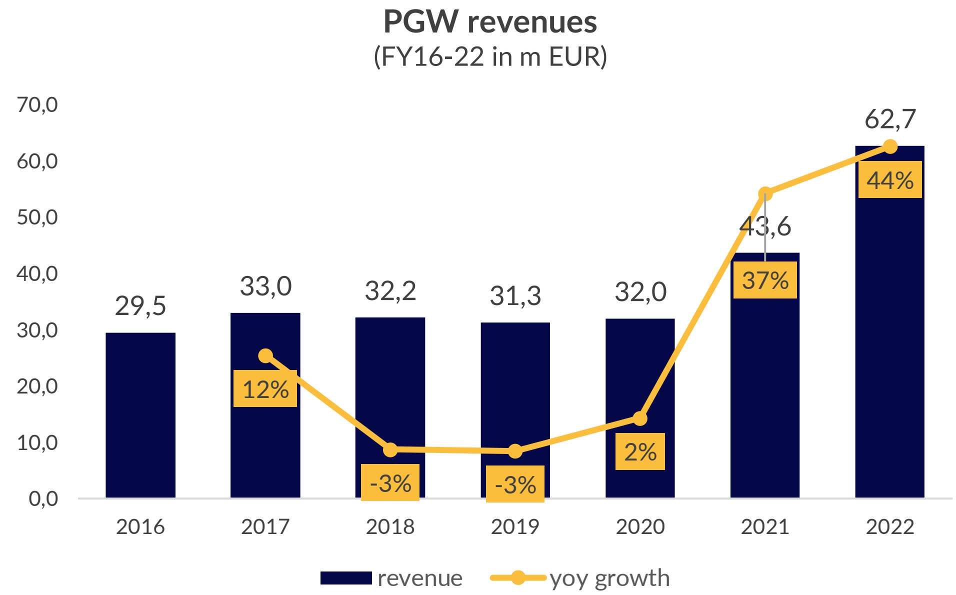
Setter produced 180bn+ paper sticks for lollipops, sweets, cotton swabs, medical applications and special applications in FY22. The company thinks it has an 80% market share (225bn total addressable market, thereof 70bn cotton buds in the EU). While there are no precise figures for market volumes including alternatives made from plastic, Setter's management estimates the penetration rate for paper sticks in its product categories is still only around 30%.

Summary: Setter is confident it will double in size again over the next four years. A growing addressable market will attract more competitors but the inhouse production of its plants as well as scale advantages might set up the company well to continue on its growth path. Setter has successfully anticipated the substitution of plastic sticks in favor of paper but should fear any significant technological jumps in biodegradable plastics or other materials gaining share (which could require new production machines or favor a different company). Setter already runs a small test production of sticks from sugar cane or bamboo paper.

Pickhardt & Gerlach (11% of revenues)

PGW is a strip steel processor and applies brass, copper, nickel or zinc coatings onto steel. It's GESCO's third largest subsidiary with a 11% share of group revenues. It grew its top line at a **CAGR of 13.4% from FY16-22**. GESCO acquired PGW in 2016. The former owner and managing director of PGW, Michael Hekhorn, bought the company in 1989 together with his wife Gisela and decided to sell as the couple had no children and no suitable successor.

PGW sees itself as the #1 strip steel finisher with brass. I'd picture this as a high throughput business with possibly below average EBIT margin.



Strip steel components are used in household appliances, sporting equipment, furniture, office supplies as well as electronics and decorative items (see some PGW product examples below).

Summary: PGW seems to be a well-run, low-margin processing business. It didn't have a significant down year since being acquired in 2016. The growth over the past two years stems from passing through rising steel prices which won't repeat in the short run. While PGW is one of GESCO's subsidiaries that benefitted from price increases, margins may have come down. In terms of relevance for the group, at an estimated ~5% of total earnings I don't assume PGW will either make or break GESCO's operating development in the long run.

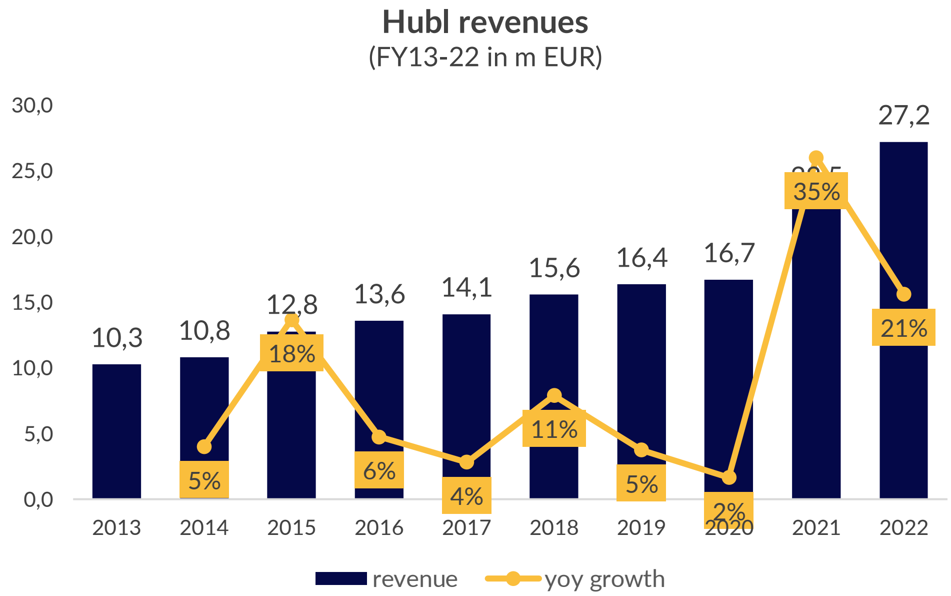
INEX solutions (10% of revenues)

The newly formed INEX solutions comprises two "boutique" processors of stainless steel: Hubl and Sommer & Strassburger (each with ~30m EUR in revenue). Combined as INEX solutions, they generated 58.5m EUR in revenue in FY22 and reported above average operating margins.

INEX solutions is GESCO's fourth largest subsidiary with a 10% share of group revenues.

Hubl grew its top line at a **CAGR of 11.4% from FY13-22.** It sees itself as the #1 global producer of biotech containers, inside which e. g. ingredients for vaccines are produced.

S&S was acquired in 2018 and grew its top line at a **CAGR of 13.3% from FY18-22.** It sees itself as the #1 global producer of membrane housings used e. g. in the biogas purification process.

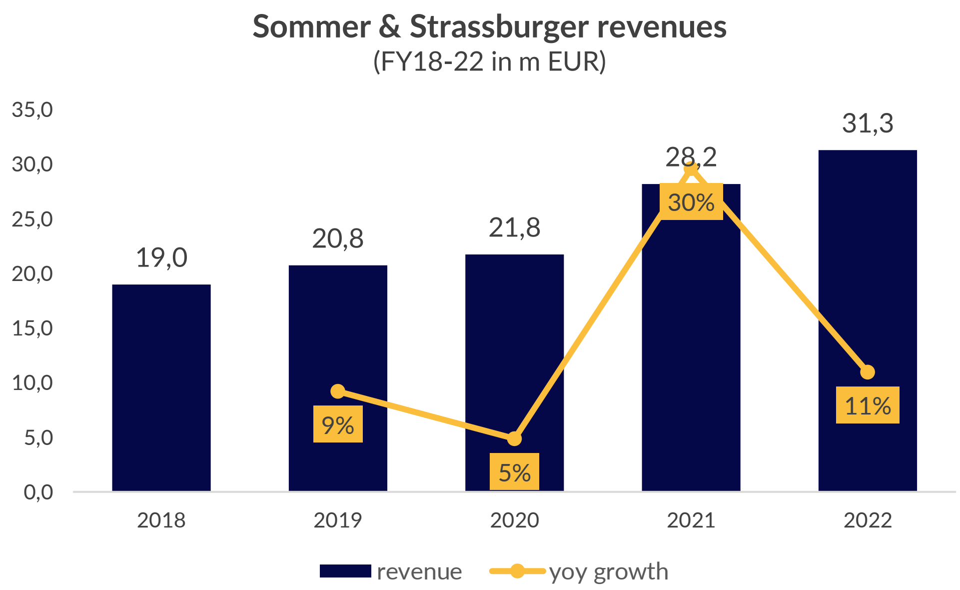


Hubl is focused on the production of biotech containers and stainless steel systems for the semiconductor industry. The most important customers come from the biotech/healthcare space, semiconductor industry (including Apple, Samsung and Intel) and food & beverage. Below one can see some product examples:

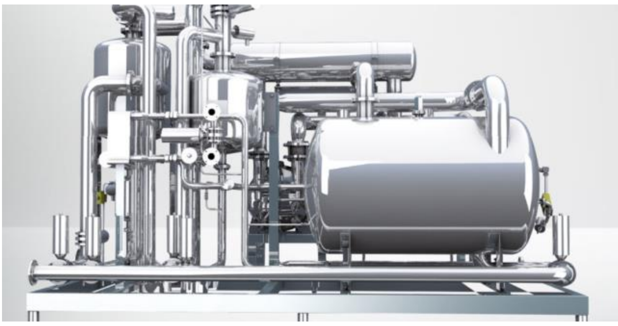
I estimate Hubl achieved an attractive DD operating margin over the past years, which should reside in the same range as for Sommer & Strassburger.

Hubl	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
EBIT in €m	0.4	0.6	1.1	1.2	1.4	1.8	1.5	1.8	2.9	3.5
EBIT margin	*3.6%*	*5.4%*	*8.2%*	*8.8%*	*10.0%*	*11.5%*	*8.9%*	*10.7%*	*12.9%*	*12.9%*

Sommer & Strassburger focuses on the manufacturing of membrane housings for filtration purposes and additionally on tanks and bioreactors made of stainless steel. It sees itself as the #1 global supplier of membrane housings.



S&S also offers complete plant engineering instead of just components. Its most important customers come from the chemical industry, water industry, food & beverage and pharma/healthcare. Below one can see some product examples:

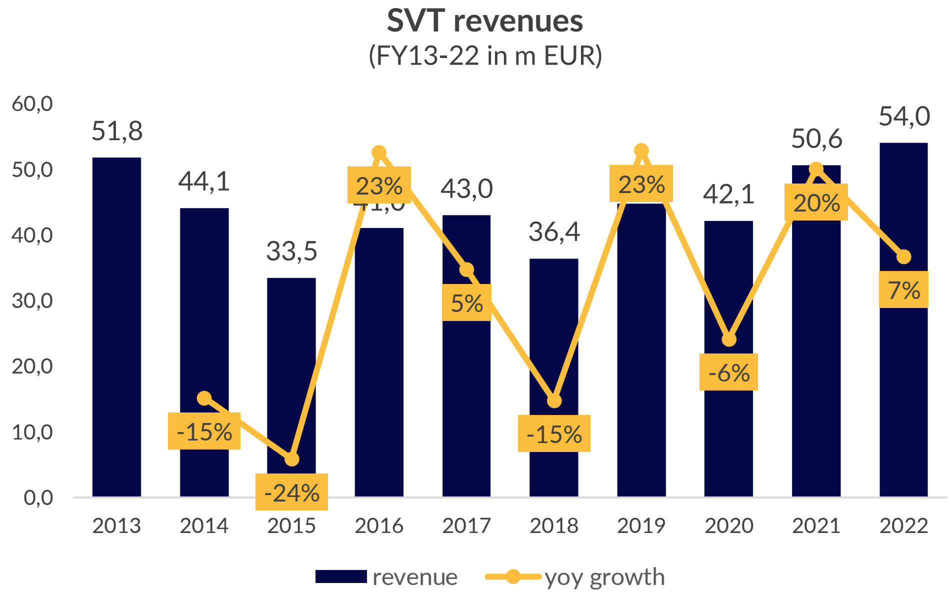


Summary: Besides Setter, INEX solutions is the most likely candidate to create profitable growth for GESCO in the mid-term. Both Hubl and S&S have solid order books and increased their operating income by +140% from FY18-FY22.

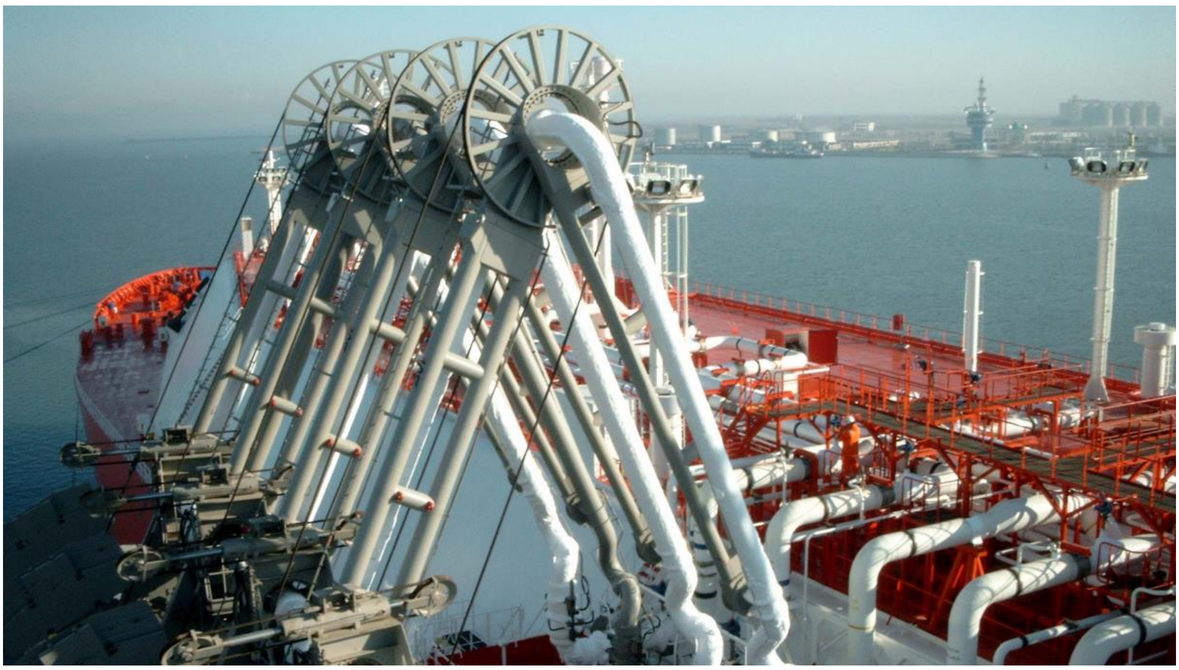
SVT (9% of revenues)

SVT is a manufacturer of loading arms for oil and gaseous media. It's GESCO's fifth largest holding with a 9% share of group revenues. It grew its top line at a **0.5% CAGR from FY13-22**.

I estimate SVT achieved 4.7m EUR in EBIT in FY22 (9% EBIT margin). SVT sees itself as the #1 player in LNG loading arms and the #2 including oil and chemicals. Since inception, the company delivered more than 2.3k loading arms to customers, thereof >700 for LNG (liquid natural gas). For LNG to be transportable efficiently between countries, it is liquified at minus 165°C and then loaded onto ships and tankers via SVT's loading arms.



SVT's business model can be lumpy and project driven. The company has to compete in tender offerings to secure new deals and its usual competitors include TechnipFMC, Emco Wheaton (part of Gardner Denver), Kanon or Niigata.



LNG loading arms are SVT's largest product category. The arms are attached to some aftermarket revenues (e. g. replacing seals) albeit these probably represent less than 20% of companywide sales today. Going forward, SVT sees three potential growth drivers for its business:

1) The installment of more LNG capacities in European/German coastal areas to become less dependent on Russian gas,
2) trying to internalize more aftermarket revenues from third party providers and
3) new product categories in the fields of hydrogen or CCS (Carbon, Capture and Storage)

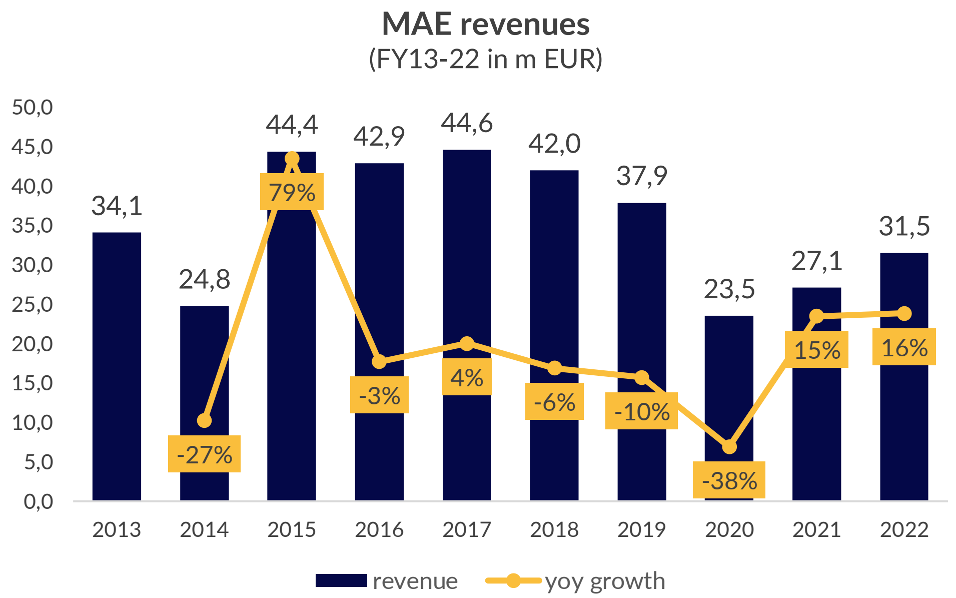
Regarding the transport of hydrogen in liquid form or in the form of ammonia as a safer hydrogen-carrying energy vector with lower reactivity, SVT makes the following remarks:

"Soon, not just individual containers, but millions of tons of ammonia will be landing in Germany and all over the world. Produced in sunny or windy regions, the deserts of Africa or the Arabian Peninsula, in Australia and Chile, as well as in the vicinity of many offshore wind farms world-wide. Ammonia is a chemical compound of nitrogen and hydrogen. ***Ammonia offers advantages over the transport of pure hydrogen: It already becomes liquid at minus 33 °C. Pure hydrogen only liquifies at minus 253 °C. Many experts assume that transporting hydrogen in the form of the derivative ammonia is ultimately more cost-effective.*** *(…) Whoever is the first to bring reliable products to the market has great chances of being successful in a completely new business field.* ***But part of the truth is that there is currently not a single proven component, not even a seal or a ball valve that has been tested and proven for commercial use for cryogenic liquid hydrogen*** *and (…)* ***it will take another ten years until the necessary technological infrastructure is in place to transport liquid hydrogen in sufficient quantities****."*

Summary: For the time being, I regard SVT as a business in a highly competitive industry with little aftermarket revenues. More opportunities in LNG loading arms seem to exist in the mid-term, while any future hydrogen fantasy still seems many years away and will also likely be competitive. At ~8% share of group earnings, SVT is an important subsidiary for GESCO.

MAE (5% of revenues)

MAE is active in two product categories: straightening machines and wheel set presses for trains. It's GESCO's sixth largest subsidiary with a 5% share of group revenues. Its top line declined at a **CAGR of -0.9% from FY13-22** and it had to undergo two restructurings over the past decade.



MAE sees itself as the #1 global manufacturer of wheel set presses and straightening machines. Like SVT, I'd picture this as a competitive business, where companies must participate in tender processes to gain new business volume. Besides that, wheel set presses are extremely durable (~20 years), so there is no significant aftermarket revenue opportunity. Below on the left side one can see an automatic straightening machine and on the right side a wheel set press.

Over the past years, MAE has reduced its automotive exposure (straightening machines) and focused more on the train sector (wheelset presses). On the outside, looking in, it appears the two product categories could represent 50:50 of revenue mix. Wheelset presses often carry high price tags and can cost around ~1m EUR per unit. Those machines are sold to train manufacturers like Siemens/Alstom or to firms operating and maintaining the trains.

In train manufacturing, the wheels cannot be welded or bolted onto the axles because neither method would withstand the high stresses of everyday usage. This is where the hydraulic presses come into play. With pressing forces of up to 150 tons, the machines press the wheels on to the shafts. Afterwards these sit so firmly on the axle that only the machine itself can press them off again. In Germany, 95% of all trams and underground trains use MAE machines as well as almost all express trains.

Internationally, MAE competes against peers like Niles-Simmons (USA) or BBM (Italy). Adding up their volumes, it appears the total market size for wheelset presses is only around 30-35 machines per year. Should MAE be accurate in seeing themselves as the #1 player, they must by logic sell more than ~12 machines per year.

Summary: MAE operates in a competitive, low growth market. It achieved no net growth over the past decade, went into restructuring twice and must secure new business volumes via tender processes. While the company is in positive margin territory today, it is imaginable MAE won't create significant incremental shareholder value going forward.

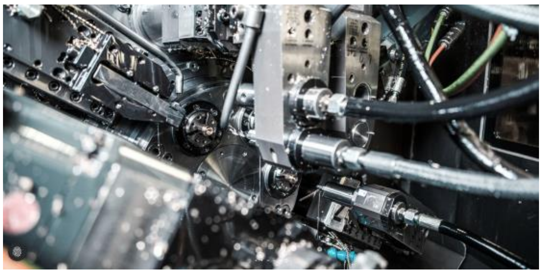
Franz Funke Zerspanungstechnik, UMT, AstroPlast, Kesel (combined: 14% of revenues)

GESCO's four smallest operating subsidiaries are:

- Franz Funke Zerspanungstechnik (4% of revenues),
- UMT (4% of revenues),
- AstroPlast (3% of revenues), and
- Kesel (3% of revenues)

Combined they represent 14% of group revenues but due to the below average profitability of Franz Funke Zerspanungstechnik, UMT and AstroPlast, it's reasonable to assume **they represent only a combined 6% of group EBIT**.

Franz Funke Zerspanungstechnik is a producer of machined metal turning parts.

UMT stands for United MedTec Holding and comprises the AMTRION subsidiary which manufactures pendant systems used in medical technology and heavy duty industrial pendant systems. Some of AMTRION's products are used in hospitals/intensive care units, a sector which is currently undergoing a demand normalization post COVID-19 (see some product examples on the next page).

To create UMT, GESCO acquired W. Krömker GmbH in 2021 and merged it with HASEKE GmbH. UMT sees itself as the global #2 in pendant systems for the medical sector with a 19% market share. The acquisition price for Krömker was 30.7m EUR (1.9x revenue) and in 2021, Krömker would have increased UMT's revenue/EBIT by 16.2m/1m EUR.

Paying 30.7m EUR for an incremental EBIT of 1m EUR doesn't look like a good deal. However, it's important to note that the mandatory information in the annual report regarding the acquired EBIT can be significantly distorted due to undisclosed PPA. In any case, the c-suite wouldn't organize the org chart the way it is right now (UMT *Holding* currently holds just one subsidiary) if it didn't have any bigger plans for UMT. The MedTec holding appears as a clear candidate to either consolidate the pendant systems market or acquire other medtech companies in adjacent fields. The #1 player in its core product category appears to be Ondal Medical Systems, headquartered in Germany, which is currently under PE ownership (IK Investment Partners). From its former owner Capvis, one can get the information that Ondal generated 73m EUR in revenues some years ago, which would make it the clear market leader with a 60% market share and more than 3x the size of UMT (FY22: 23.1m EUR revenue).

AstroPlast is a manufacturer of injection-moulded plastic spools which are sold to manufacturers of wires, cables, tapes and optical fibres. Additionally, it manufactures transparent thermoplastics components which are used e. g. as covers for industrial lighting. It's a no-moat, low margin business and most likely won't create any value for shareholders.

Kesel is GESCO's smallest subsidiary and a manufacturer of milling machines for bandsaws (Sägebänder) and grinding machines. Besides machines to produce bandsaws, Kesel also offers milling and grinding machines to produce gear racks (Zahnstangen). The company sees itself as the #1 global manufacturer of grinding machines which are used to produce bandsaws with a 66% market share.


Summary: Kesel is the leader in a niche market but achieved no growth from FY13-21. In FY22 it saw an uncommon uptick in revenues due to the 2021 introduction of a new generation of grinding machines (developed since 2019). With 3% share of GESCO group revenues, developments at Kesel (although it should have good profitability) won’t move the needle much.

ECONOMIC MOAT

Three non-exhaustive indicators whether GESCO possesses any competitive advantage are:

1) stable or growing market share
2) high ROIC and ROIIC
3) outstanding LT shareholder returns

1) Market share development

Most of GESCO's operating subsidiaries are self-proclaimed #1 or #2 players albeit in narrowly defined markets. Due to a lack of publicly available financials from competitors a reliable comparison whether the subsidiaries have lost or gained share in the past can't be done.

2) ROIC, ROE and ROIIC

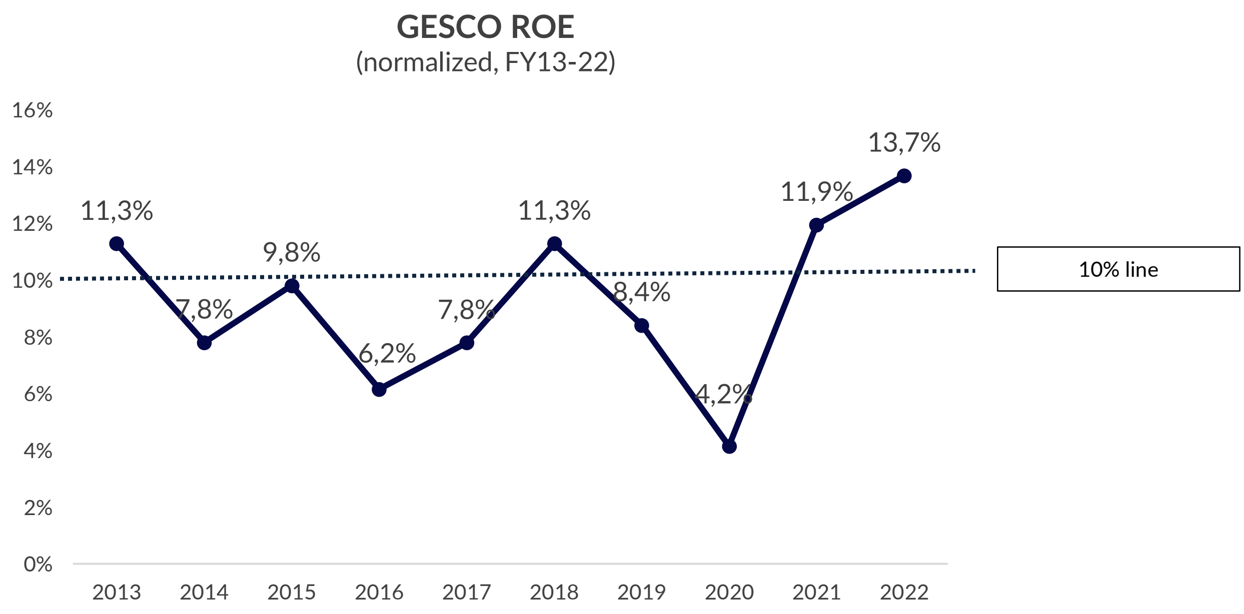
Calculating two standard yardsticks for GESCO's returns on capital, namely:

$$ROIC = \frac{NOPAT}{Invested\ Capital}$$

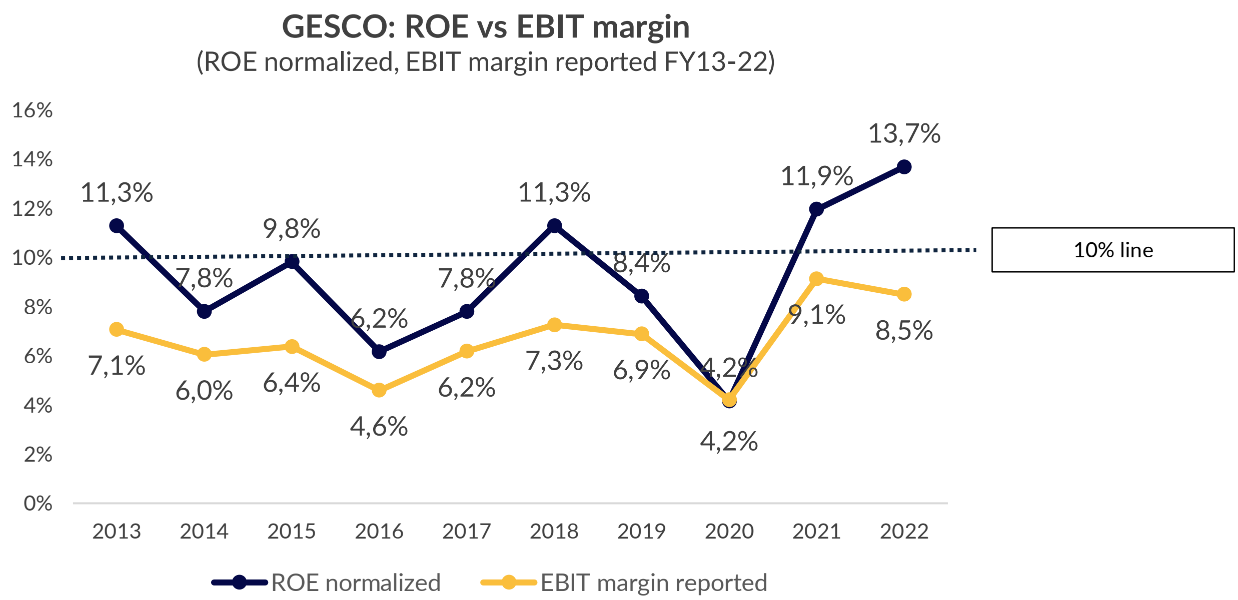
$$ROE = \frac{Net\ Income}{Equity}$$

leads us to a **ROIC of 10.3%** and a **reported ROE of 12.8%** for FY22.

Normalizing for PPA and one-offs leads to a **normalized ROE of 13.7%**. One can see repeating *cyclical swings* in GESCO's historical financial profile from FY13-22:

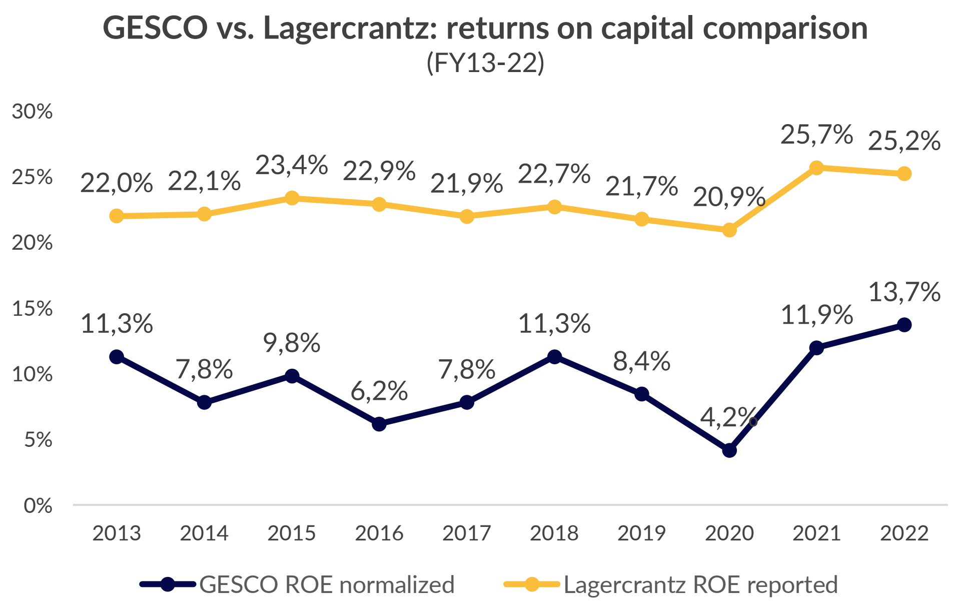


Charting normalized ROE and normalized EBIT margin, it becomes evident that **GESCO needs to reach at least a 7% EBIT margin in order to generate a 10%+ ROE**.



After the sale of its cyclical automotive business, the CEO's ambition going forward is to **achieve an EBIT margin of 8-10% through the cycle**. Even in weaker economic times, management doesn't want margins to fall significantly below the 8% threshold. Should they deliver as promised, this would imply ROIC and ROE coming in consistently above 10%.

One final comparison between GESCO and Lagercrantz highlights the less attractive economic profile of GESCO's operating businesses and why every EUR of retained earnings at GESCO reinvested at comparable economics (ROIIC) will generate only *a fraction* of Lagercantz' value-add due to the significantly lower ROIC-WACC spread.



3) LT shareholder returns

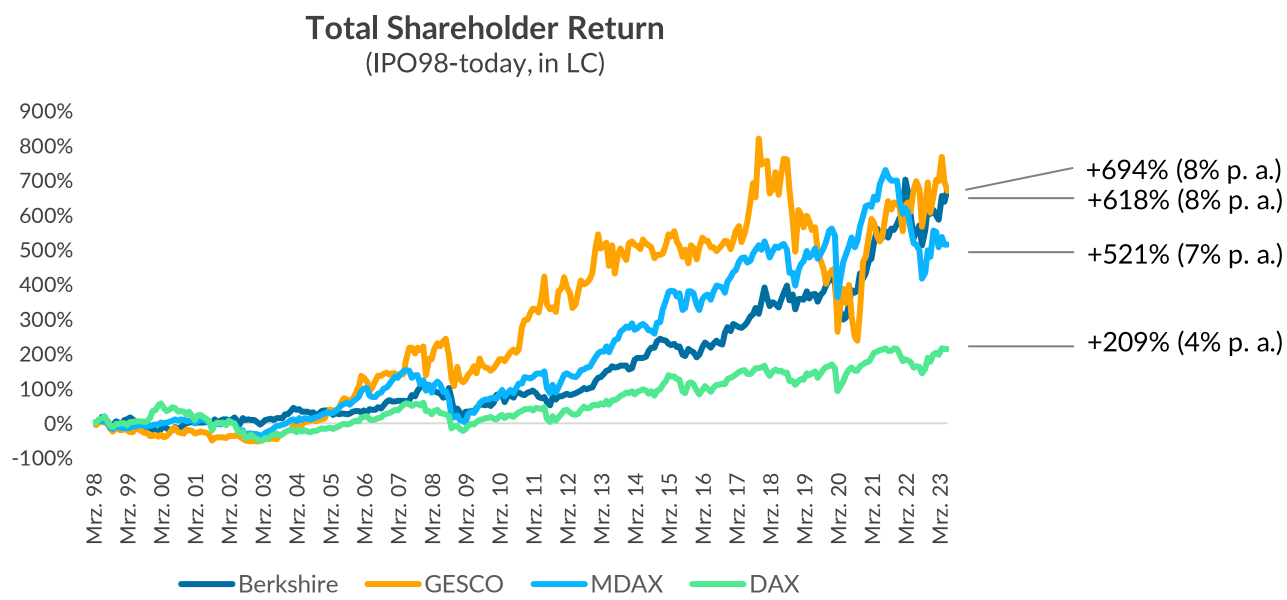
A final place to look for a moat can be an outstanding TSR over really long timeframes. Charlie Munger coined an old investing wisdom perfectly during a speech to students at the University of Southern California Marshall School of Business, when he said:

*"Over the long term, **it's hard for a stock to earn a much better return than the business which underlies it earns. If the business earns 6% on capital over 40 years and you hold it for that 40 years, you're not going to make much different than a 6% return** – even if you originally buy it at a huge discount. Conversely, if a business earns 18% on capital over 20 or 30 years, even if you pay an expensive looking price, you'll end up with a fine result."*

- Charles Thomas Munger, Vice-Chairman Berkshire

GESCO earned an average 9% ROE over the past 10 years. **Lagercrantz earned an average 23% ROE**. Over the longest possible time frame, **GESCO's stock generated an annualized 8% TSR** since its IPO on March 24th, 1998 and **Lagercrantz' stock generated an annualized 22% TSR** since its listing on September 3rd, 2001.

The correspondence of both companies' returns on capital and their total shareholder returns doesn't come as a surprise. While GESCO's 9% ROE and 8% annualized TSR didn't allow it to create outstanding performance, it at least matched Berkshire (8%) and beat Germany's MDAX (7%).



In conclusion, GESCO's historical operating profile is typical for an average quality industrial conglomerate. Operating margin hovers around in the MSD to HSD range, ROE struggles to come in above DD on a constant basis and reinvestment at these economics isn't value destructive, but neither will it lead to outstanding compounding in value per share over the long run. **Testing for the three indicators above shows no proof that GESCO possesses a strong competitive advantage** (in stark contrast to virtually all other sizable holdings in the Covesto Patient Capital fund).

HISTORICAL FINANCIALS

Most important cost positions

The most important costs position for GESCO are cost of materials (59% of revenue in FY22). COGS comprise primarily the purchase of raw materials like steel for trading purposes (Dörrenberg) or steel for plant engineering (SVT, INEX solutions) but also the purchase of paper for Setter's paper sticks.

cost of sales (59% of revenue)

raw materials, consumables and purchased services

personnel costs (21% of revenue)

wages, salaries and social security contributions

other OPEX (11% of revenue)

all other operating expenses, distribution and administrative expenses

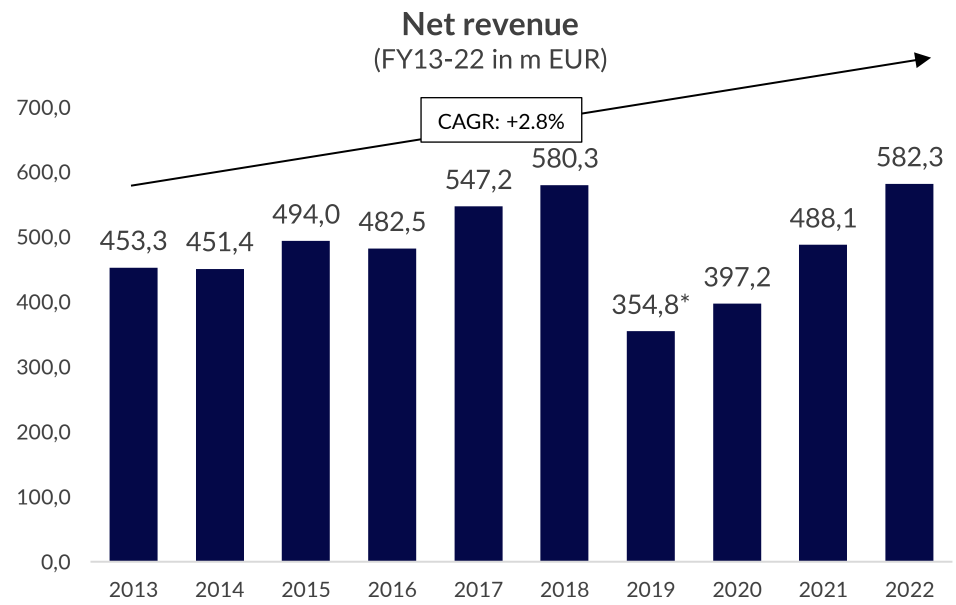
Looking at FY22, one can see that inflation in raw materials negatively affected gross margin while it benefitted revenues per employee and total personnel costs as % of revenues.

GESCO common size P&L	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total revenue	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
COGS	50%	52%	49%	48%	50%	53%	54%	56%	54%	59%
GM (incl. other operating income)	***50%***	***53%***	***51%***	***53%***	***52%***	***51%***	***45%***	***46%***	***48%***	***44%***
personnel costs	27%	29%	28%	30%	27%	27%	24%	26%	23%	21%
other OPEX	12%	13%	12%	13%	15%	13%	11%	11%	12%	11%
EBITDA margin	***11%***	***10%***	***11%***	***10%***	***10%***	***12%***	***10%***	***8%***	***13%***	***12%***

Key Performance Indicators

Revenue

GESCO's net revenue grew at a +2.8% CAGR from FY13-22. In FY22 revenue grew +19% yoy, half of which came from pricing. The number for FY19* shows an abbreviated fiscal year.



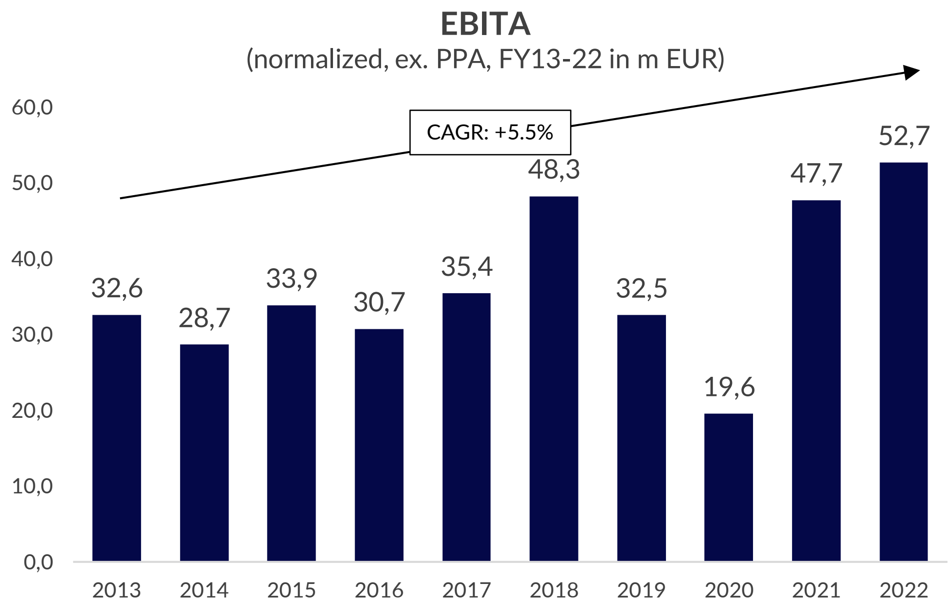
Revenues per employee

Helped by efficiency gains and inflation, revenues per employee are at historically high levels.

Revenue per employee in k EUR	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Dörrenberg	327	343	352	346	374	409	389	303	374	434
Setter-Gruppe	246	247	275	268	271	260	280	261	263	318
SVT	277	242	180	223	231	217	253	221	266	274
Pickhardt & Gerlach				720	785	715	695	743	909	1.254
Sommer & Strassburger						139	144	157	175	206
Frank Funke Zerspanungstechnik	199	208	192	204	209	215	214	218	284	253
MAE	243	155	200	193	206	190	174	136	159	185
Hubl-GmbH	97	107	121	122	134	142	139	149	164	169
UMT Gruppe	203	202	203	199	201	198	178	175	205	241
AstroPlast Kunststofftechnik	185	181	177	153	151	195	151	157	176	201
Kesel-Gruppe	158	180	187	186	203	218	210	153	179	256
Total	*256*	*248*	*249*	*264*	*281*	*279*	*269*	*237*	*277*	*320*

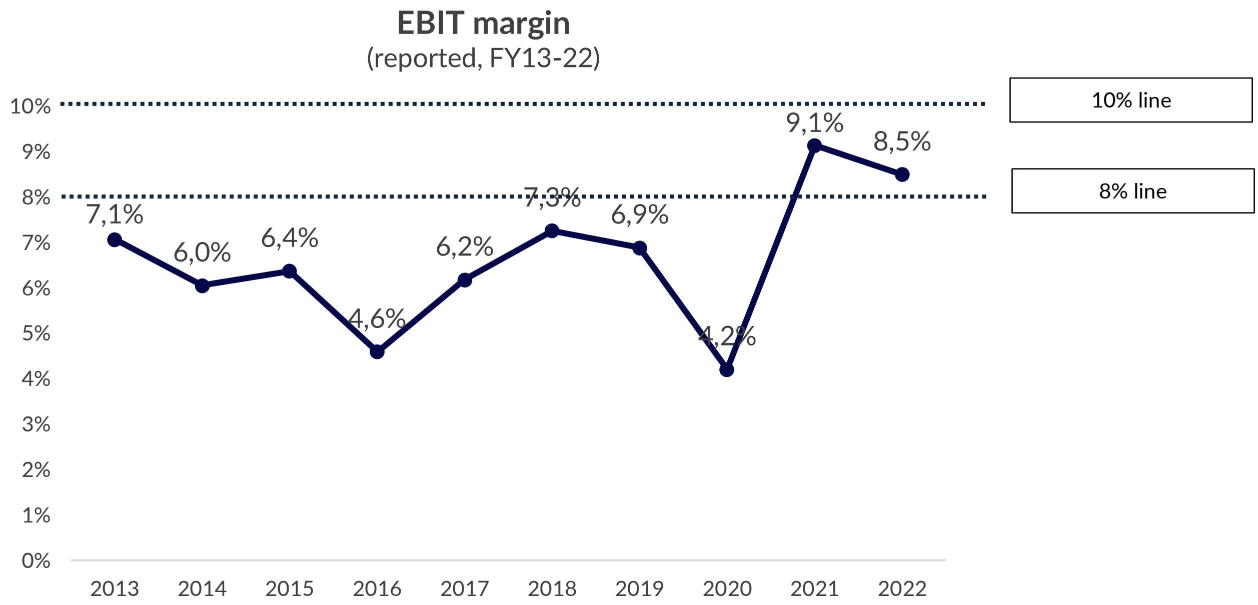
EBITA

GESCO's EBITA historically grew faster than revenues at a +5.5% CAGR.



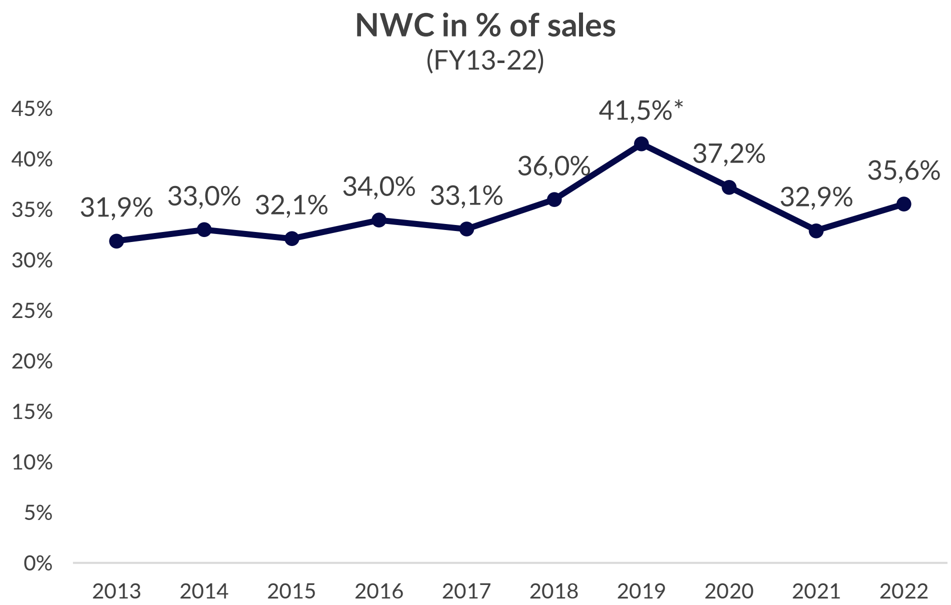
EBIT margin

Management targets an 8-10% operating margin throughout the cycle (which was achieved in the past two years). Ever since its IPO, GESCO has *never* generated an operating loss.



Working Capital

GESCO usually operates with a NWC ratio of 30%+ of sales. The FY19* number is distorted through the abbreviated fiscal year. In FY22, the ratio rose towards the upper end of its historical range with a negative effect on cash flow. At 600m+ EUR in revenue, each PP deterioration in the NWC ratio means a cash drag of 6m EUR vs. a net profit outlook of 32-34m EUR in FY23.

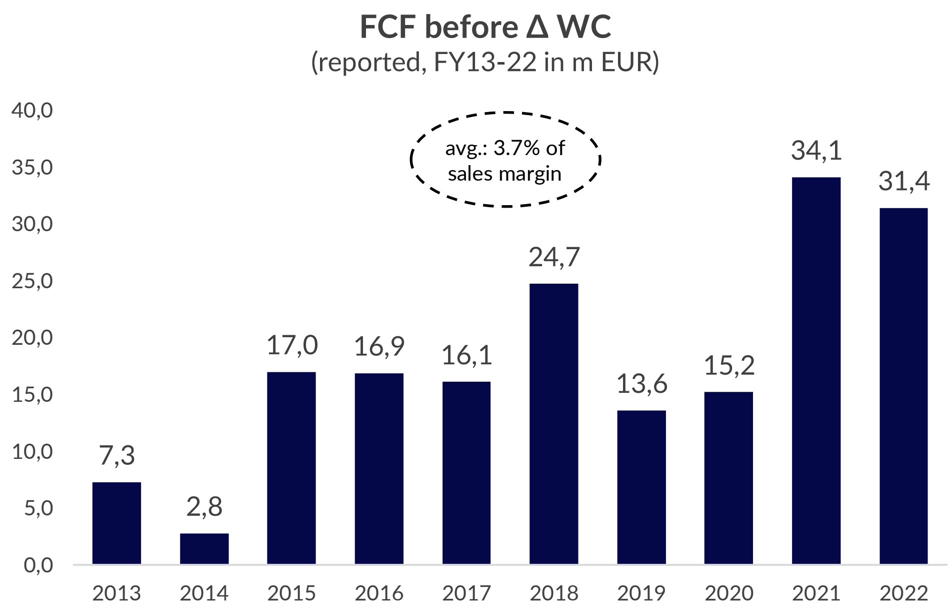


A part of the higher NWC ratio stems from GESCO's largest subsidiary Dörrenberg building up inventories driven by opportunistic buying and entering a new product category (precision flat steels). Management made the following remarks about the higher than usual NWC ratio:

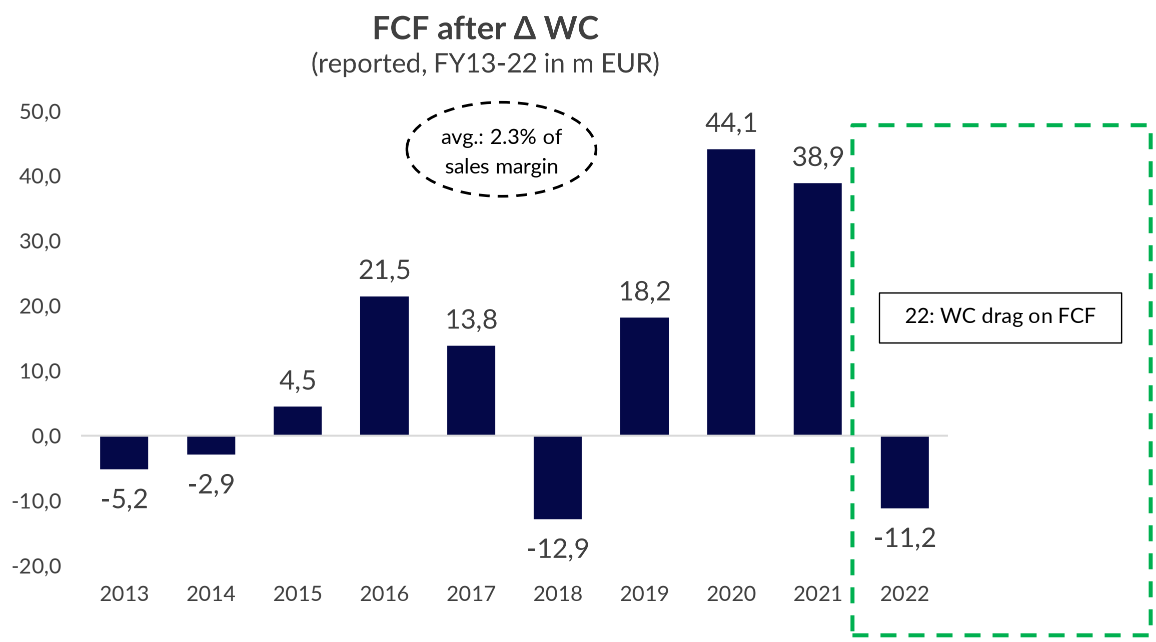
"The issue of adequate material supply also became more of a focus for the subsidiaries and led to a turnaround in inventories. While good progress had been made in previous years to reduce inventories in relative terms – the so-called working capital ratio – this trend was broken in the past year in order to maintain the ability to deliver throughout. […] ***We want to refocus on optimizing working capital in 2023. After the deliberate increase in inventories to ensure the ability to deliver, the focus is now back on reducing them.****"*

FCF

From FY13-22, GESCO converted 55% of its EBIT into net income (based on an average 7.2% EBIT margin and a 3.9% normalized net income margin). Excluding Δ WC, GESCO converts roughly 100% of its net income into FCF.



However, adding Δ WC into the equation moves the FCF generation around quite a bit. FY22 has been impacted by a -42.6m EUR cash drag stemming from the beforementioned increase in inventories (see below).



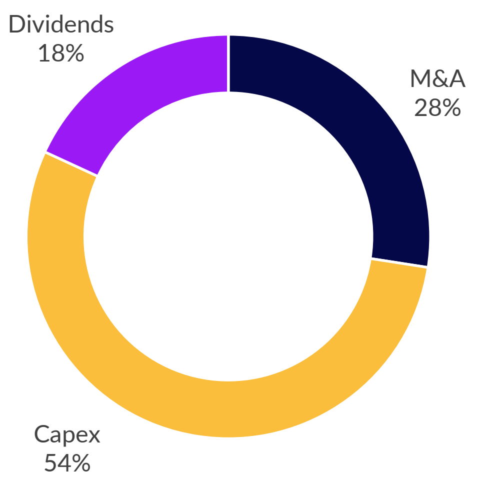
Overall, since the portfolio restructuring in 2020 (Project Matterhorn), the following applies:

- **GESCO converted ~60-65% of its EBIT into net income**
- **GESCO converted roughly ~100% of its net income into FCF after Δ WC**

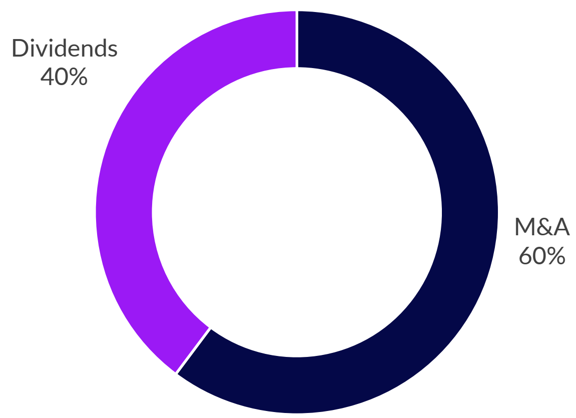
Cash Flow usage

Between FY13 and FY22, GESCO generated a cumulative FCF of 109m EUR after CapEx and used its cash flow primarily for M&A (60%) and for paying dividends (40%).

Use of Cash Flow before CapEx
(FY13-22)

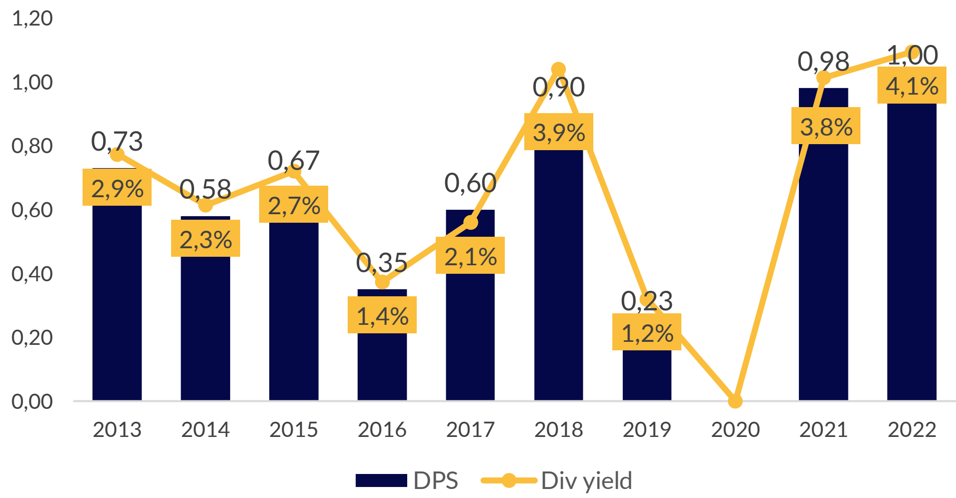


Use of Cash Flow after CapEx
(FY13-22)



Going forward, **GESCO plans to pay out 20-60% of its annual net income in the form of dividends**. In FY22 its net profit was 33.8m EUR. Divided by 10.8m shares leads to an EPS of 3.12 EUR. GESCO paid out a DPS of 1.00 EUR, therefore the payout ratio was 32%. At a share price around ~24 EUR, the implied ~4% dividend yield ranks in the higher range of GESCO's historical distribution (see below).

Dividend history
(DPS in EUR)



Some historical numbers: 5 YR Summary

(in m EUR, unless otherwise stated)						
GESCO – P&L	**2018**	**2019**	**2020**	**2021**	**2022**	***4YR CAGR***
net revenues	**580**	**355**	**397**	**488**	**582**	*0.1%*
COGS	306	193	221	266	342	
GP	295	160	183	232	254	*-3,7%*
gross margin	50.9%	45.1%	46.1%	47.6%	43.6%	
personnel expenses	154	83	104	113	122	*-5.8%*
other operating expenses	72	39	45	57	63	*-3.4%*
EBIT	42	24	17	45	49	*4.1%*
PPA	4	2	3	3	3	
EBIT (PPA adj.)	**48**	**33**	**20**	**48**	**53**	***2.2%***
EBIT margin	8.3%	9.2%	4.9%	9.8%	9.0%	
EBT	40	23	13	43	49	
tax rate	35.3%	32.7%	46.6%	31.0%	26.7%	
NI (reported, contr. int, cont. operations)	**23**	**15**	**6**	**27**	**34**	
NI (normalized)	27	20	9	29	36	*10.6%*
NI margin (normalized)	**4.6%**	**5.6%**	**2.3%**	**6.0%**	**6.2%**	***8.6%***
CF						
OCF before Δ WC	51	34	31	47	53	*0.9%*
Δ WC	-38	5	29	5	-43	
OCF after Δ WC	14	39	60	52	11	
Capex	-21	-14	-10	-8	-11	
FCF reported (after leases)	**-13**	**18**	**44**	**39**	**-11**	
FCF reported/NI normalized	-48%	92%	493%	134%	-31%	
Bilanz						
Goodwill in % of TA	5.1%	5.3%	6.0%	8.6%	8.2%	
NWC	209	196	148	161	207	
NWC in % of Sales	36.0%	41.5%	37.2%	32.9%	35.6%	
DIO	191	234	215	161	152	
DSO	62	76	74	52	52	
DPO	27	30	20	17	18	
Equity Ratio	48%	49%	58%	57%	58%	
net debt	128	121	45	31	50	
net debt/EBITDA	1.9	2.4	1.3	0.5	0.7	
ROA	4.3%	3.8%	2.0%	6.0%	7.1%	
ROE normalized	**11.3%**	**8.4%**	**4.2%**	**11.9%**	**13.7%**	
ROIC	7.2%	4.3%	4.6%	9.9%	10.3%	

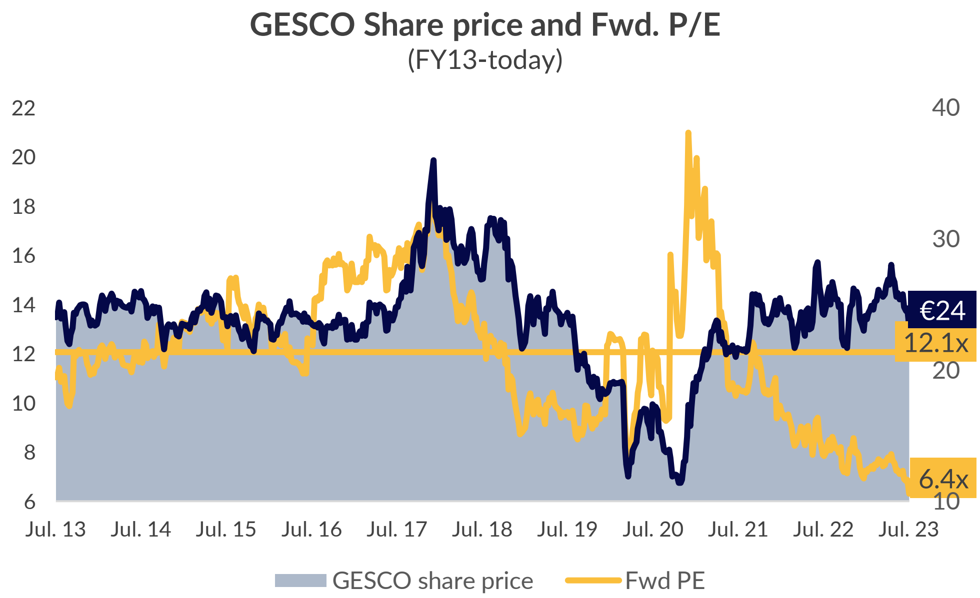
[redacted] [REDACTED]

Historical trading range

GESCO currently trades at 6.5x EV/EBIT23(e) and 7.7x net profit23(e). In reference to its historical trading range, this falls in the lower part of its prior statistical distribution.

Disclaimer: Please note that these are consensus numbers. I take no stance on the likelihood of GESCO reaching or missing the FY23 consensus numbers. This document is a marketing message. It is for informational purposes and professional investors only. It is no investment advice and no financial analysis. Investing in stocks, bonds and funds involves risk of loss. Please refer to the disclaimer on page 2.

Solely based on the distribution of historical Fwd. multiples, GESCO would trade near a bottom/top around [redacted] per share.



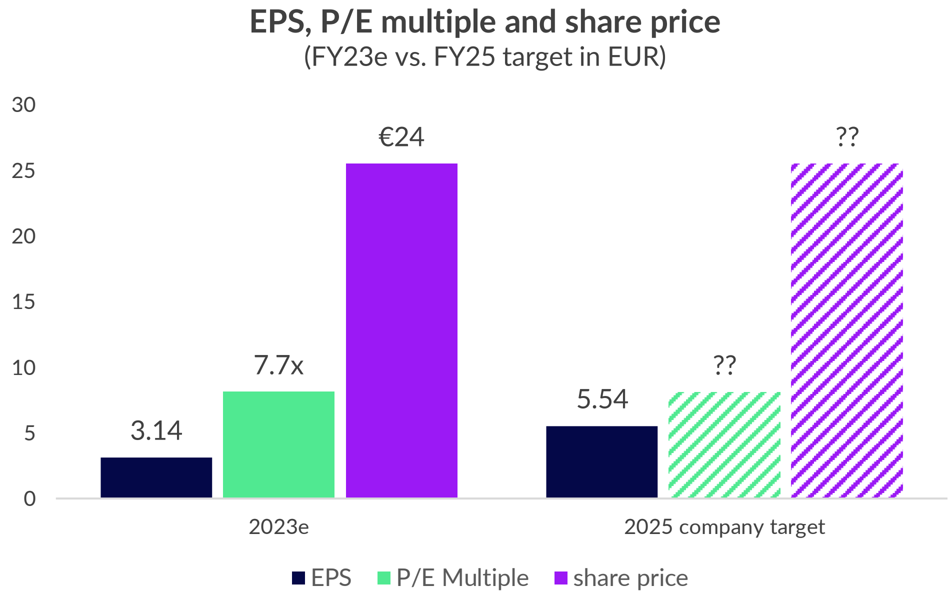
Out of the last 10 years, GESCO's stock had its worst return in 2018, when the share price fell from €30.67 to €21.80 (-28.9%). The **starting multiple was a 14.7x Fwd. P/E at year-end 2017**.

GESCO had its best year in 2021, when the share price increased from €18.35 to €25.5 (+39.0%). The **starting multiple was a 7.4x Fwd. P/E at year-end 2020**.

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
EPS	1,82	1,24	1,62	0,79	1,49	2,08	1,79	0,74	2,48	3,12
share price (year-end)	23,40	23,36	23,63	22,49	30,67	21,80	18,86	18,35	25,50	24,10
Fwd. P/E	18,9	14,4	29,9	14,0	14,7	12,2	25,6	7,4	8,2	7,7
yoy stock return		*-0,2%*	*1,2%*	*-4,8%*	*36,4%*	*-28,9%*	*-13,5%*	*-2,7%*	*39,0%*	*-5,5%*

Next Level 25 implied trajectory

In case market participants would assume GESCO's CEO reaches his 2025 targets for the company (and close five acquisitions without the need to raise additional equity), the diagram below shows the evolution of GESCO's earnings per share until the year 2025:



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[redacted] [REDACTED]

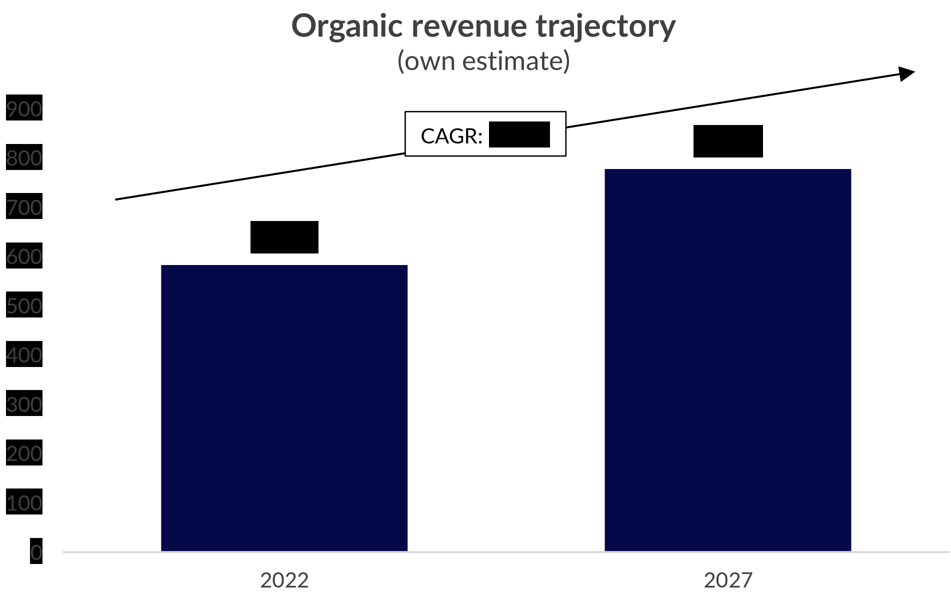
[redacted] following parameters:

Organic development:

- Revenue CAGR 2022-27: [redacted]
- EBIT margin 2022 group level: 9%
- EBIT margin 2027 group level: [redacted]
- EBIT CAGR 2022-27: [redacted]
- [redacted]: [redacted]% [redacted], [redacted]% [redacted]
- Organic EPS [redacted]: [redacted]
- [redacted]

Inorganic development:

- Target leverage 2027: [redacted]
- Acquired EBIT by 2027: [redacted]
- [redacted]: [redacted]
- [redacted]



Conclusion: The current [redacted].

BULLS SAY / BEARS SAY

(+) “GESCO’s portfolio simplification in 2020 from an automotive-oriented group to a more diversified group with lower leverage may not yet have been perceived everywhere.”

(+) “Based on consensus expectations, GESCO trades at 7.7x net profit23(e) which from a statistical standpoint falls two sigma below its historical 10YR average.”

(+) “With the largest shareholder getting more actively involved since 2017 and a new CEO on board since 2018, GESCO has set ambitious targets to double its EBIT over the next two years.”

(-) “While management targets an EBIT margin of 8-10%, in prior recessions margin often fell below 5% which could significantly lower aggregated owner earnings through the whole cycle.”

(-) “Some of GESCO’s subsidiaries have profited from inflation in 2021/22 and especially Dörrenberg could likely decline this year and thereby hinder any increase in group earnings.”

(-) “Ambitious mid-term targets often fail and if NL25 should not be reached, some investors may aggressively sell their relatively illiquid GESCO shares and hurt the share price.”