

DNICK plc

Share price has started to turn in anticipation of better than expected half-year results

- The general stock market malaise as well as fears about a downturn in customer orders have led to DNICK's share price sagging. However, the market simply didn't get it right. The recent shareholders meeting yielded clarity about the business' performance, which has turned out to be much more stable than the market expected. DNICK continues to be a cashcow, with 2009 cashflow estimated to come in on the same level as during the previous year (and an even better outlook for 2010).
- A recent 66-page company valuation carried out by an academic team confirmed our analysis of the company having a much higher intrinsic value.
- The share has recently seen heavy buying and the share price has started to crawl back up. A quirk in the company's tax position would allow for a tax-free special dividend of up to EUR2 per share. We expect the company to either turn into a dividend spinner, where sales proceeds from the gradual sale of the various divisions will be paid out, or for the company to be sold in its entirety, with minority shareholders receiving a bid.

Quo vadis, DNICK?

Dear Reader,

John Hannibal Smith, the legendary leader of NBC's series "A-Team", had a simple way of summing up what makes for a successful job:

"I love it when a plan comes together."

I, too, love to analyse and plan things, so as to ensure a successful outcome. That's why I put a lot of planning into my original investment into DNICK. Considerable time and effort not just from myself, but also of two analysts who work for me, went into the task of working out an earnings projection. The result was published in my 28-page report on DNICK in August last year.

Lo and behold, the plan that we had assembled so carefully, did work. At least, as far as the earnings projections were concerned. We wanted to stay on the safe side and then have the actuals exceed our estimate. As the table shows, that's just what happened.

So far, so good.

	Projection UVS report August 2008	Projection UVS report September 2008	Actuals (as per announcement in May 2009)
EBITDA	EUR13.5m	EUR16m-EUR17m	EUR15.8m
Profit	EUR7.2m	EUR7.8m	EUR8.7m
Earnings / Share	EUR1.29	EUR1.40	EUR1.54

(All figures adjusted for the yearly revaluing of the company's permanent metal stock, see the August 2008 report for a more detailed explanation of this particular factor influencing the company's balance sheet)

What I didn't get right – at least so far – is the share price's performance. My earnings projection proved too conservative. The share price, however, went for a nose-dive. Also, the bid that I expected to be made for the company sometime in Spring 2009, has not yet materialized. To top it all off, the company rowed back on its earlier commitment to pay out a dividend for 2008.

DNICK – one of those investments that only in hindsight only brought losses and regret?

Not quite, as a careful analysis of the current situation goes to show.

What has happened so far

In retrospect, the best decision would have been to sell all investments ahead of the Autumn 2008 stock market crash. I am among those who had not quite expected to see almost all of the world's major banks topple over, and subsequently, I also did not expect the sharpest economic contraction that the world has seen during the past 70 years. Having missed that opportunity to sell in May and go away (ideally for a one year holiday), I am now facing the task of sifting through my investments to make a decision on what to sell, what to hold and what to buy more of. In the aftermath of the world's worst crash since 1929, we all need to re-evaluate our investments and make a decision where to go from here.

That said, I still feel extremely comfortable with my investment into DNICK. As has become evident in the meantime, the producer of nickel alloys and blank coins is running a business that is much more stable, than the stock market seems to have expected. That's probably the reason why a mystery buyer spent the last few months visibly buying up large chunks of shares in the open market. Just last week, the equally large sell orders came to an end and the share price started to rise again.

For everyone who is new to this website, let's briefly recapitulate the original 28 page report from August 2008.

Nickel alloys are a niche part of the metal industry, and DNICK's subsidiary Deutsche Nickel GmbH has been operating in this niche since 1839. The company's second large subsidiary, Saxonia Eurocoin, is a producer of blank coins. These are usually only bought by governments and central banks, and occasionally for medallions. The most recent addition to the company's portfolio is a stake in a nickel alloy joint venture company in India. Besides that, DNICK owns considerable amounts of property, much of which isn't needed to run the operative business and could be developed or sold.

The company had emerged from the bankruptcy of what used to be Vereinigte Deutsche Nickel AG, a stock market listed German company. A team of cunning legal experts had come across a way to use British bankruptcy laws to restructure the German company. The result of this work was DNICK plc, a UK-registered company that took over the profitable parts of the bankrupt German entity and which then became listed in Germany. In exchange for its work, the team of restructuring experts that is running DNICK were incentivized with DNICK shares – they now own 5% of DNICK's share capital. Their contribution is now essentially finished, and if they wanted to cash in at the highest possible price, then finding a strategic buyer who would launch a bid for the entire company is the best option. Needless to say, such a bid would benefit not just the management team, but also every shareholder.

The other two large shareholders are Goldman Sachs (23.13%) and Bear Stearns (10.34%). Both these investment banks had loans outstanding to Vereinigte Deutsche Nickel, and they agreed to become equity holders in the reorganized company (thereby enabling the entire restructuring to go forward). Neither Goldman Sachs nor Bear Stearns will have any strategic interest in a German Mittelstand metal specialist, and should be equally keen to eventually receive a bid and exit their investment. I have always been of the opinion that the investment banks and the management team are actually working together quite closely. In any case, their interests are perfectly aligned.



A sale of the company, or individual parts thereof, would crystallize the value that the restructuring team has created. Most of the old debt has been absolved or turned into equity when DNICK plc was created. Thus it was only the profitable parts of Vereinigte Deutsche Nickel that made it into the entity. What's more, the management applied some lateral thinking by putting some of the old assets to use. A bunch of disused industrial machines were used as an in-kind contribution to the Indian joint venture, turning what was essentially scrap metal into a valuable stake in a company with great growth potential (because of certain import restrictions, Indian-based nickel alloy producers have an edge over foreign companies trying to sell nickel alloy products to Indian customers).

As recently as 2004, DNICK's legal predecessor was mired in debt and unable to pay its employees' wages. Today, the company has no long-term debt and it has long shed all unprofitable activities. That's why, for 2008, I expected earnings per share of EUR1.29. In the end, earnings actually came out at EUR1.54. Compared to the share price of EUR8.20 at the time of my first report, DNICK shares were trading for a price/earnings ratio of just 5.

As far as the earnings projections were concerned, my original report was right on target. However, I didn't get the share price movements right. After some initial gains, the price fell back to as low as EUR4.90. It was only in recent weeks that it has started to recover, and it was last trading at EUR6.20 (see chart below).

Why did the relatively illiquid share fall quite that much, and what is the chance that my original expectation of a lucrative bid (or substantial special dividends) is going to be met eventually?

An analysis of all recent facts leads to some surprising conclusions.

How DNICK has countered the economic crisis

The A-Team often got itself into hairy situations, but always managed to extricate themselves out of them by creatively putting their combined skills to use. Key among their skills was some lateral thinking, leading to the ability to form weaponry and vehicles out of old parts.

Cunning solutions to unusual problems, is what the management team of DNICK also excels at. Their use of British bankruptcy laws to restructure a German (!) company was nothing short of a stroke of genius, and by now has even been discussed in academic legal circles as a model case. The restructuring of the actual business, too, was equivalent to a world-class success. And as part of all this work, DNICK's management team also prepared the company for the kind of economic downturn that they expected would eventually happen (simply because no boom lasts forever).

The fixed costs of the company's nickel alloy division have been reduced to just 15% of overall costs. In other words, any reduction in customer orders automatically leads to a rapid decline in costs. Many other industrial companies suffer under much higher fixed costs and end up writing heavy losses during cyclical downturns. DNICK is expecting the amount of orders in this division to decline by about 20% this year – albeit from an extremely high level, given that DNICK until fairly recently used to keep its machines running 24/7 in a three shift operation. Also, some of the order decline has been due to customers shifting their orders to 2010. The division's cost base declined rapidly, and some further measures such as reducing the number of temp workers and having the core staff agree to working shorter hours yielded additional cost savings. To put all these measures into place, DNICK had to shell out an additional EUR0.4m during the first half of 2009. However, all this should amount to total cost savings of EUR1m during the rest of the year.

In the meantime, the blank coin subsidiary has proven virtually resistant against the economic downturn. The company's order book is as full as ever, with some areas booked out well into 2010. This division is planning some small investments to further grow the business and to avoid bottlenecks in the existing production. Margins are slightly lower than in 2008. However, overall this division of DNICK has not really been affected by the tough economic climate. Most of its clients are governments and central bankers.

The Indian subsidiary will start production during this current quarter, and orders are coming in at such a rate that the company is already looking into an expansion of its capacity.

When the share price of DNICK halved, one could have easily concluded that the market was discounting a major drop in business. However, as has now become evident, this simply isn't the case. In the meantime, the management has projected cashflow to remain stable during 2009.

So why, in the end, did DNICK shares come under such pressure?

The stock market hates uncertainty, and generally tends to react with falling prices if something is in doubt. In the case of DNICK, the problem was that it had become impossible to make a reasonably precise call as to the 2009 earnings. Even those who went to great lengths to come up with a projection, could not do so given all the uncertainty about the economic outlook.

It was only at the company's AGM back in June, that it became clear to me that fears about a massive drop in revenue and profits were unjustified. The publication of the company's half-year results on September 8th should yield yet more clarity about the situation. In anticipation of those results coming out much better than expected, the share price has recently started to turn. 2009 will not become the most profitable year in DNICK's history. However, it'll be a lucrative year nonetheless. That's why the share is now gradually crawling upwards.

After all, the factors in play are not only those leading to a decline in profits. A few people have realized that there are also some positive extraordinary factors at work.

- The only debt that DNICK has on its balance sheet, is short-term financing to purchase raw materials after client orders have come in. Because of lower commodities prices, DNICK has to take on less financing and thus will be paying less interest.
- Interest rates for this kind of financing have fallen. DNICK is paying a variable interest rate based on EONIA (= "Euro OverNight Index Average"). At last count, EOINA stood at 0.334% on top of which DNICK has to pay a 2.25% premium. The overall rate currently payable is rather low now.
- During 2008, DNICK paid EUR2m in consulting fees in connection with getting further joint ventures in Asia up and running. No such consulting fees will be payable this year. Compared to last year's profit of EUR8.7m a EUR2m saving amounts to a massive amount.

Just how much will DNICK earn during this year? It still is anyone's guess. Contrary to last year I would not yet want to commit to a concrete figure just yet. Let's wait for the half-year results and then run a closer analysis based on the additional information that will be made available in the report.

My guess is, that the wording of the half-year result will be quite cautious. The company's management team occasionally has to negotiate shorter working hours with its employees, and communicating just how well the company is actually doing would not exactly help such negotiations. Such strategic considerations were also behind the eventual decision to not pay a dividend for 2008. DNICK would have had the excess liquidity to pay out a dividend, and the company had already promised a dividend payment to its shareholders. However, to account for German sensitivities it seemed wiser to not pay out cash to shareholders at a time when workers are asked to tighten their belts.

It is quite clear, that the company has carried out all the right measures to get through the crisis without experiencing more than a small bump in its earnings. Such decisive management should actually be applauded. It helps to strengthen the entire investment case, and once the situation improves, DNICK will emerge with an even stronger position.

Also, we will eventually get back to the times when it is possible to make a reasonably precise earnings estimate. Until then, we need to value the company using some other measures. That is not to say, that the company currently can't be valued at all. Quite the opposite, the undervaluation of DNICK's share price is apparent even in the current situation.

The original report's assessment still holds true

Undervalued-Shares.com prefers investments that offer considerable upside while having a comparatively small downside.

Despite the current tough economic climate, DNICK still perfectly fits the bill. The company's book value amounts to EUR11 per share, compared to a current share price of EUR6.40. Usually, only companies running up huge losses trade below book value.

To look at a more specific example, let's take a look at the value of Saxonia Eurocoin, the subsidiary producing blank coins. Last year, the company's EBIT (earnings before interest and taxes) came out at EUR8.6m. Let's assume that this year's EBIT is stable. Even when applying a relatively modest multiple of 4, the division is worth EUR34m. This compares to debt-free DNICK currently being valued at EUR35m. In other words, anyone buying into DNICK currently only pays for the blank coin division, whilst all the other assets (the nickel alloy division, the Indian joint venture, as well as the property reserves) are thrown in for free.

And the best part is, that the blank coin division is already marked for sale. This subsidiary's sale is not currently not being pursued, because the market for such transactions went into a tailspin when the crisis set in. However, the M&A market will improve eventually and Saxonia Eurocoin will then be the first asset to go.

This one transaction alone could yield more cash, than the entire value that DNICK is currently worth on the stock market. Because of a quirk in the company's tax position, DNICK could then opt to pay out a tax-free special dividend of up to EUR2 per share. So with a bit of luck, anyone who buys in now at EUR6.40 per share could see a tax free payout of EUR2 per share sometime during 2010.

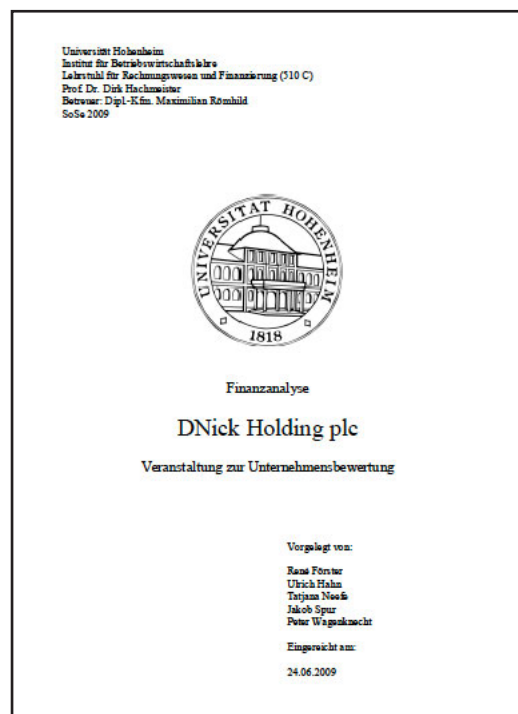
Even at today's somewhat depressed prices for transactions involving companies, DNICK would likely yield at least double the current share price if the company were broken up. Once the economic situation has stabilized, DNICK's break-up value would likely be 3 times the current share price. It might be even higher, given that by then the Indian joint venture will also contribute to the equation and given that I never attached an actual price tag to the large property reserves hidden in DNICK's balance sheet.

Last year I was the only analyst following this company. Today, I am no longer the only person who has caught up with all this.

A group of analysts from University Hohenheim in Germany recently published a 66-page report on DNICK. They had valued the company as part of an academic exercise, using different scenarios to come up with an estimate of DNICK's intrinsic value. Their worst-case scenario involved falling demand for nickel alloys until 2011, and still came out at a value of EUR5.84 per share. A more realistic scenario involving a further small decrease in demand for nickel alloys during 2010 and a return to growth in 2011, yielded EUR19.26. The estimate goes to show just how much of a leverage effect this investment has.

Curiously, the academic paper was written with a view to presenting it to the company's CFO as well as to the auditing firm, Warth & Klein. This is the auditing firm that used to audit DNICK's books in the past. Also, anyone with some knowledge of corporate action opportunities in Germany will recognize Warth & Klein as one of THE most-often used consulting firms when it comes to minority shareholders being bought out from listed firms (during bid situations or when a major shareholder wants to take 100% possession of a company and de-list it).

Honi soit qui mal y pense.



The 66-page DNICK report recently published by a group of analysts from University Hohenheim in Germany

Why the management of this company is truly working for the benefit of all shareholders

DNICK's management team is now holding a 5% stake. This was part of their pay package, and the agreement to issue more shares to them based on operational milestones being met has now come to an end. They won't get any more shares, and their job is essentially done.

Eventually, the management team members will want to turn their stake into cash. How to best do this? Given that the share price is not reflecting the true underlying value of the company, the only two ways to crystallize the result of their work are to either find a strategic buyer who makes a bid for the entire company, or to sell the different divisions and pay out the cash proceeds as special dividends (thereby effectively liquidating DNICK). The management team's interests are perfectly aligned with those of the outside shareholders – everyone wants to see cash! This includes Goldman Sachs and Bear Stearns, who will have no interest in holding on to this company for longer than is absolutely necessary.

With the overall situation of financial markets improving somewhat, it'd even be possible that financial investors start to take a look at DNICK. One of those entertaining details that you stumble across when spending way too much time researching on the Internet – DNICK's Chairman, Paul Felton-Smith, happens to be CFO of Lupus Capital, a London-listed firm specialized in investments into undervalued industrial companies.

Clearly, DNICK is run by the right set of people and there is a lot of additional value to be realized. The market had temporarily been distracted from these facts, given that everyone thought the world as we knew it was coming to an end. Now that the worst of the panic is over, the market has started to once more value the company based on the indisputable facts. And it's for that reason, that I believe the share price really only has one way to go from here. Latecomers are, thus, being given a second opportunity.

With best regards



Swen Lorenz
Undervalued-Shares.com

P.S.: One of my good friends from London, Adrian Kempton-Cumber, is an expert for technical analysis. He operates his own blog website, www.tradeandtested.co.uk, where he regularly churns out trading analysis as well as all sorts of amusing thoughts about life, the universe and everything. Adrian has offered to run a technical analysis of the shares that I discuss on Undervalued-Shares.com. Needless to say, his technical analysis as well as my fundamental analysis will not always come to the same conclusion (which is great, as it means that he can offer a genuinely useful additional view). If you like to read up on Adrian's technical view of DNICK's share price, then click [here](#).

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