EDISON Scale research report - Update

FCR Immobilien

Real estate

30 August 2019

Price	**€10.00**
Market cap	**€88m**

Share price graph

Share details

Code	FC9
Listing	Deutsche Börse Scale
Shares in issue	8.8m
Last reported net debt at end-June 2019	€159.3m

Business description

FCR Immobilien is a German real estate investor primarily focused on small and mid-sized properties in tier two domestic locations. It looks for special situations translating into bargain purchases. Subsequent measures are aimed at improving rental income generation. FCR's portfolio currently consists of 71 properties with a lettable area of c 325k sqm, of which more than 80% represent retail properties.

Bull

- Expertise in sourcing attractively priced properties.
- Considerable portfolio expansion leading to rental income growth.
- Exposure to mostly non-cyclical tenants with limited threat from online shopping.

Bear

- High leverage level vs peers.
- Relatively high tenant concentration.
- Key personnel risk.

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Edison profile page

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Progressing with portfolio expansion agenda

FCR consistently implements its growth strategy of increasing its market penetration in the German retail property market coupled with selective, rental-oriented expansion in other real estate segments. As a result, its portfolio at end-June 2019 reached 64 properties with a leasable floorspace of 306k sqm (vs 58 and 248k sqm, respectively, at end-2018). A further seven retail properties were acquired post reporting date. Consequently, FCR's portfolio is now generating a rental income of more than €16m pa (vs €14.8m at end-2018). FCR's shares are currently traded at a price to last reported NAV ratio of 0.94x vs the peer median of 1.07x.

H119 earnings illustrate portfolio growth

FCR's EBITDA came in at €11.7m compared with €3.9m in H118, driven by the higher rental income (€9.6m at top line level) from the enlarged property portfolio as well as disposal gains of €10.3m (vs €2.2m in H118) realised on three transactions. The company's net debt to total assets ratio was slightly down to 79% from 84% at end-2018 on the back of the recently completed share issue. We estimate FCR's LTV at property level at 65% at end-June 2019 (compared with 67% at end-2018 and the targeted range of 70–80%).

Continued high exposure to retail properties

FCR remains predominantly focused on retail properties, which at end-June 2019 represented 82% of rental income generated by its portfolio. Importantly, the majority of FCR's tenants are from non-cyclical sectors that should also be immune to the e-commerce threat. The company is also pursuing selective rental-oriented expansion outside of the retail segment, as illustrated by the acquisition of a residential project in Berlin-Köpenick, a hotel in Westerburg as well as a distribution centre in Zeithain. We estimate that initial yields for recent transactions were around 8–10% compared with FCR's target of more than 10%.

Valuation: Trading at a slight discount to NAV

FCR's NAV per share as at end-June 2019 was €21.31, while its shares are now traded at a c 6% discount. This compares with a median premium to NAV for FCR's peer group of c 7%. FCR's in-house NAV estimate implies an aggregate potential value uplift on disposal of €84m for the entire portfolio. FCR's recent dividend of €0.35 represents a yield of 1.8%.

Consensus estimates

Year end	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/17	16.4	1.3	0.23*	0.00	87.0	N/A
12/18	37.2	3.0	0.34*	0.35*	58.8	1.8
12/19e	54.5	10.3	0.78	0.32	12.9	3.2
12/20e	68.6	10.7	0.82	0.35	12.2	3.5

Source: Company accounts, Refinitiv consensus at 30 August 2019. Note: *Not adjusted for the recent issue of bonus shares.

H119 results: Higher rental income and disposal gains

FCR's H119 figures reflect its considerable portfolio expansion executed over the last 12 months (see our discussion below). Its EBITDA (accounting for both rental income and gain on property disposals) reached €11.7m in H119 compared with €3.9m in H118, while revenues doubled to €29.5m from €14.5m in H118. Rental income contributed €9.6m in H119 to the top line (up from €6.0m in H118), while revenue from property disposals reached €19.9m (compared with €8.6m in H118) on the back of three transactions closed in H119. These disposals yielded a €10.3m gain in H119 (vs €2.2m in H118). As a reminder, property disposals are part of FCR's core business of purchasing assets from distressed buyers, enhancing their rental generation potential through asset management initiatives and subsequently realising the value-add in the form of disposal gains.

Material expenses went up to €13.8m from €8.8m in H118, with the increase driven both by the book value of sold properties (€9.6m vs €6.4m in H118) and facility management costs (€4.2m vs €2.4m in H118). Meanwhile, personnel expenses went up to €2.7m from €0.9m in H118, reflecting FCR's overall business expansion. Following the new bond issue as well as further bank financing to fuel the portfolio growth, FCR's interest expenses went up to €2.9m from €1.7m in H118 (of which €1.6m is attributable to the interest on bonds issued at holding level and €1.4m to property-level debt). Consequently, net income came in at €4.3m (vs €1.1m in H118), while FCR's funds from operations (FFO, ie net income after adding back D&A) reached €6.7m vs €1.9m in H118.

Exhibit 1: H119 results highlights

€000s, unless otherwise stated	H119	H118	Change y-o-y
Revenues, of which:	29,478	14,526	102.9%
Rental income	9,578	5,976	60.3%
Sale of investment properties	19,900	8,550	132.7%
Increase/decrease in unfinished goods and services	0	(65)	N/M
Total revenue	**29,478**	**14,461**	**103.8%**
Material expenses	(13,788)	(8,763)	57.3%
Personnel expenses	(2,704)	(931)	190.5%
Other operating income	278	130	113.6%
Other operating expense	(1,528)	(995)	53.6%
EBITDA	**11,734**	**3,901**	200.8%
EBITDA margin	*39.8%*	*27.0%*	*1,283bp*
D&A	(2,481)	(872)	184.6%
EBIT	**9,254**	**3,030**	205.4%
EBIT margin	*31.4%*	*21.0%*	*1,044bp*
Other interest and similar income	18	119	N/M
Interest and similar expense	(2,949)	(1,691)	74.5%
Pre-tax profit	**6,323**	**1,459**	**333.5%**
Income taxes	(1,641)	(228)	N/M
Profit after tax	**4,681**	**1,230**	**280.5%**
Other taxes	(426)	(168)	154.0%
Net profit	**4,255**	**1,063**	**300.4%**

Source: FCR Immobilien,

At end-June 2019, FCR's ratio of bank liabilities to book value of properties stood at c 65% vs 67% at end-2018. This compares with FCR's financing strategy which assumes 70–80% leverage (preferably at the upper end of the range) at individual property level, which usually takes the form of non-recourse, first-lien bank loans. These currently have an average coupon rate of 2.1%. After accounting for bonds issued at the holding level, FCR's net debt to total assets stood at 79% at end-June 2019. This is a slight decline from 84% at end-2018, which is a function of the recent new share issue (discussed in more detail in the valuation section). With respect to other funding measures, the company has launched a new 5.25% bond issue in April 2019 with a total volume of €30m, of which more than €16m has already been placed (compared to close to €14m as at 29 May). The private placement is still in progress, while bonds that were already placed as part of this issue are traded at the Frankfurt exchange.

Portfolio generating more than €16m rental income pa

FCR continues the dynamic expansion of its property portfolio, which at end-June 2019 consisted of 64 properties, compared with 58 at end-2018, representing a total leasable space of 306k sqm and generating annual rental income of c €15.9m (vs 248k sqm and €14.8m, respectively, at end-2018; see Exhibit 2). If we compare the current rental income to the book value of FCR's properties, we arrive at a rental yield of 9.5%, or 11.2% based on the estimated potential additional rental income following the implementation of FCR's planned asset management measures (as described below). This compares with 9.7% and 11.5% at end-2018, respectively and is slightly below the company's targeted initial rental yield in excess of 10%. We estimate that FCR's initial yields in transactions completed over the last 12 months were closer to 8–10%. It is also important to note that all but one of the properties acquired so far this year are close to fully or fully occupied. This means that potential rental income increase will come from the optimisation of tenant mix and/or lease terms rather than a reduction of the vacancy rate. The weighted average unexpired lease term (WAULT) across FCR's portfolio declined only slightly to 5.3 years from 5.5 at end-2018 (but went up visibly vs the 4.5 years at end-June 2018).

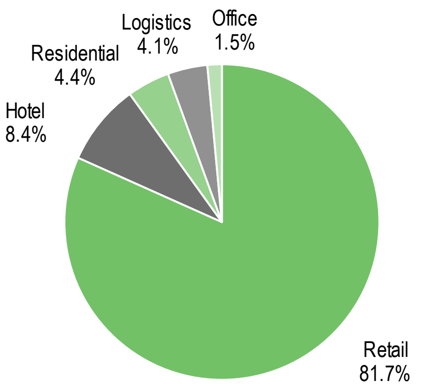
Exhibit 2: FCR's key portfolio statistics

	H119	FY18	H118
Number of properties	64	58	42
Leasable floorspace (000 sqm)	306	248	158
Net rental income pa (€m)	15.9	14.8	9.3
Occupancy rate	86%	85%	83%
Potential net rental income pa (€m)	18.8	17.7	11.5
WAULT (years)	5.3	5.5	4.5
Net rental yield pa	9.5%	9.7%	12.9%
Potential net rental yield pa	11.2%	11.5%	16.0%

Source: FCR Immobilien

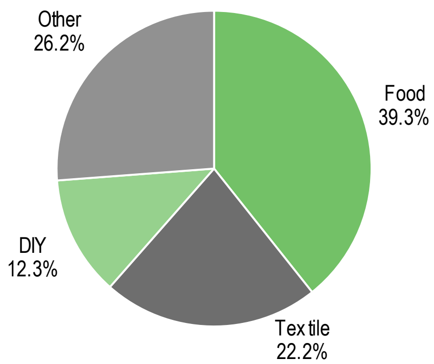
Retail still represents the majority of the portfolio at 82% (as measured by current rental income; see Exhibit 3), although recently acquisitions have also been completed in other real estate segments (see below). We appreciate the fact that FCR's portfolio remains highly exposed to tenants from non-cyclical sectors that are also largely immune to the growing penetration of e-commerce, such as food (39.3% of portfolio at end-June 2019) and DIY (12.3%). Moreover, within the textile tenant group (22.2%), a significant part constitutes discount retailers, which should exhibit similar resilience.

Exhibit 3: FCR's portfolio split by segment



Source: FCR Immobilien. Note: Calculated based on rental income generated by the portfolio as at end-June 2019.

Exhibit 4: FCR's tenant split by sector



Source: FCR Immobilien. Note: Calculated based on rental income generated by the portfolio as at end-June 2019.

In H119, the company acquired nine new properties, including six retail properties with leasable floorspace in excess of 20k sqm, a distribution centre in Zeithain with a floorspace of 44k sqm (FCR's first logistics property if we exclude the headquarters and central warehouse of Jawoll purchased in November 2018), as well as a four-star hotel in Westerburg (5.2k sqm) and a residential property in Berlin-Köpenick (457sqm). Meanwhile, FCR sold three retail properties with a total leasable floorspace of around 14.2k sqm (as discussed above). The company continued to be active post reporting date, with a further seven retail properties purchased, representing a total floorspace of 18.6k sqm acquired until the date of this report. Its investment volume thus surpassed €36m year-to-date. Following these purchases, FCR's net rental income increased to €16.3m pa.

The management expects a significantly positive net income and a considerable increase in both rental and disposal income in FY19. Amid continued strength in the German real estate market, the company intends to further expand its property portfolio. The company's strategy involves increasing market penetration in the German retail real estate segment, but also selective rental-oriented expansion of the business model into the hotel, residential, office and logistics segments. Apart from Germany, FCR is also aiming to explore other markets, such as Austria, Italy and Spain. In fact, the company already owns certain assets outside Germany (representing around 5.3% of its rental income), such as the Il Pelagone hotel and golf resort in Italy. In its August 2019 investor presentation, FCR highlighted that it is currently in the process of acquiring 19 properties constituting an investment volume in excess of €90m (which most likely includes the most recently acquired retail property in Hambühren).

Valuation

FCR's NAV at end-June 2019 reached €93.9m, up c 5% from €89.3m at end-2018. NAV per share however remained broadly unchanged at €21.31 (vs €21.30 at end-2018) due to the dilutive impact of the new share issue conducted in March 2019. The company issued 186,072 new shares translating into a c 4.4% dilution. It is important to note that after the reporting date, the company has conducted a share issue by granting bonus shares to all existing shareholders (one for every share held). Consequently, the number of shares outstanding doubled while NAV per share was reduced by half (and now stands around €10.66). When comparing it with last closing price of €10.00, this implies a discount to last reported NAV of around 6%.

We note that FCR's NAV estimate is not based on regular valuations performed by external real estate experts (which is often the case with real estate investment companies). Instead, FCR relies mostly on received purchase offers, as well as bank valuations on debt refinancing and internal fair market value assessments. FCR estimates the gross market value of its portfolio at €261m vs the current book value of €177m (implying a potential value uplift on disposal of c €84m).

It is instructive to review the market multiples at which FCR and peers are currently trading. Based on the last reported NAV per share, FCR is trading at a P/NAV ratio at 0.94x, which represents a 12% discount to the peer group. Based on the FY19e EV/EBITDA ratio, FCR is trading at a 28% discount to the peer average. Since FCR recognises its real estate portfolio under property, plant and equipment (which is being depreciated on an ongoing basis), while some of its peers book it under investment property (under IFRS) and revalue it regularly, a comparison based on P/E ratios has limited informational value. FCR's AGM recently approved a dividend payout of €0.35 per share (calculated excluding the bonus shares), which currently represents a dividend yield of 1.8%.

Exhibit 5: Peer comparison

	Market cap (€m)	P/NAV (last reported)	P/E (x)		EV/EBITDA (x)	
			2019e	2020e	2019e	2020e
Demire	523	0.83	7.8	11.5	18.9	16.9
Deutsche Konsum REIT	446	1.61	9.5	8.5	11.2	9.5
Defama	67	1.32	25.8	11.2	18.3	11.3
Hamborner REIT	750	0.89	41.6	25.5	20.1	19.3
VIB Vermogen	731	1.25	11.4	10.9	17.3	16.5
Deutsche EuroShop	1,445	0.54	10.5	10.6	14.6	14.6
Peer group median	**-**	**1.07**	**11.0**	**11.1**	**17.8**	**15.5**
FCR Immobilien	88	0.94	12.9	12.2	12.8	11.8
Premium/(discount)	**-**	**(12%)**	**17%**	**10%**	**(28%)**	**(24%)**

Source: FCR Immobilien, Edison Investment Research, Refinitiv consensus as at 30 August 2019

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