EDISON

Scale research report - Update

FCR Immobilien

Real estate

11 May 2020

Maintaining good momentum in FY19

FCR Immobilien (FCR) maintained its growth path in FY19, with EPRA NAV per share up by c 22% y-o-y and annualised net rental revenue generated by its portfolio of €19.5m (up 32% y-o-y). Consequently, we estimate that it was able to deliver a NAV total return (TR) per share of around 24% despite the dilutive impact of last year's share issue. Management remains committed to further portfolio expansion, with a target of €400–450m asset value, which may require additional external funding, eg through the new bond issue announced in March 2020.

Portfolio value reached close to €300m

In FY19, FCR acquired 25 new properties while exiting seven, and held 76 investments valued by external appraisers at €296m at end 2019. The company has now moved to IFRS accounting, posting an EBITDA increase to €18.5m in FY19 from €7.6m in FY18 (both figures in IFRS terms). Revenue increased by 33% y-o-y to €49.7m. Following the portfolio revaluation, FCR's equity to total assets ratio now stands at 26%. In March, it launched a new bond offering targeting proceeds of up to €30m. FCR remains in buying mode and sees compelling opportunities in the logistics and office segments, but retail will remain its core segment (76% of the portfolio at end 2019).

Management expects limited impact from COVID-19

Given FCR's high exposure to tenants such as food retailers and neighbourhood stores, it expects a relatively moderate impact from the COVID-19 lockdown, with deferred rental revenue in the period April to June 2020 of c €150k per month and aggregate maximum loss in rental revenue of c €200k (1% of its FY19 rental revenue). No rent losses were reported to date. Its hotel operations in Italy are also likely to be impaired. While the company has a liquid position of €10m, we also note its high loan amortisation rate (5% at group level at end-2019).

Valuation: P/NAV discount to closest peers

FCR's last reported EPRA NAV/share translates into a P/NAV multiple of 0.94x. While this represents a 5% premium to its peer group, we also note that it implies a 34% discount to its closest peers (Deutsche Konsum REIT and Defama). The company intends to pay a dividend of €0.30 per share, implying a dividend yield of around 2.9%.

Consensus estimates

Year end	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/18*	37.3	2.8	0.70	0.35*	14.7	1.7
12/19	49.7	11.9	1.46	0.30**	7.1	2.9
12/20e	84.5	17.1	1.09	0.49	9.4	4.8
12/21e	92.5	17.3	1.11	0.50	9.3	4.9

Source: FCR Immobilien, Refinitiv consensus at 11 May 2020 Note: *Not adjusted for the issue of bonus shares in FY19. **Based on management proposal.

Price	€10.30
Market cap	€94m

Share price graph

Share details

Code	FC9
Listing	Deutsche Börse Scale
Shares in issue	9.1m
Last reported net debt at 31 December 2019	€207m

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.

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.

Analyst

Milosz Papst +44 (0)20 3077 5700

financials@edisongroup.com

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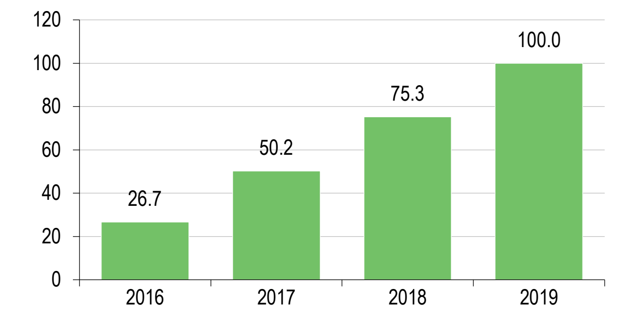
FY19 portfolio highlights: Building further mass

In 2019, FCR continued the dynamic growth of its investment property portfolio, with 25 projects acquired during the year for €68m. Simultaneously, it sold seven properties for €28m, generating a combined gross profit of around €13.6m. As well as property transactions, FCR made good progress in asset management initiatives for a number of existing holdings. For instance, for the logistics centre in Zeithain, it signed lease agreements generating close to €1m in annual net rental revenue starting in 2020. This is particularly noticeable given that the property was acquired for just €3m from a distressed seller in June 2019. FCR also signed new or extended existing lease agreements on, among others, the properties in Dessau, Oer-Erkenschwick, Schleiz and Gera.

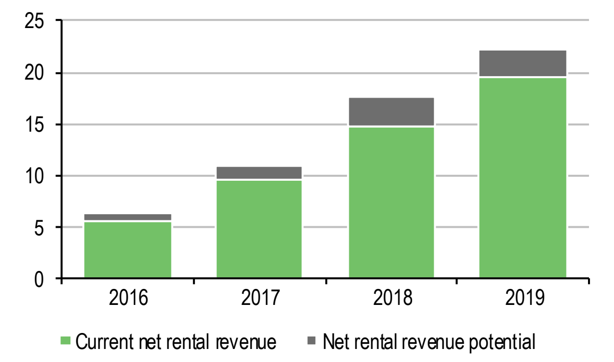
As a result of the above, FCR's property portfolio at end 2019 represented around 326,000sqm of leasable floor space (up 31% y-o-y) and net rental revenue of €19.5m (32% higher y-o-y), translating into a net rental yield of c 7.0% (vs 9.7% at end 2018). FCR estimates that on successful completion of its asset management initiatives (and assuming a 100% occupancy rate, currently c 87–88%), net rental revenue for the properties held at end 2019 could increase to €22.2m (compared with a potential of €17.7m at end 2018), implying an 8.0% net rental yield. This is in line with the annualised net rental yield reported by Deutsche Konsum REIT (FCR's closest peer) at end 2019 (on a pro forma basis including notarised properties).

Exhibit 1: FCR's EPRA NAV (€m)



Source: FCR Immobilien

Exhibit 2: FCR's net rental revenue (€m)



Source: FCR Immobilien. Note: Potential at full occupancy.

Based on an external appraisal, FCR's property portfolio at end 2019 is valued at €296m, which translates into an EPRA NAV per share of €10.93. This compares with €8.92 per share at end-2018 (when adjusted for the issue of bonus shares) and, together with the dividend paid last year of €0.17, translates into a NAV total return of 24%. The weighted average unexpired lease term (WAULT) of the portfolio at end 2019 was down to 4.4 years compared with 5.5 years at end 2018.

Financials: Moving to IFRS accounting

FCR Immobilien moved to IFRS accounting (from local German accounting standards – HGB) from FY19. The main (but not the only) differences between IFRS and HGB accounting relate to the treatment of FCR's properties. Under HGB, these were accounted for as constituents of property, plant and equipment which, on acquisition, were gradually depreciated rather than revalued. However, under IFRS they are considered investment properties and are subject to periodic revaluations reflected in their balance sheet value (with no ongoing depreciation). The first-time valuation uplift for FCR's current portfolio was directly reflected in equity and thus did not artificially boost profits in FY19. As a result, FCR's equity at end 2019 reached €85.5m, translating into an equity to total assets ratio of 26%. The change in accounting standards aligns FCR's reporting with standard market practice, also used by its closest peer (Deutsche Konsum REIT). As part of FCR's efforts to follow best market practice, it became a member of the European Public Real Estate Association (EPRA) earlier this year.

FCR reported IFRS EBITDA of €18.5m in FY19 compared with €7.6m in FY18 (restated for IFRS) and pre-tax profit of €11.9m (FY18: €2.8m). FCR's revenue came in at €49.7m, up 33% y-o-y. This reflects some disposal gains during the period, although we note that part of the value uplift was already accounted for in the restated FY18 figures before the properties were sold. Furthermore, sales and earnings growth was assisted by growing rental revenue, as well as higher revenue from the Pelagone 'Villaggio' hotel operations. The company intends to pay a dividend of €0.30 per share, which at the current price implies a dividend yield of c 2.9%.

Exhibit 3: FY19 results highlights

€m	FY19	FY18	Change y-o-y
Revenue, including:	49.7	37.3	33%
Rental revenue	*19.1*	*14.4*	*32%*
Sale of properties	*28.0*	*21.3*	*32%*
Hotel revenue	*2.6*	*1.6*	*59%*
EBITDA	18.5	7.6	144%
EBIT	18.1	7.1	156%
Pre-tax profit	11.9	2.8	325%
Net income	9.7	2.9	232%
FFO 2	9.5	8.6	10%

Source: FCR Immobilien

COVID-19 impact

FCR's portfolio is predominantly composed of retail properties, which predominantly have exposure to tenants such as food retailers and neighbourhood stores that were affected less severely than eg shopping malls by the current lockdown. Most of the remaining portfolio covers office and logistics properties, which are also likely to have seen limited impact. Nevertheless, some of FCR's tenants are subject to the measures introduced to contain the pandemic, with management estimating deferred rental revenue in the period April to June 2020 of c €150k per month. At present, it expects an aggregate maximum loss in rental revenue of c €200k (or 1% of its FY19 rental revenue). However, as per the company's May investor presentation, it has not experienced any rental revenue losses so far. At the same time, we note that its Pelagone 'Villaggio' hotel operations in Italy (which generated c 5% of FCR's revenue in FY19) are likely to have experienced considerable disruption. As highlighted above, FCR's liquidity stands at c €10m at present. In this context, we note the relatively high amortisation rate of its annuity loans (5% pa as at end-2019). Management continues to guide to significant positive net income in 2020. We will examine the COVID-19 impact in more detail in our forthcoming update note following FCR's Q120 update publication scheduled in May.

Management targets €400–450m portfolio value

FCR intends to further grow its property portfolio with the current target in terms of market value of €400–450m (vs almost €300m at end 2019). This was revised from €500m by end 2020 earlier this year. It is likely that the company will aim to deliver the target by acquiring a large number of relatively small properties (each valued at a mid-single digit euro level). While FCR is also open to larger transactions in the range of €20–25m, it faces stronger competition in this market segment from players such as Patrizia, Corestate or other institutional investors, which often push down yields below acceptable levels for FCR. After the balance sheet date, FCR acquired two fully let retail properties in Gummersbach (leasable space of more than 4,500sqm) and Höchstadt a.d. Aisch (leasable space of more than 1,700sqm), as well as a portfolio of three specialist retailer properties in Bavaria with a total leasable space of 3,300sqm.

FCR's portfolio expansion may be fuelled by: 1) its cash balance of c €10m as per the company's corporate presentation in May 2020; 2) property disposals (although these may be more difficult to close in the current environment); and 3) external funding (equity and/or debt). In this context, we note that FCR launched a new five-year bond offering in March with a volume of up to €30m and a coupon rate of 4.25% (the previous €30m bond issue has already been fully placed). FCR's loan-to-value (LTV) ratio at end-2019 stood at 67.4% (according to the company).

While retail remains FCR's core segment (with 76% share of the portfolio at end 2019, measured by current net rental revenue), it also intends to expand its office (9.2%) and logistics (5.6%) property portfolio given the wealth of deal opportunities it sees in those segments. At the same time, it will be more cautious with respect to hotel properties (5.6%), which require more effort to realize value than other types of properties.

Valuation

Based on FCR's last reported EPRA NAV per share of €10.93, the company is trading at a P/NAV multiple of 0.95x. This represents a 5% premium to the broader peer average (including Demire, Deutsche Konsum REIT, Defama, Hamborner REIT and Deutsche EuroShop) of 0.93x. However, we note that FCR trades at a 34% discount to the average multiple for its closest peers (Deutsche Konsum REIT and Defama) based on last reported NAV per share.

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