EDISON

Scale research report - Update

Noratis

Real estate

8 September 2020

Portfolio expansion continues

The significant decline in the H120 results reflects Noratis's decision, announced earlier this year, to postpone major asset sales beyond 2020. Its focus this year is instead on building up the portfolio, which it hopes will provide longer-term earnings sustainability. Portfolio expansion will be supported by €5m equity provided by the company's new core shareholder Merz Real Estate in May 2020. Noratis plans to raise a further €16.9m for portfolio growth in a public capital increase, announced in August 2020.

H120 results reflect postponement of asset sales

EBIT was down c 52% y-o-y to €4.2m in H120, while PBT declined to €2.3m from €6.9m a year earlier, affected by visibly lower revenues from asset disposals (€6.0m in H120 vs €41.8m in H119). These were partly offset by higher rental income (up 36% y-o-y to €8.0m), which followed a dynamic portfolio expansion in recent months. Net debt increased to €194.3m at end-H120 from €172.4m at end-FY19 after the company added €25.5m of bank liabilities to fuel ongoing portfolio growth. Only around 6% of its debt exposure matures in the next 12 months.

Management confirms subdued full-year forecast

Noratis has maintained its full-year guidance, which assumes significant year-on-year declines in EBIT and PBT vs prior years. The company believes that the ongoing portfolio expansion (amid lower competition in the current environment) will allow it to become profitable from rental business alone (when we subtract gross profit on assets sales from the H120 PBT ex capital increase costs, we arrive at a loss of €0.3m). This could also enhance profits by allowing the company to better time its asset sales (which will remain its main top-line and earnings driver over the longer term). The company highlights that the impact of the COVID-19 pandemic on the group has been moderate so far and resulted mainly from broader market trends, which suggests a slowdown in investment activity in the real estate market in Q220. So far has Noratis experienced only limited rental deferrals (just under 2% between April and June), mostly in the case of commercial tenants.

Valuation: Long-term commitment

The company's FY20e earnings multiples (P/E of 46.4x) may seem high, but they are driven its decision to postpone asset disposals this year and focus on securing longer-term earnings stability. Still, the dividend yield for 2020 and 2021 remains attractive compared with its closest peers, Accentro and Peach Property Group.

Consensus estimates

Year end	Revenue (€m)	EBIT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/18	56.1	15.6*	2.6	1.3	7.0	7.2
12/19	75.9	15.8	2.4	0.8	7.5	4.4
12/20e	28.9	7.1	0.4	0.4	46.4	2.4
12/21e	61.1	14.5	1.2	0.6	14.7	3.4

Source: Noratis accounts, Refinitiv consensus estimates. Note: *Includes €0.8m capital increase costs and €0.5m reversal of a rental guarantee provision.

Price	€18.1
Market cap	€70m

Share price graph

Share details

Code	NUVA
Listing	Deutsche Börse Scale
Shares in issue	3.9m
Last reported net debt at end-H120	€194.3m

Business description

Noratis is a specialised asset developer, acquiring residential rental income-producing assets in secondary locations with optimisation potential. Investing in the asset base and improving the tenant mix creates value, which it exploits in well-structured asset sales through individual or block sales.

Bull

- Equity funding from the new and existing shareholders may support liquidity and further portfolio growth.
- Focus on portfolio expansion may bring greater stability to sales and earnings.
- Strong experience operating in Germany's non-core areas.

Bear

- Subdued management guidance for 2020.
- COVID-19 pandemic has affected overall demand and transaction activity in the real estate market.
- Tenants are low- and mid-income earners, likely to be affected by the COVID-19 crisis.

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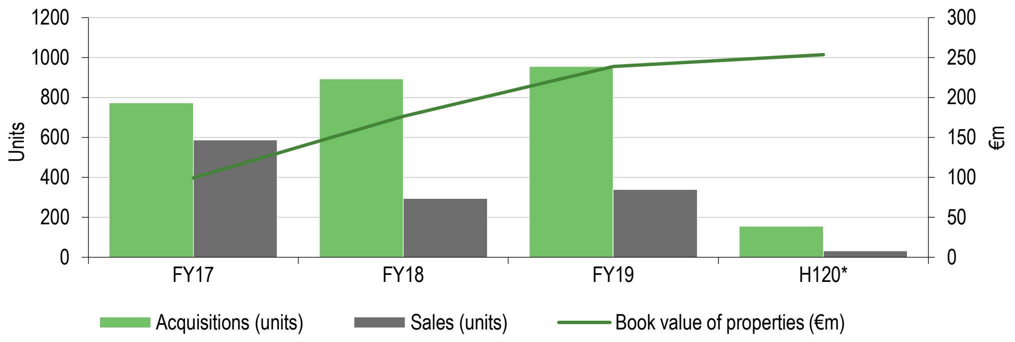
Muted asset sales coupled with higher rental income

Noratis's total H120 revenues fell to €14.0m from €47.7m in H119, affected by notably lower asset sales (€6.0m in H120 vs €41.8m a year earlier). These declines follow the company's decision communicated earlier this year to temporarily postpone some asset disposals and focus on portfolio expansion in 2020. In H120, Noratis sold 32 residential units (vs 177 in H119 and 162 in H219), generating gross margin on sales of 45%, compared with 20% in H119 and 29% on average between FY17 and FY19.

The company completed the acquisition of 155 residential units in H120, expanding its portfolio to 2,530 units. A dynamic portfolio expansion in recent months translated into a 36% y-o-y increase in rental revenues to €8.0m in H120 and was coupled with higher rental margin in H120 compared with H119, according to the company. It is worth noting that overall Noratis has announced the purchase of 753 units in H120 and expects to complete the acquisition of the remaining c 600 units in H220. Major transactions announced in existing locations included the Rhine-Main region (298 units), the Hanover-Braunschweig-Göttingen-Wolfsburg region (126) and the Leipzig region (51). It also expanded its presence to Bavaria (around 160) and Emden (79).

Exhibit 1: Portfolio development



Source: Noratis accounts, Edison Investment Research. Note: *Includes only acquisitions already completed in H120.

H120 EBIT fell to €4.2m (which includes one-time capital increase costs of €0.1m) from €8.8m a year earlier. It was affected by higher personnel expenses (up 32% y-o-y to €2.5m in H120) after the company expanded its workforce during H219. PBT declined to €2.3m in H120 from €6.9m in H119 as net interest expenses remained broadly stable year-on-year in the period. The latter were assisted by lower interest rates and the repayment of unsecured loans during H119, which had a volume of €6.0m and a relatively high coupon of 7% pa. The total average cost of debt was c 1.4% as of end-June 2020 (vs 1.7% at end-December 2019).

Noratis has reaffirmed its full-year guidance released earlier this year of a significant year-on-year decline in EBIT and PBT in 2020. The company does not plan any large portfolio disposals for the rest of the year and highlights that growing rental income driven by portfolio expansion will not compensate for the revenue decline due to postponed disposals. That said, management is considering paying out a dividend from the FY20 earnings and aims to achieve or exceed results recorded in recent years by 2022 at the latest.

The company's net debt increased to €194.3m at end-H120 from €172.4m at end-FY19 as portfolio expansion in the period led to a €25.5m growth in liabilities to banks to €200.6m. This was partly offset by an early repayment of the company's bond (€5.9m), which had a coupon of 7.5% pa. Cash was €6.3m at end-H120 vs €7.0m at end-FY19.

At first glance, the group's leverage may look relatively high, with a loan to value (LTV) ratio at the property level (expressed as the percentage of bank borrowings relative to the carrying amount of properties) of 78% at end-H120 (vs 76% at end-FY19) and a net debt to total assets ratio at the holding level of 73% (67%). We note however that Noratis's properties are reflected entirely in current assets at cost (with no subsequent revaluations) as they are acquired with the aim of being sold after successful development. This also means that all revenues from Noratis's asset sales are booked at the time of the disposal and are therefore cash earnings. It is noteworthy that only c 6% (or c €13m) of its financial liabilities (all of which are liabilities to banks) mature in the next 12 months, while the remaining exposure has maturity of one to five years (86%) and over five years (7%).

In August 2020, at the AGM shareholders agreed to pay out an annual dividend of €0.80 per share, which we estimate implies a cash outflow of c €2.9m for H220.

Exhibit 2: Financial performance

HGB figures in €m unless otherwise stated	H120	H119	Change y-o-y	FY19	FY18
Revenue					
Asset sales	6.0	41.8	-86%	63.0	48.2
Rental	8.0	5.9	36%	12.9	7.9
Total	14.0	47.7	-71%	75.9	56.1
Gross profit					
Asset sales	2.7	8.4	-68%	14.4	17.3
Margin	45%	20%	124%	23%	36%
Rental	5.0	3.5	43%	7.2	4.3
Total	7.7	11.9	-35%	21.6	21.7
EBIT - reported	**4.2**	**8.8**	**-52%**	**15.8**	**15.6**
Exceptional items:					
IPO/capital increase costs	(0.1)	0.0	N/A	0.0	(0.8)
Reversal of a rental guarantee provision	0.0	0.0	N/A	0.0	0.5
EBIT - adjusted	**4.3**	**8.8**	**-51%**	**15.8**	**15.9**
Net interest expense	(1.9)	(1.9)	0%	(3.7)	(2.8)
Pre-tax profit - reported	**2.3**	**6.9**	**-67%**	**12.1**	**12.8**
Pre-tax profit - adjusted	**2.4**	**6.9**	**-65%**	**12.1**	**13.1**
Net profit - reported	1.6	5.0	-68%	8.7	9.3
EPS (€) - reported	**0.42**	**1.39**	**-70%**	**2.40**	**2.57**

Source: Noratis accounts, Edison Investment Research

Capital increases to fuel portfolio growth

Noratis remains focused on further portfolio expansion, which it hopes will allow it to increase the share of rental income in total sales to c 40% (vs c 10–20% between FY17 and FY19) and become profitable from managing its carried portfolio alone. Expansion of the portfolio is also aimed at enhancing profits by allowing Noratis to better time its asset sales. That said, management confirms that asset disposals will remain its main activity over the longer term.

Noratis plans to support the ongoing portfolio growth with the financing from Merz, a core investor that acquired a c 29% stake in the company in March 2020 (see more details in our previous update note). Merz has agreed to invest in Noratis up to €50m via capital increases by the end of 2024. Noratis completed the first capital increase with Merz in May 2020, issuing c 253k shares at a price of €19.80 per share, which translated into gross proceeds of c €5.0m. As a result, Merz held a 34.9% stake in the company as of end-H120, which it increased to c 46.2% in early July following the acquisition of a c 11.3% stake from Terratis, its former large shareholder.

On top of that, Noratis announced in August 2020, that it will issue up to c 964k shares to its existing shareholders at a subscription price of €17.55 (vs €19.30 on the closing a day before the announcement). This would translate into gross proceeds of up to €16.9m that the company plans to use for further portfolio growth. The existing shareholders will be entitled to acquire one new share for every four existing shares. Its two main shareholders, Merz Real Estate and Igor Bugarski, have waived their subscription rights. All unsubscribed shares will be offered in a subsequent private placement to qualified investors at a price of at least the subscription price. Merz has committed to acquire all shares that are not subscribed to in the private placement. The public offer will take place between 1 September and 15 September 2020.

COVID-19 pandemic cools down the residential market

Noratis highlights that the impact of the COVID-19 pandemic on the group has been moderate so far and has resulted mainly from broader market sentiment. While in the COVID-19 crisis, the affordable living sector may be less exposed to demand shocks than high-end apartments, we acknowledge that the company's tenants are low- and middle-income earners, who may be affected by the economic effects of the pandemic. Based on our conversation with management we understand that rent deferrals for Noratis between April and June represented just under 2% of its monthly target rent and concerned mainly its commercial tenants (commercial space represented c 3% of Noratis's portfolio as of end-June 2020). It is worth noting that as a precautionary measure, the company's shareholders agreed in August 2020 to allocate €0.10 per share from FY19 earnings to a social fund aimed at supporting its tenants affected by the coronavirus crisis. This implies an amount of €0.4m based on the number of shares as of end-FY19 (vs rental income of €8.0m in H120 and €12.9m in FY19).

In-place net annualized rent increased to €12.0m at end-H120 from €11.6m at end-FY19, while the vacancy rate was 6.3% vs 5.6% at end-FY19. Based on our conversation with management we understand that a slight growth in the latter follows the ongoing portfolio expansion (vacancies tend to rise in the first months after a takeover) as well as the continuing optimisation of the existing portfolio (when flats are deliberately not re-let before disposals or where renovations have started).

The German residential market has remained relatively resilient to COVID-19. Q220 saw a notable slowdown, with investment volume on the residential market of c €3.2bn vs the quarterly average of the last five years of c €4.1bn, according to Savills estimates. That said, this followed a particularly strong Q120, bringing the residential transaction volume in H120 to €12.5bn, up 96% y-o-y. Savills warns that the low point of the crisis in the real estate market is likely ahead given that it reacts with a time lag to changes in the macro environment. At the same time, it notes that market activity picked up again in June after a weak April and May.

Valuation

Noratis's position between asset holder and developer makes for a difficult comparison with listed companies. We believe its closest peers are RCM Beteiligungs, a German property developer acquiring rental income-producing assets in and around Dresden and investing in refurbishment (for which no consensus forecasts are available), Accentro, a German residential property company focused on privatisation, and Peach Property Group, a company investing in high-yielding residential real estates, mainly in German secondary locations.

Based on the Refinitiv consensus, Noratis is trading at an FY20e P/E of 46.4x, which compares with 22.5x for Accentro and 7.8x for Peach Property Group. While Noratis's FY20e earnings multiples may look high, we note that it has intentionally postponed asset sales this year to provide better earnings prospects over the longer term. We believe this is already partly reflected in its FY21e P/E multiple of 14.7x, compared with 13.7x for Accentro and 6.6x for Peach Property Group.

Noteworthy, Noratis's FY20e dividend yield of 2.4% is visibly higher than Accentro's (0.8%) and slightly higher than Peach Property Group's (2.0%). Its dividend yield increases to 3.4% in 2021, well ahead of its peers (1.8% for Accentro and 2.6% for Peach Property Group).

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