EDISON

Scale research report - Update

Consus Real Estate

Real estate

10 September 2020

Acquired by ADO Properties

On 29 June 2020, Consus Real Estate announced that ADO Properties is taking control of Consus following the exercise of its call option, bringing its total stake to over 75%. Consequently, Consus will shift its strategy from pure property development to a build-to-hold model. At end-June 2020, adjusted for recent disposals, its portfolio consisted of 39 projects with a gross development value (GDV) of €8.0bn, including c €2.6bn in forward-sold projects. As some initially planned new forward/ upfront sales will not be executed and will thus not contribute to FY20 earnings, management has withdrawn its guidance for adjusted EBITDA of €450m.

Improved earnings on asset disposals

In H120 Consus improved its total income to €613.6m vs €210.3m in H119, following €339.7m in real estate inventory disposals (€2.4m in H119). As no new forward sales agreements were signed over the period, the 13.3% y-o-y improvement in income from property development was due to progress made in existing building projects. Adjusted EBITDA pre-PPA increased to €136.3m from €121.6m in H119, with reported EBITDA up just 3.7% y-o-y to €120.9m. A higher financial result (assisted by a one-off) and €8.9m loss attributable to minorities resulted in net income of €18.2m vs a €1.3m loss in H119.

Reducing level of indebtedness and associated cost

In May 2020 Consus sold 25 of its development projects (€4.3bn GDV) in two separate transactions, for a combined total of c €1.1bn. The corresponding project debt reduction amounted to €865m, including €350m in expensive mezzanine finance, which reduced the pro forma average run-rate cost of debt from 7.8% to 7.4%. According to management, the overall net debt reduction from asset disposals vs end-2019 should exceed €1bn; meanwhile, at 30 June 2020, net debt was €2,617m vs €2,700m at end-December 2019.

Valuation: Share price linked to ADO Properties

As ADO will launch a tender offer for the remaining Consus shares at a ratio of one to 0.2390 ADO share, we expect Consus's valuation may be somewhat pegged to ADO's share price. However, following the significant rebound since mid-March, Consus shares currently trade at a ratio of 0.2999 to ADO. Based on Refinitiv consensus data, Consus currently trades at a discount to peers on 2020e P/E and EV/EBITDA multiples, moving to an EV/EBITDA premium in 2021e and 2022e.

Consensus estimates

Year end	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/19	863.8	11.5	(0.15)	0.00	N/A	N/A
12/20e	1,083.7	131.0	0.57	0.00	13.1	N/A
12/21e	1,187.0	193.1	0.79	0.10	9.5	1.3
12/22e	1,313.5	275.5	1.21	0.20	6.2	2.7

Source: Consus Real Estate accounts, Refinitiv consensus at 10 September 2020, adjusted to remove impact of including non-forecasting analysts

Price	€7.48
Market cap	€1,207m

Share price graph

Share details

Code	CC1
Listing	Deutsche Börse Scale
Shares in issue	161.3m
Last reported net debt at 30 June 2020	€2,617m

Business description

Consus Real Estate, based in Berlin, is a listed residential real estate developer operating in the nine largest cities in Germany. Acquisition by ADO Properties will result in a strategic shift to a build-to-hold model. Following the recent disposal of 25 projects, Consus's portfolio will consist of 39 projects with a GDV of c €8.0bn.

Bull

- Supply shortage in the German residential market.
- Extensive development pipeline.
- Joining a strong, country-wide real estate group.

Bear

- Relatively high leverage and associated cost.
- Risks to new business model implementation.
- Potential delisting in the near future.

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H120 financials: Overall performance improved by 47%

In H120 Consus reported an almost three-fold y-o-y improvement in total income, reaching €613.6m due to €339.7m earned from real estate inventory disposals (€2.4m in H119). This was in part offset by the corresponding negative change in project-related inventory (valued at cost), resulting in a 47% y-o-y increase in overall performance to €490.4m vs €333.6m in H119. In H120, all 47 projects held at the end of the period contributed to the €217.7m income from property development, which exceeded the previous year's figure by 13.3%. Earnings from letting activities remained broadly stable at €8.4m in H120 vs €8.7m in H119, as it remained a non-core business activity in the period. However, we note that these operations will expand as part of the strategic shift to a build-to-hold model, following the acquisition of control by ADO.

As several development projects moved to the construction phase, including the Südtribüne housing project in Dortmund, where the foundation stone was laid in February 2020, and the Brauhöfe project in Passau, initiated in March 2020, the cost of materials born by Consus increased in H120 to €291.5m from €168.1m in H119. With personnel and other operating expenses increasing by 28.9% and 51.6% y-o-y respectively, improved income translated into just 3.7% growth in EBITDA and 2.0% in EBIT. However, once adjusted for purchase price allocation (PPA), which is one of the company's key performance indicators, EBITDA increased from €121.6m in H119 to €136.3m in H120.

Financial costs in H120 increased by 30.5% y-o-y as net debt increased to €2.6bn at 30 June 2020 vs €2.5bn a year earlier and the steps taken during H120 to deleverage have not yet had a material impact on the company's results. Financial income improved significantly to €54.4m due to the positive revaluation of the derivative embedded within its €450m bond due to the ADO transaction. As a result, the net financial result was a loss of €102.3m in H120 versus a loss of €106.9m in H119. Consequently, Consus doubled EBT and consolidated net income, reporting €13.2m and €9.2m, respectively, against €6.3m and €4.4m in H119. With a €8.9m loss attributable to the non-controlling interests, net income excluding minorities reached €18.2m.

Exhibit 1: Financial highlights

€000s, unless otherwise stated	H120	H119	y-o-y
Income from letting activities	8,359	8,724	-4.2%
Income from real estate inventory disposed of	339,697	2,400	NM
Income from property development	217,728	192,099	13.3%
Income from service, maintenance, and management activities	47,846	7,123	NM
Total income	**613,630**	**210,346**	**191.7%**
Change in project related inventory	(123,214)	123,281	NM
Overall performance	**490,416**	**333,627**	**47.0%**
Expenses from letting activities	(3,120)	(4,840)	-35.5%
Cost of materials	(291,524)	(168,073)	73.5%
Net income from the remeasurement of investment properties	-	8,403	NM
Other operating income	10,961	8,482	29.2%
Personnel expenses	(37,872)	(29,382)	28.9%
Other operating expenses	(47,943)	(31,628)	51.6%
EBITDA	**120,919**	**116,589**	**3.7%**
Depreciation and amortization	(5,369)	(3,319)	61.8%
EBIT	**115,550**	**113,270**	**2.0%**
Financial income	54,448	13,192	312.7%
Financial expenses	(156,758)	(120,124)	30.5%
EBT	**13,240**	**6,338**	**108.9%**
Income tax expenses	(3,995)	(1,909)	109.3%
Consolidated net income	**9,245**	**4,429**	**108.7%**
Minorities adjustment	8,908	-5,756	NM
Net income ex. minorities	**18,153**	**(1,327)**	**NM**

Source: Consus Real Estate accounts

According to management, the pandemic has not had a significant impact on the business (except for some limited rise in costs and limited delays to project completion) and it does not expect this to change in the upcoming months. However, certain new forward and upfront sales that were previously expected to contribute to FY20 results, may not be completed due to the pandemic impact, but also the strategic shift towards a build-to hold operating model. Therefore, management has withdrawn its guidance for adjusted EBITDA (pre-PPA) of €450m for 2020. We note that total upfront sales in H120 (including the two large portfolio disposals) reached €4.3bn, well above the €2.0bn guided in the FY19 financial statement.

ADO Properties takes control

As we described in our January update note, ADO Properties has held a 25% stake in Consus since the end of 2019, with a call option for further 51% due to mature in mid-2021. On 29 June 2020, ADO announced the exercise of the option, which completed on 6 July, giving ADO full control over Consus. It also announced that a public voluntary tender offer to all remaining minority shareholders will be launched as soon as possible, at the same ratio of 0.2390 ADO shares for each share in Consus. At 10 September 2020 the ratio was 0.2999.

As part of the combined group, Consus will move from pure property development to a build-to hold operating model. Prior to the exercise of the option, both companies had a strategic co-operation agreement, to jointly develop both existing and potential new realisations from Consus's portfolio. It also gave ADO the pre-emptive right to match any third-party offer for these joint projects. Currently, the forward sales are on hold with no new agreement signed in the first six months of 2020 as Consus will be extending its letting activities on its developments.

Changes were also made in the company's management, as chief executive officer, Andreas Steyer, and chief financial officer, Benjamin Lee, left their positions on 11 July and on 26 July 2020, respectively, with a golden handshake of €2.8m. With Jens Jäpel, the former chief development officer, resigning from his role on 14 May 2020, the management board consists now of only one member, Theodorus Gorens.

The acquisition of the majority stake by ADO was also considered as a change of control in accordance with the terms of the company's €450m secured bond, maturing in 2024, and the €200m convertible bond due in 2022. It triggered notional repayments totalling €75.8m, made on 6 August and 14 August 2020.

As part of the process of simplifying its corporate structure, in July 2020 Consus acquired the remaining 25% minority stake in Consus RE (previously CG Gruppe), for €27.5m in cash and 24.75m Consus shares, from Christoph Gröner (the former CEO of CG Gruppe). With Consus RE becoming a wholly owned subsidiary, Consus now plans to convert it to a limited liability company, releasing Christoph Gröner from his duty on the supervisory board.

Deleveraging through project disposals

The uncertain global business environment due to the pandemic encouraged Consus to embark on extensive deleveraging measures. Over the first six months of 2020, the company agreed the upfront sale of 25 projects in two separate transactions. On 8 May, it announced the disposal of 17 projects (representing €2.3bn of GDV) to Gröner Group (controlled by Christoph Gröner) with a transaction value of around €690m, representing a double-digit percentage premium to the market value as at end-2019. Based on the preliminary purchase price, the transaction will result in a €53.9m profit and a reduction in project debt of c €475m.

On 20 May 2020, Consus announced a further significant asset sale, regarding eight projects with €2.0bn of GDV, to the real estate fund Partners Immobilien Capital Management. It was conducted at a premium to end-2019 market values and brought the total transaction value to c €1.1bn. Upon completion (expected in Q320) it will also reduce the company's debt by an additional €390m. We note that this includes €350m of expensive mezzanine debt, helping reduce the average run-rate cost of debt, which adjusted for both transactions will fall to 7.4% from 7.8%. Management indicated in May that both transactions should eventually reduce net debt by well over €1bn.

It is worth highlighting that despite the €475m project debt reduction from the first disposal, group net debt decreased only slightly between end-December 2019 (€2,700m) and end-June 2020 (€2,617m). This is because in Q120 net debt expanded to €2,817m, driven by funding of growth in inventory and investment properties, while a decrease in cash and cash equivalents in H120, from €150.6m to €103.3m, has also partly offset the impact of deleveraging measures. We note that net debt to adjusted last 12 months EBITDA sits at 7.3x as at end-June 2020 vs 7.8x at end FY19.

Narrowed portfolio focused on residential properties

Entering FY20 Consus held an investment portfolio consisting of 65 development projects with a total GDV of c €12.3bn. It was focused on residential properties with a significant share of quartier realisations, which also included commercial areas. The aforementioned disposals will reduce the portfolio to 39 projects, with a total GDV of c €8.0bn (at 30 June 2020 the portfolio was 47 projects with €10.0bn of GDV, as the last upfront sale had yet to be completed). The assets sold had a relatively higher proportion of commercial space, thus the company's focus on residential properties has increased to 63% of net floor area (post completion of both transactions) vs 52% earlier.

As the eight recently sold projects are located in Bayreuth, Cologne, Hamburg, Munich, Offenbach and Passau, c 99% of the company's remaining portfolio is located in the nine largest cities in Germany, with c 92% of GDV being attributable to the top seven cities (excluding Leipzig and Dresden). It is worth noting that all eight projects were in development phase with construction expected to start in 2021 or 2022, and that six of them were ranked among the top 25 assets in the company's portfolio. The second transaction comprised somewhat smaller projects, with only four out of the 17 projects sold on 8 May among the company's top 10 assets. Consequently, the market gross asset value, pro forma of both transactions, fell to €2.9bn at 30 June 2020 vs €3.6bn as at end-December 2019. With a relatively small number of the divested projects already forward sold to third parties, the forward sale share for the remaining portfolio now stands at c 32%, falling slightly from €2.8bn to €2.6bn in nominal terms.

Valuation

Based on Refinitiv consensus data, Consus is trading at a 9.5% P/E and 17.7% EV/EBITDA discount to peers on 2020e multiples, moving to a premium for the latter on both 2021e and 2022e figures. We assume, however, that Refinitiv consensus data have yet to fully reflect the recently announced strategic shift in the company's business model, as none of the analysts contributing to consensus has updated their forecasts since May 2020.

Exhibit 2: Peer group comparison

	Market	P/E (x)			EV/EBITDA (x)		
Company	**cap (mLCY)**	**2020e**	**2021e**	**2022e**	**2020e**	**2021e**	**2022e**
Instone Real Estate	961	21.5	8.2	6.3	16.9	8.5	6.1
Helma Eigenheimbau	140	13.3	9.6	7.4	16.1	12.6	10.2
UBM Development	242	7.8	8.2	5.9	11.9	12.1	9.6
Barrat Development	5,093	11.8	9.9	8.5	8.8	7.5	6.5
Taylor Wimpey	4,109	18.6	9.0	7.6	11.9	6.2	5.2
Bonava	7,425	14.0	10.7	9.9	16.5	13.1	12.3
Peer group average		**14.5**	**9.3**	**7.6**	**13.7**	**10.0**	**8.3**
Consus Real Estate	1,207	13.1	9.5	6.2	11.3	12.8	10.1
Premium/(discount) to peers		**(9.5%)**	**2.1%**	**(18.3%)**	**(17.7%)**	**28.1%**	**22.0%**

Source: Refinitiv consensus at 10 September 2020, adjusted for impact of including non-forecasting analysts

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