EDISON

Spotlight - Outlook

S Immo

Real estate

16 June 2021

Future strategy depends on takeover bid

So far, S Immo has weathered the COVID-19 crisis relatively well, with its EPRA net tangible assets (NTA) per share down by only c 6% between end-2019 and end-March 2021, mostly due to the impact on its hotels (c 9% of its property portfolio at present). Its future investments agenda depends on the outcome of the IMMOFINANZ takeover bid. Success would trigger a review of its hotel and residential strategy, whereas a failure would likely result in the sale of its minority stakes in both listed peers, with proceeds redeployed into new properties to further enhance its FFO1.

Balance sheet remains solid

S Immo's funds from operations (FFO1) per share fell by c 31.6% y-o-y to €0.13 in Q121 (and by 39.8% to €0.59 in FY20 vs FY19), with lockdowns resulting in a gross loss on its hotel operations of €1.3m in Q121 (€0.3m loss in FY20). In FY20, the decline was also due to the lack of dividend from IMMOFINANZ. Meanwhile, its rental income increased by 2.8% y-o-y in Q121 (3.3% in FY20), with no major COVID-19 impact on rents and vacancy. It retained a solid balance sheet with a loan-to-value (LTV) of 46.4% at end-Q121 (vs 46.9% at end-2019) and a favourable debt maturity profile (only 12.5% maturing until 2023).

Offer price with no meaningful premium for control

On 14 March, IMMOFINANZ announced the intention to launch a takeover bid for all remaining S Immo's shares with the acceptance period ending on 16 July 2021. IMMOFINANZ is offering €22.25 per S Immo share, which is at a c 40% premium to S Immo's average six-month share price before the announcement, but still 10% below its EPRA NTA per share at end-Q121. If we added the €85m portfolio value uplift in April flagged by S Immo and valued its minority stakes in IMMOFINANZ and CA Immobilien Anlagen (CA Immo) at their last actual EPRA NTA, the discount would be c 24% (excluding any deferred tax) versus the current peer average of 21%. Hence, the offer price does not seem to include any notable premium for control.

Valuation: Trading at a P/EPRA NTA of 0.89x

S Immo shares trade at 0.89x its last reported EPRA NTA of €24.79 per share. While this implies a 13% premium to peer median of 0.79x, it does not yet reflect the portfolio uplift in April 2021 (partially assisted by the Berlin rental cap repeal). Based on Refinitiv consensus, the FFO1 yield for FY21e and FY22e is 3.3% and 4.1%, respectively, 159bp and 108bp below peer median, respectively.

Consensus estimates

Year end	Revenue (€m)	EPRA NAV/share (€)	FFO1/share* (€)	DPS (€)	P/EPRA NTA (x)	Dividend yield
12/19	210.4	26.23	0.98	0.70	0.8	3.2
12/20	173.9	24.06	0.59	0.70	0.9	3.2
12/21e	195.0	N/A	0.73	0.48	N/A	2.2
12/22e	234.9	N/A	0.91	0.73	N/A	3.3

Source: S Immo, Refinitiv at 15 June. Note: *Funds from operations defined as net income excluding property revaluation/disposal gains, D&A and selected other non-cash charges.

Price	**€22.15**
Market cap	**€1,630m**

Share price graph

Share details

Code	SPI
Listing	Vienna
Shares in issue	73.6m
Net debt (€bn) at end March 2021	1.40
LTV (net) at end March 2021	46.4%

Business description

S Immo is a real estate investment company, with headquarters in Vienna. It invests in Austria, Germany and selected CEE/SEE markets. At end-March 2021, it held properties with a book value of c €2.5bn, including commercial (68%) and residential (30%) properties, as well as land plots (2%).

Bull

- Solid track record as illustrated by NAV TR.
- Extensive experience in leveraging property cycles.
- Moderate LTV and good liquidity.

Bear

- Impact from COVID-19, particularly on hotel and retail properties.
- Potential impact from the 'work from home' setup on demand for office space.
- Inflationary pressure may trigger interest rate hikes and negative valuation effects.

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Edison profile page

S Immo is a research client of Edison Investment Research Limited

Active property investor in Germany, Austria and CEE

S Immo is a real estate investment company headquartered in Vienna and operating in Austria, Germany and Central and Eastern European (CEE) countries, including Czech Republic, Slovakia, Hungary, Romania and Croatia. It was established as a result of the merger of two listed subsidiaries of Erste Bank, Sparkassen Immobilienanlagen and Erste Immobilien, in 2002. It acquires properties generating rental income across real estate sectors, including commercial properties (office, retail and hotels), which made up almost 70% of its book value at end-March 2021, with the remaining 30% invested in residential properties and land plots. The company aims to deliver sustainable dividend income to shareholders by following a cycle-oriented business model based on a buy-manage-sell principle (see Exhibit 1).

Exhibit 1: S Immo's value creation process

Source: S Immo

S Immo is also active in other parts of the real estate value chain, such as hotel management, property revitalisation and renovation, as well as property development. The company's strategy involves enhancing short-term earnings through the acquisition of properties with rental growth potential; facilitating medium-term momentum through project development; and securing long-term growth through land bank expansion.

An active approach to the property market cycle

Instead of following a pre-defined sector or regional allocation, the company's investment approach is based on anticipating property cycles and benefiting from them. To successfully execute the strategy, a group of local real estate experts monitors selected markets and associated trends to evaluate the attractiveness of potential acquisitions and disposals. S Immo has a solid track record of cleverly anticipating regional/sectoral real estate cycles in Europe. This includes the expansion into CEE in the early 2000s, later investments in the German residential and office markets and subsequent diversification outside of Berlin. We discussed this in more detail in our initiation note. S Immo's focus continues to be on secondary German residential and office markets and selective CEE investments. In the longer term, it plans to pursue development projects using its extensive landbank in the Berlin commuter belt.

Emphasis on ESG considerations

In the investment process, S Immo is factoring in environmental, social and governance (ESG) aspects such as energy efficiency of properties, both through energy-saving building services and devices (eg LED and photovoltaic), as well as deployment of renewable energy sources. Austrian and German properties are already powered by green energy, while the process for CEE properties will be completed until end-2022, according to the company. The environmentally friendly approach is illustrated by the usage of ecological construction materials, including recyclable and sourced regionally. Another key topic from S Immo's perspective is ensuring sustainable mobility of managed properties with incentives to use environmentally friendly means of transport, providing access to a broad network of public transport, foot and bicycle paths, as well as e-mobility infrastructure. S Immo respects local architecture, seeking to blend their buildings into the city skyline.

We note that at end-2020, 22% of S Immo's portfolio by area was certified under the Building Research Establishment Environmental Assessment Method and the company's prospective projects will also be certified in line with international standards. Moreover, S Immo received a medium risk ESG rating from Sustainalytics, ranking 537 out of 1,027 in its real estate industry group (and 3,384 out of a global universe of 13,733 companies). In February 2021, the company issued a €150m green bond (see details below).

Portfolio overview

S Immo held a well-diversified portfolio of 360 properties at end-March 2021, representing c 1.08m sqm of main leasable area (or 1.3m sqm total area) located exclusively in EU member countries. The average rental yield across S Immo's portfolio stood at 5.1% at end-March 2021 (vs 5.4% at end-2019), while the occupancy rate was 93.5% (2019: 95.5%; see Exhibit 2).

Around 53% of the portfolio by main lettable area at end-March 2021 was in Germany, followed by CEE (34%) and Austria (13%, see Exhibit 3). In Germany, in recent years S Immo has put more emphasis on tier 2 cities (especially Leipzig, Erfurt, Halle and Magdeburg) and as a result Berlin represented c 38% of its portfolio by main lettable area at end-2020 (last available data). In CEE, the company holds a commercial property portfolio in capital cities of selected countries, such as Romania (39% of main lettable space in CEE at end-2020), Slovakia (25%), Hungary (17%), as well as Croatia (14%) and the Czech Republic (5%). In the CEE region, S Immo also owns and operates the Budapest Marriott hotel. S Immo's Austrian portfolio is largely concentrated in Vienna (except for two small retail projects in Breitenfurt and Feldkirchen), where it also owns and operates the 328-room Hotel Marriot Vienna.

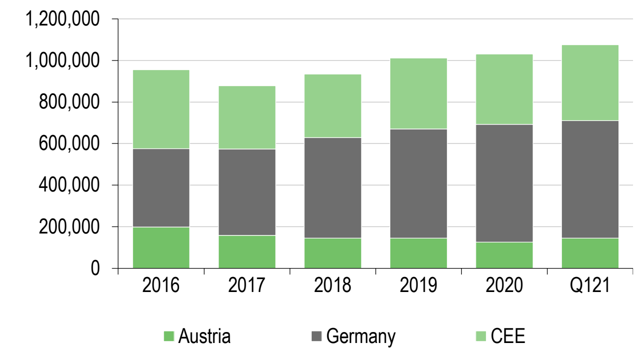
Exhibit 2: S Immo basic portfolio statistics

	2016	2017	2018	2019	2020	Q121
No of properties at period-end	194	241	284	331	358	360
Property value* (€m)	2,063.9	1,839.7	2,121.4	2,371.0	2,476.9	2,482.8
Main lettable area (in '000 sqm)	955.9	878.7	935.1	1,011.1	1,030.4	1,075.8
Rental yield	6.2%	6.1%	5.7%	5.4%	5.1%	5.1%
Occupancy rate	93.9%	94.8%	95.8%	95.5%	93.9%	93.5%

Source: Company data: Note: *Property value is based on external, independent valuation.

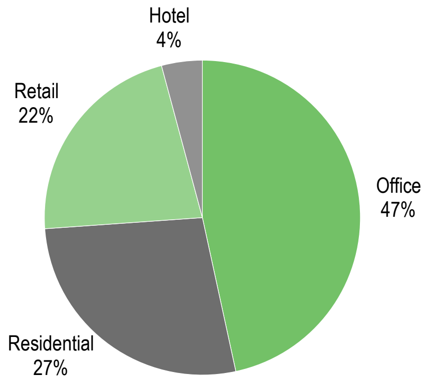
At end-March 2021, 47% of S Immo's portfolio by total lettable area represented office properties (across all regions), while residential made up 27% (mostly Germany and some minor exposure in Austria), retail 22% (of which 53% by book value was in CEE) and hotel properties 4% (excluding the two owner-occupied hotels; see Exhibit 4). The end-March 2021 sector split at fair value (with both Marriott hotels operated by S Immo accounted for at fair value) is office 42.1%, residential 29.7%, retail 17.5%, hotels 8.5% and land plots 2.2%.

Exhibit 3: Regional portfolio split by main lettable area (sqm)



Source: Company data, Edison Investment Research. Note: *CEE includes Hungary, Czechia, Slovakia, Bulgaria, Croatia and Romania.

Exhibit 4: S Immo's portfolio by real estate sector (in terms of total lettable area) in sqm



Source: Company data, Edison Investment Research

S Immo holds a sizeable land bank, predominantly in Germany where the focus is on land for residential purposes. In particular, this includes land in the Berlin commuter belt (up to 40km from Berlin centre) providing significant development opportunities in the long term. At present, this covers purchase contracts representing c 2.5m sqm of space on more than 30 land plots, with an average acquisition cost at c €14.77 per sqm (ownership of some of these was not yet transferred to S Immo as at end-March 2021). All these projects are at the development stage (mostly zoning and planning) with realisation expected over a longer period. We believe projects executed on this landbank constitute an interesting potential growth driver for S Immo, given favourable, migration-driven demographics and the housing shortage in Berlin. Moreover, S Immo has four development projects in Germany and three in CEE, with a total implied rental yield of 6.2% (see Exhibit 5).

Exhibit 5: S Immo's development projects at end-March 2021

Location	Type of use	Planned total investment costs (€m)*	Planned rental income pa (€m)	Implied rental yield (%)	Planned project period
Berlin (3 projects)	Office and residential	468	27.0	5.8	2021–2025
Potsdam	Office	26	2.0	7.7	2023–2025
Hungary (Váci út)**	Office	73	5.1	7.0	2021–2024
Romania (Dorobanti)***	Office	12	1.0	8.3	2021–2024
Slovakia (Petrzalka)****	Office	45	3.5	7.8	2021–2024
Total	**-**	**624**	**38.6**	**6.2**	**-**

Source: S Immo, Edison Investment Research. Note: *Includes both historic acquisition costs and planned investment costs; **29,000 sqm of lettable area planned; ***5,000 sqm of lettable are planned; ****22,000 sqm of lettable area planned.

Investments and disposals in 2020 and 2021 to date

S Immo maintained the investment pace from H120, closing 2020 with €106.7m spent on 28 properties, including the 48,370 sqm Zagrebtower office building in Croatia (€33.4m), a land plot in Bratislava (see above) and property acquisitions in Germany. Moreover, S Immo bought 2.7m additional shares in IMMOFINANZ (c 2% of its share capital) for €41.3m as part of the latter's share issue in July 2020, as well as subordinated mandatory convertible bonds issued by IMMOFINANZ for c €18m. Finally, it conducted share repurchases with an aggregate volume of €22.4m. In total, this represents close to €190m invested in 2020. S Immo generated €46.9m in proceeds from the sale of four assets in 2020. Since being reclassified as held-for-sale, these assets generated €38.8m in revaluation gains.

At end-March 2021, S Immo held a cash position of €216.2m. The company had expected to close the acquisition of two class-A office buildings in Bucharest (completed in 2021 and already fully let) with c 38,000 sqm lettable area for €97m after this balance sheet date. These properties generate an annual rental income of €6.7m (key tenants are Microsoft and Société Générale), which implies a rental yield of 6.8%. No major property disposals have been completed so far this year. While S Immo's buyback programme covering up to 1m shares is still in place (with a remaining repurchase limit of c 239.k shares), it recently refrained from purchasing any own shares following the stock price increase in response to the takeover bid. Therefore, it should still have more than €100m of cash for new investments (excluding any available credit lines).

We note that S Immo's CEO (Bruno Ettenauer) recently declared that if IMMOFINANZ fails to acquire the company, S Immo will sell its c 5.96% and 13.42% stakes in CA Immo and IMMOFINANZ, respectively. The market values these at c €549.0m and S Immo sees particularly high investor demand for the CA Immo stake. After levering up, these funds could be used to acquire €1.0bn worth of real estate, with management especially focusing on rent generating properties in Germany and capital cities in Eastern Europe (eg Romania or Hungary), which would immediately enhance S Immo's rental income and FFO1 level. At this stage, management refrains from indicating any potential timeframe for the re-deployment of the proceeds.

IMMOFINANZ seeking to acquire a controlling stake

In recent years, various configurations of a merger between the three listed Austrian real estate companies, IMMOFINANZ, S Immo and CA Immo (involving any of the two or all three companies), has been considered, but no deal has been struck. CA Immo attracted the private equity company Starwood Capital as an investor (and IMMOFINANZ sold its stake in CA Immo) in 2018.

A business combination between IMMOFINANZ and S Immo was then still considered, although it was put on hold amid the COVID-19 outbreak. However, on 14 March 2021, IMMOFINANZ (S Immo's largest shareholder, with a 26.49% stake) announced it intended to launch a voluntary public takeover offer to S Immo's shareholders. This was followed by the publication of an offer document outlining the final deal terms on 19 May 2021. S Immo shareholders now have the option to accept the offer until 16 July 2021.

IMMOFINANZ has offered €22.25 per share (paid fully in cash and subject to adjustments for any dividend payouts), which represents a 40.3% premium to the volume weighted average price of S Immo shares for the six months to 13 March 2021 (€15.86), when IMMOFINANZ announced the intention to launch the offer. It is also 22.3% above S Immo's last closing price before the announcement (currently, S Immo's shares trade close to the offer price at €22.15).

The takeover terms include a minimum acceptance threshold of 50% of the shares subject to the offer plus one share, that is, c 25.7m shares. Moreover, the deal completion depends on the cancellation of the current cap on voting rights per shareholder (set at 15%) included in S Immo's Articles of Association. This has to be passed during a shareholder meeting scheduled for 24 June 2021. Finally, the takeover is subject to merger control clearance in Austria, Germany, Slovakia, Hungary, Serbia and Romania no later than 90 days after the end of the acceptance period (except for Romania – 120 days).

IMMOFINANZ highlighted that it reserves the right to undertake parallel transactions to obtain a controlling interest in S Immo.

Deal rationale: Strengthening the market position in core segments

IMMOFINANZ's management considers the acquisition of S Immo an opportunity to strengthen its market position in its core strategic office and retail real estate segments, which represented 63.8% and 34.5% of its portfolio value at end-March 2021, respectively. At the same time, these made up 42.2% and 17.5% of S Immo's portfolio book value at end-2020, respectively. IMMOFINANZ highlighted that it will undertake a portfolio analysis of S Immo's hotel and residential properties, which will be the basis for deciding if it will continue to manage these or decide to sell them. At present, IMMOFINANZ does not plan any changes to S Immo's management board on successful completion of the takeover. We note however, that Ernst Vejdovszky (former CEO) left the management board in March 2021 and the supervisory board has already designated his successor (see details below).

A successful takeover would translate into a shift in geographical footprint of the combined business compared to standalone exposures (see Exhibit 6). IMMOFINANZ has a higher portfolio share in the CEE region, in particular Poland and Czech Republic, which made up 20% and 11% of its portfolio value at end-2020 (S Immo had no exposure to the former and only a minor hotel presence in the latter). Moreover, IMMOFINANZ has a much lower exposure to Germany, where S Immo owns a large residential and office portfolio.

Exhibit 6: Portfolio exposure by region at end-2020

	IMMOFINANZ (%)	S Immo (%)	Combined (%)
Austria	18	20	19
Hungary	10	10	10
Slovakia	7	7	7
Poland	20	0	13
Czech Republic	11	1	8
Romania	15	11	14
Germany	13	47	24
Adriatic region*	7	4	6

Source: IMMOFINANZ, S Immo, Edison Investment Research; Note: *Slovenia, Serbia and Croatia for IMMOFINANZ, Croatia for S Immo.

The deal should also result in overhead cost savings and improved position on the capital markets, which would translate into financing synergies, according to IMMOFINANZ's management. IMMOFINANZ intends to maintain S Immo's listing, although it acknowledges that a high acceptance rate may result in a free float below the requirements for admission of shares to the Official Market (or a continuation in the Prime Market of the Vienna Stock Exchange).

Takeover price with no meaningful premium for control

While we have not prepared our own valuation of S Immo's shares, we still consider the offer price as only moderately attractive. Firstly, it implies a 10% discount to S Immo's last reported EPRA NTA (€24.79 per share) and an 18% discount to the last reported EPRA net reinstatement value (€27.15 per share), the latter aims to represent the value required to rebuild the entity and assumes that no selling of assets takes place. Importantly, these EPRA figures do not account for the additional value analysis of the company's German and Austrian portfolio performed in April 2021 (with the involvement of an independent external appraiser), which indicated an incremental portfolio value versus end-2020 of €85m. After deducting the c €2.5m revaluation gain booked in Q121 from the incremental portfolio value, this translates into an incremental EPRA NTA of c €1.16 per share before any deferred tax (and a c 14% discount implied by the offer price).

In this context, we note that in a recent takeover offer for CA Immo shares and convertible bonds launched by Starwood Capital Group earlier this year, the acceptance rate was just 3.71% of the tendered shares (40.55% of the convertibles), as a number of shareholders considered the offer price too low given that it was at a c 11% discount to the diluted EPRA NAV per share at end-2020 (the additional acceptance period ends on 14 July 2021). Moreover, on 25 May 2021, Vonovia (one of the leading residential investors in Germany) launched a takeover bid for Deutsche Wohnen at €52.0 per share, close to the latter's last reported EPRA NTA per share of €52.50 as at end-March 2021 (with the current shareholders retaining the right to the declared 1.03 dividend per share). Finally, we note that IMMOFINANZ paid a c 13% premium to the last reported EPRA NAV at end-2017 when it agreed to acquire its minority stake in S Immo in April 2018.

Secondly, we note that the minority stakes in IMMOFINANZ and CA Immo are accounted for in S Immo's EPRA NTA at their current share prices as at end-March 2021, which were 40% and 13% below their last reported EPRA NTA as at the same date. We estimate that accounting for these stakes at their respective EPRA NTA (to evaluate the discount implied by the offer price on a look-through basis) would add another €3.14 per share to S Immo's EPRA NTA (before any deferred tax).

After factoring in the above two points, we calculate that the offer price implies a 24% discount to S Immo's EPRA NTA, which is broadly in line with the average 21% discount at which S Immo's peers currently trade to their EPRA NTA. Consequently, it seems that (even after accounting for any deferred tax) IMMOFINANZ's offer price does not include any meaningful premium for control, which normally applies to transactions where the acquirer seeks to obtain a controlling stake.

It is also worth highlighting that the value of S Immo's hotel properties (including the owner-operated Marriott's) has declined since end-2019 by €52.8m (or €0.74 per S Immo's share). While the sector may take around three years to fully recover from the impact of COVID-19 (according to S Immo's management), fully reopening the economies in which S Immo operates and the resumption of international travel could provide some valuation tailwinds to the sector (and S Immo's hotel properties).

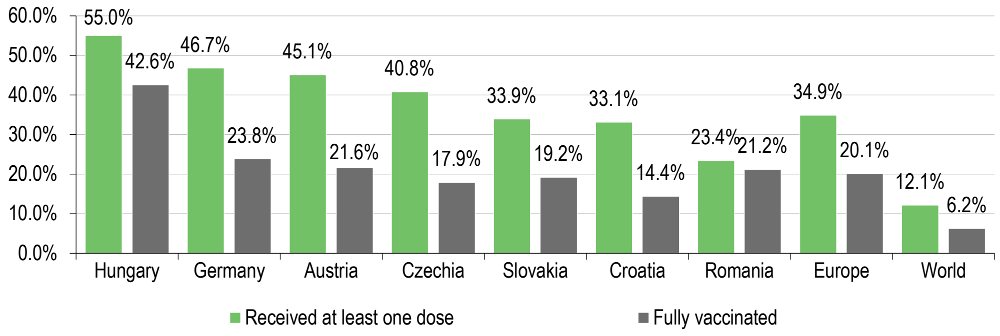
Günther Walcher interested in Austrian listed real estate businesses

In the context of the takeover bid, it is worth summarising the recent changes in the shareholder structure of both companies. On 29 January 2021, IMMOFINANZ announced a potential change in its shareholder structure with Revenite Austria seeking to acquire RPPK Immo, which holds a 10.5% stake in IMMOFINANZ. Revenite Austria is controlled by the predominantly Germany-focused real estate investment company Aggregate Holdings, fully owned by the Austrian investor Günther Walcher, while RPPK Immo is owned by Ronny Pecik (IMMOFINANZ's CEO) and Peter Korbacka. The acquisition's completion is now subject to a legal debate over whether Peter Korbacka accepted the deal terms within the specified timeframe (until 31 March). Moreover, on 10 February 2021, Aggregate Holdings reported an indirect holding of a 10.78% stake in S Immo through Revenite Austria. Aggregate Holdings also considered a rival bid for CA Immo, but we understand that it has abandoned the idea. Finally, in May 2021, Radovan Patrick Vitek announced that he has acquired (via WXZ1) a 10% stake in IMMOFINANZ.

Market outlook: Residential markets most resilient

COVID-19 has had a varying impact on the respective real estate market segments, with hotels and retail hit considerably, office seeing limited impact and the residential market proving resilient (especially in developed markets such as Germany). In 2021, CBRE expects that investors will continue to focus on the more resilient segments, including in particular residential, office and logistics properties. Having said that, we note that the progress in the vaccination process to date warrants a certain degree of optimism with respect to the less resilient real estate segments as well, as c 30–50% of the population in S Immo's countries of operations already received at least one dose (except for Romania: 23.4%), according to Our World in Data statistics (see Exhibit 7).

Exhibit 7: Percentage of vaccinated population in S Immo's countries of operation



Source: Our World in Data at 9 June 2021

German residential market a safe haven during COVID-19

The German residential investment market closed 2020 with total transactions worth €21.7bn according to JLL (up 9% y-o-y and 16% ahead of the five-year average) and a particularly strong Q420 (€5.2bn, 53% above the Q2-Q320 average). Q121 saw a continuation of the residential market's strength with a volume at just under €7.6bn (45% of the total investment activity in the German real estate investment market). This has been assisted by the low interest rate environment and the defensive profile of this asset class as illustrated by the low vacancy rates and sustained rental income with long-term growth potential. Purchase prices of condominium apartments in Germany increased by 9.3% y-o-y (vs a five-year average growth rate of 8.6%), according to JLL. Importantly, the increasing trend towards working from home and the search to save on commuting costs coupled with restricted housing supply and rising housing costs in city centres triggered a strong increase in average purchase prices in suburban zones around the Big 8 German cities (almost 50% faster than in the city centres), according to JLL. We believe that this should benefit S Immo's prospective development projects in the Berlin commuter belt. Asking rents continued to increase in Germany as well, albeit at a somewhat slower pace of 3.5% y-o-y in H220 (in line with growth in the preceding 12-month period, but below the five-year average of 4.9%).

Berlin rental cap repealed

In our initiation note, we discussed the impact of the five-year rental cap (covering 90% of rental properties in Berlin), which was approved by local authorities on 30 January 2020 and became effective in November 2020. At that time, we flagged that the regulation was subject to the Federal Constitutional Court's review after a Berlin district court found it unconstitutional and referred it for a definitive ruling. In April 2021, the law was repealed by the Federal Constitutional Court. We note that the impact of the rental cap on S Immo was relatively moderate, given that its residential portfolio in Germany's capital city largely consists of affordable housing projects. Moreover, the company was able to reduce its Berlin exposure through the disposal of a residential portfolio in 2016 and has been focusing on office investments in Berlin for several years now. Nevertheless, the ruling provides some valuation tailwinds for its residential portfolio in Germany (as discussed above).

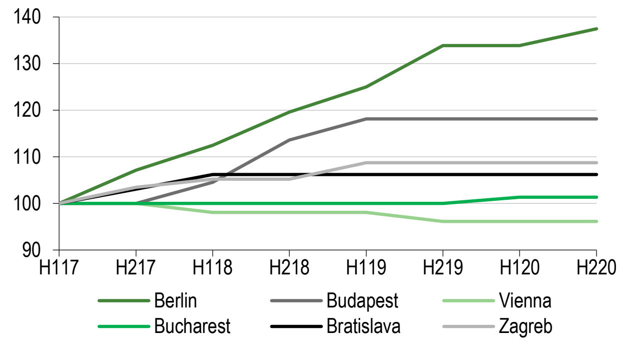
Office rents and yields across most of S Immo's major markets remain stable

Prime rents for office space in Vienna and CEE capital cities in 2020 were broadly unchanged versus 2019 (see Exhibit 8), while rents in Berlin continue to increase (up 3% y-o-y to €38.5/sqm in H220 according to CBRE). JLL forecasts a further 2.6% y-o-y increase in Berlin office rents in 2021. This has been accompanied by limited movements in prime gross yields, except for Budapest where yields increased to 5.75% in H220 versus 5.25% in H219 (though pricing for core and premium offices remained stable at end-2020, according to JLL). Transaction volumes in the Hungarian office markets were up 5% y-o-y to €0.8bn in 2020 (as per JLL data) and the outlook for 2021 is positive with several ongoing transactions, according to CBRE.

The office market in the German Big 7 cities saw a robust take-up in Q121 at 715k sqm (close to the Q120 level) and JLL expects the take-up to increase by 10% y-o-y in 2021. The average vacancy rate increased recently but was still a moderate 3.9% in Q121, with JLL forecasting some further growth to an average 4.5% in 2021. However, it considers the vacancy risk to be significantly lower for new, flexible and well-appointed spaces. At the same time, new office completions in the Big 7 German cities should stand at almost 1.9m sqm according to JLL, which is 300k sqm below the expectations at end-2020, suggesting that development projects continue to be postponed. Overall, 4.2m sqm of new office space is under construction (of which around 50% has already been pre-let), representing a relatively moderate 4.4% of total stock.

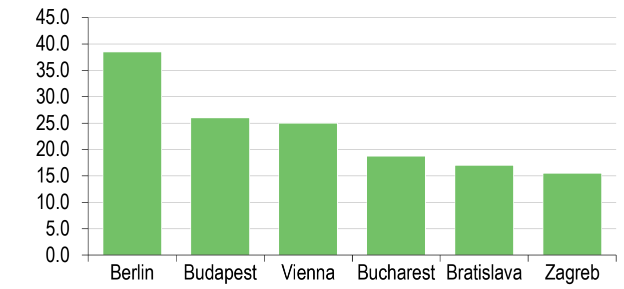
The Vienna office market proved resilient as new office space remains in short supply and the number of new construction projects is likely to remain low in the coming years, according to CBRE. The vacancy rate remained low (and CBRE expects it to decline to 4.4% in 2021), while take-up was down only 7% y-o-y to 205k sqm in 2020.

Exhibit 8: Progression of prime office rents in S Immo's end markets (€ per sqm indexed)



Source: S Immo's annual reports based on CBRE estimates

Exhibit 9: Prime office rents in S Immo's end markets (H220, € per sqm)



Source: S Immo's annual report FY20 based on CBRE estimates

Retail and hotel properties under pressure

Prime yields expanded somewhat across several markets where S Immo is present, with yields in Romania (which makes up 47% of its retail exposure) increasing by 50bp to 7% in 2020, according to CBRE. Moreover, prime retail rents declined in Romania by 18% y-o-y to €45/sqm in H220, while rents in Germany and Austria were down by 19% and 7% y-o-y in H220 to €250/sqm and €325/sqm, respectively. While JLL saw a slight increase in demand for German high street retail properties with good rental levels in Q121, these need to exhibit solid tenant creditworthiness and lease terms to attract investors. S Immo expects that following the suspension of COVID-19 restrictions, retail space with entertainment facilities (such as shopping centres) should recover more quickly.

The hotel market has suffered the most from COVID-19 restrictions (eg net revenue from overnight stays in Vienna hotels declined by 76.6% y-o-y in 2020 to €239m, which was generated mostly during the stronger pre COVID-19 months). Average occupancy in Vienna was 12.2% during the summer season (vs 2019 at 64.1%) and 37.6% in the 2019/20 winter season (vs 54.4% in 2018/19). In January 2021, only c 32,000 hotel beds were available in Vienna due to the lockdown, down c 52.2% y-o-y, according to Wien Tourismus. S Immo's management estimates that a full recovery of the hotel industry will take about three years. Having said that, the company has already seen an encouraging pick-up in bookings for 2021 and 2022 at its Marriott hotels.

Management, organisation and corporate governance

A number of personnel changes have recently been implemented in both the management and supervisory boards of S Immo. In March 2021, the former CEO of the company (Ernst Vejdovszky), who had been a board member since 2001, was succeeded by Bruno Ettenauer, a real estate market specialist with 30 years of experience, including 2006–2015 as CEO of CA Immobilien Anlagen. Between 2016 and 2021, he served as a managing partner at his own company, ETTERRA Real Estate. In April 2021, the management board was expanded to three members with the appointment of Herwig Teufelsdorfer as chief investment officer. Prior to joining S Immo, he served as managing partner at 21st Real Estate in Berlin (2019–2021) and as chief operating officer at BUWOG (2015-2019). Friedrich Wachering, who was first appointed on 15 November 2007, remained on the board as well.

At the AGM in October 2020, the supervisory board was reduced from eight to four members, with Karin Rest appointed as chair of the board. As of 21 January 2021, the supervisory board was expanded to six members with the appointment of Holger Schmidtmayr and Elisabeth Wagerer (the latter as employee representative).

Financials

Income statement: Impact of COVID-19 on the hotel business

S Immo was able to weather the COVID-19 crisis relatively well, with its rental income increasing by 3.3% in FY20 and 2.8% y-o-y in Q121. That said, its gross margin on letting activities was down to 73% in FY20 (vs 76% in FY19) and to 71% in Q121 (vs 77% in Q120). This was primarily due to the impact of acquisitions on property expenses, higher maintenance expenses incurred to productively use the time of the COVID-19 standstill, as well as higher write-downs and impairments of receivables in FY20 (€4.4m vs €0.5m in FY19) triggered by the pandemic. Consequently, S Immo's gross profit on letting activities was broadly stable at €91.9m in FY20 (vs €92.9m in FY19) and €24.5m in Q121 (vs €24.2m in Q120). This illustrates that overall, COVID-19 did not have a major impact on S Immo's rental levels.

Meanwhile, the company's hotel operations (ie the two owned Marriott hotels in Vienna and Budapest) were severely affected by the pandemic, though this was coupled with a significant reduction in hotel operating expenses, resulting in a minor €0.3m loss from the hotel business in FY20 (vs a €16.9m profit in FY19) and a €1.3m loss in Q121 (vs a €1.6m profit in Q120). Consequently, S Immo's EBITDA declined by 18.3% to €71.1m in FY20 and was down 15.3% y-o-y to €18.1m in Q121. The company's Q121 P&L was assisted by an improved financial result, which included a non-cash effect from the derivatives valuation and fx. In FY20, a negative impact came from the lack of dividend from IMMOFINANZ (resulting in a dividend income decline to €6.3m from €17.0m in FY19). S Immo's FFO1 per share stood at €0.59 in FY20 (vs €0.98 in FY19) and €0.13 in Q121 (vs €0.19 in Q120).

Exhibit 10: S Immo results highlights Q121 and FY20

€000's, unless otherwise stated	Q121	Q120	% change y-o-y	FY20	FY19	change y-o-y
Rental income	31,992	31,133	2.8%	123,255	119,373	3.3%
Revenues from operating costs	9,130	9,598	-4.9%	32,871	31,952	2.9%
Revenues from hotel operations	1,894	9,913	-80.9%	17,789	59,102	-69.9%
Total revenues	**43,016**	**50,644**	**-15.1%**	**173,915**	**210,427**	**-17.4%**
Other operating income	1,654	327	405.8%	2,501	2,481	0.8%
Property operating expenses	(18,254)	(16,842)	8.4%	(66,760)	(60,952)	9.5%
Hotel operating expenses	(3,193)	(8,340)	-61.7%	(18,126)	(42,250)	-57.1%
Gross profit	**23,223**	**25,789**	**-9.9%**	**91,530**	**109,706**	**-16.6%**
gross margin on rental activities	*71%*	*77%*	*-5.3pp*	*73%*	*76%*	*-3.2pp*
gross operating profit on hotel operations	(1,299)	1,573	NM	(337)	16,852	N/M
Gains on property disposals	0	0	NM	0	0	N/M
Management expenses	(5,130)	(4,426)	15.9%	(20,398)	(22,669)	-10.0%
EBITDA	**18,093**	**21,363**	**-15.3%**	**71,132**	**87,037**	**-18.3%**
D&A	(2,351)	(2,289)	2.7%	(9,232)	(8,264)	11.7%
Results from property valuation	2,480	(31,538)	N/M	39,056	192,671	-79.7%
EBIT	**18,222**	**(12,464)**	**N/M**	**100,956**	**271,444**	**-62.8%**
Financing cost	(7,058)	(13,858)	-49.1%	(43,226)	(50,444)	-14.3%
Financing income	1,523	567	168.6%	8,821	19,064	-53.7%
of which: dividend income	0	0	N/M	6,317	17,000	-62.8%
Results from companies measured at equity	148	53	179.2%	5,035	11,359	-55.7%
Financial result	(5,387)	(13,238)	N/M	(29,370)	(20,021)	46.7%
Pre-tax profit	**12,835**	**(25,702**	**N/M**	**71,586**	**251,423**	**-71.5%**
Income taxes	(2,941)	4,282	N/M	(14,674)	(38,116)	-61.5%
Consolidated net income	9,894	(21,420)	N/M	56,912	213,307	-73.3%
attributable to shareholders of the parent	**9,874**	**(21,439)**	**N/M**	**56,537**	**212,774**	**-73.4%**
attributable to non-controlling interests	20	19	5.3%	375	533	-29.6%
Earnings per share (€)	**0.14**	**(0.30)**	**N/M**	**0.79**	**3.21**	**-75.6%**
EPRA EPS (€)	**0.09**	**0.10**	**-10.0%**	**0.40**	**0.77**	**-48.1%**
FFO1 per share (€)	**0.13**	**0.19**	**-31.6%**	**0.59**	**0.98**	**-39.8%**

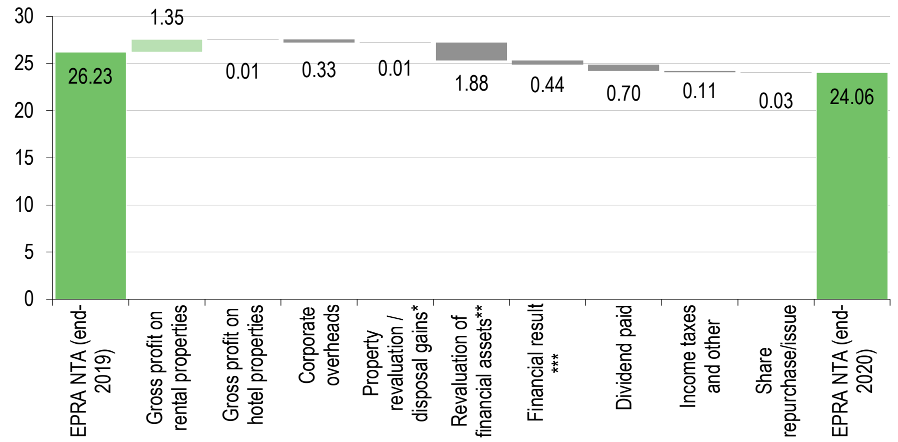
Source: S Immo accounts

Strong investor demand for residential and to some extent office properties allowed S Immo to report a €39.1m revaluation gain in FY20, driven mostly by its German portfolio (€52.7m), while Austria and CEE respectively posted an €8.7m gain and €22.3m loss. Its residential and office properties where positively revalued by €33.4m and €27.9m respectively, while the respective value of retail and hotel properties was adjusted downwards by €11.0m and 14.0m. We note that this does not account for the c €32.0m decline in the value of S Immo's owner-operated Marriott hotels in FY20, which is reflected in its EPRA NAV but not in the IFRS accounts. Moreover, the declining value of the company's stakes in IMMOFINANZ and CA Immo had a negative NAV impact of c €1.88 per share (see Exhibit 11).

In Q121 S Immo booked a minor property revaluation gain of €2.5m while the value of its owned-operated hotels remained broadly unchanged. Having said that, we note that in response to the takeover offer launched by IMMOFINANZ, S Immo carried out an additional value analysis of its German and Austrian portfolio as of 30 April 2021 with the assistance of an independent external appraiser. Based on this alone, management expects a further c €85m increase in the value of its property portfolio versus end-2020. We estimate that this translates into an incremental EPRA NTA of c €1.20 per share (before any deferred tax).

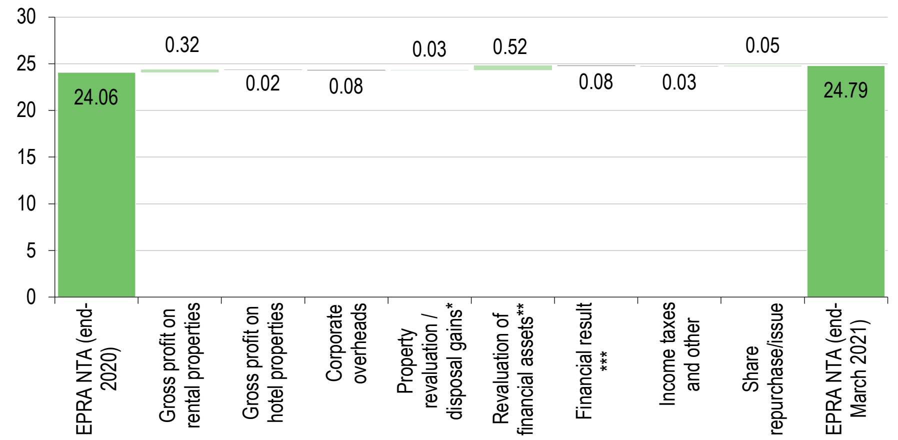
During the FY20 results call, management highlighted that it will recommend to pay 70% of the FY20 FFO1 in dividends, which would imply a dividend per share at around €0.41 (and a dividend yield of c 1.9%). In this context, the DPS of €0.48 implied by the current Refinitiv consensus may seem high.

Exhibit 11: S Immo's FY20 EPRA NTA growth decomposition (€ per share)



Source: S Immo data, Edison Investment Research. Note: *Includes revaluation of owner-operated hotels. **Includes predominantly S Immo's stakes in IMMOFINANZ and CA Immobilien Anlagen, as well as some minor group interests. ***Includes dividends from IMMOFINANZ and CA Immobilien Anlagen.

Exhibit 12: S Immo's Q121 EPRA NTA growth decomposition (€ per share)

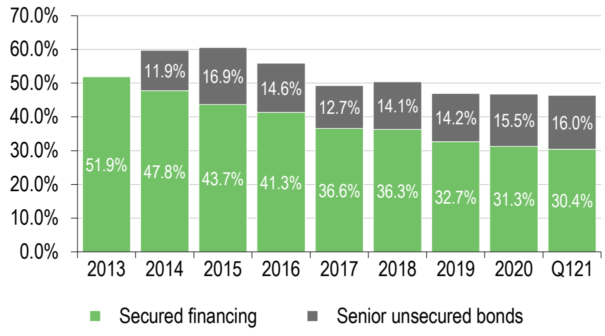


Source: S Immo data, Edison Investment Research. Note: *Includes revaluation of owner-operated hotels. **Includes predominantly S Immo's stakes in IMMOFINANZ and CA Immobilien Anlagen, as well as some minor group interests. ***Includes dividends from IMMOFINANZ and CA Immobilien Anlagen.

Balance sheet remains strong with LTV below 50%

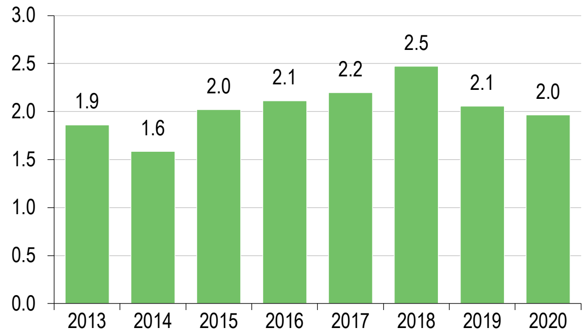
S Immo's net LTV remains at a safe level of 46.4% at end-March 2021, of which 30.4% is attributable to secured financing and 16.0% to senior unsecured bonds (less cash). This is broadly stable versus 46.8% at end-2020 and 46.9% at end-2019 (see Exhibit 13) and compares with 30–40% for most of the company's major Austrian and German peers (except for Demire: 49.5% at end March 2021). The property value used to calculate the LTV ratio includes S Immo's stakes in the listed IMMOFINANZ and CA Immobilien Anlagen. S Immo's EBITDA interest coverage also remained solid at 2.0x in FY20, slightly down from 2.1x in FY19 (see Exhibit 14).

Exhibit 13: S Immo's LTV evolution



Source: Company data. Note: As interest paid on participating notes was a function of group EBIT, they have not been included in the LTV calculations for 2013–17 (these were fully retired by 2018).

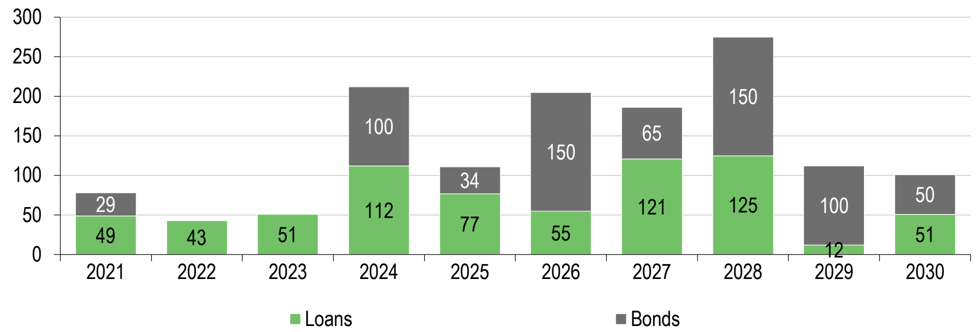
Exhibit 14: S Immo's EBITDA interest coverage ratio



Source: Company data, Edison Investment Research. Note: Calculated based on EBITDA excluding valuation/disposal gains and interest expense excluding participating certificates and effects arising from hedge accounting and the measurement of derivatives through profit and loss.

S Immo's average cost of funding including hedging has been declining in recent years and in FY20 and Q121 reached 2.29% and 2.22% respectively (vs 2.30% in FY19). This compares with 1.98% for IMMOFINANZ and 1.50% for CA Immo. The decline has recently been assisted by the issue of a €150m seven-year senior unsecured green bond at a coupon rate of 1.75% in February 2021. Management indicated that the current cost of bank loans is 1.26% (with 15% of the bank debt being fixed rate), while the interest rate on bonds is 2.23%. Furthermore, we underline S Immo's favourable debt maturity profile, with only 12.5% of its loans and bonds maturing until 2023 and maturities of the remaining debt being spread over multiple years. However, it is worth noting that its outstanding bonds include certain change of control clauses which would be triggered following a successful takeover bid from IMMOFINANZ.

Exhibit 15: S Immo's debt maturity profile (€m)



Source: Company data

Peer valuation

For valuation purposes we have prepared a peer group of real estate investment companies active in S Immo's end markets. These include its two closest domestic competitors: CA Immobilien Anlagen and IMMOFINANZ. Both companies invest in commercial properties, with the former specialising in office buildings in the capital cities across Central European countries, while the latter has a broader focus comprising retail properties in the seven core markets in CEE: Austria, Germany, Poland, Czech Republic, Slovakia, Hungary and Romania. Given a significant part of S Immo's portfolio is located in Germany, we have added local comparators including LEG Immobilien and Grand City Properties, focused on residential units located around the largest and up-and-coming cities. We have also added TLG Immobilien and Demire, which manage portfolios of commercial properties (mainly office and retail) with the former also holding hotel properties in Germany (see Exhibit 16).

Exhibit 16: Peer group valuation

Company name	Market cap (€m)	P/EPRA NTA (x)	FFO yield (%)			Dividend yield (%)	
		Last reported*	2021e	2022e	2023e	2021e	2022e
CA Immobilien Anlagen	3,326	0.81	4.0	4.2	4.7	3.0	3.2
IMMOFINANZ	2,267	0.64	5.3	5.6	6.0	4.1	4.5
LEG Immobilien	8,774	0.98	4.8	5.2	5.6	3.4	3.5
TLG Immobilien	2,814	0.77	4.3	4.6	N/A	3.2	3.2
Grand City Properties	4,018	0.89	4.9	5.2	5.4	3.5	3.8
Demire	465	0.73	11.5	12.1	13.2	4.4	4.8
Peer median	**-**	**0.79**	**4.9**	**5.2**	**5.6**	**3.4**	**3.6**
S Immo	1,630	0.89	3.3	4.1	4.5	2.2	3.3
Premium/(Discount) to peers	**-**	**13%**	**(159 bp)**	**(113 bp)**	**(105 bp)**	**(127 bp)**	**(34 bp)**

Source: Company accounts, Refinitiv. Note: Priced at 15 June 2021. *EPRA NTA as at end March 2021 except for TLG Immobilien which is as at end 2020.

It is instructive to review the key market multiples at which S Immo and its peers are trading. As we have not prepared our own forecasts for S Immo, we have examined the P/EPRA NTA ratio based on last reported figures (as no Refinitiv consensus for EPRA NTA is currently available), as well as the FFO yield and dividend yield, calculated on Refinitiv consensus data for 2021 to 2023.

All peers currently trade at a discount to their last reported EPRA NTA, though to a different extent which is likely at least partially a function of their varying sector exposure. The discount ranges from just 2% for the pure-play residential company LEG Immobilien, to 36% for IMMOFINANZ which has the highest exposure to retail properties in the group (34.5% at end March 2021). S Immo is trading at a P/EPRA NTA ratio of c 0.89x (not adjusted for the April 2021 revaluations), which represents a 13% premium to the peer group. In this context, we note S Immo's limited exposure to retail, but more significant exposure to hotel properties. At the same time, S Immo's FFO yield (calculated as FFO 1 divided by the current share price) is somewhat below the peer median.

Sensitivities

Based on our examination of S Immo's business profile, as well as the current market environment, we have identified a number of sensitivity factors that we discuss below.

- **COVID-19:** while the recent progress in the vaccination process and fall in the number of new COVID-19 cases across S Immo's markets of operations has been encouraging, we are wary of potential risks associated with new coronavirus variants which could prove immune to the currently used vaccines and force governments to re-impose lockdowns. This would prolong the COVID-19 impact on the real estate sector, retail and hotel properties in particular.
- **'Working from home' impact on office demand**: while the COVID-19 lockdowns validated the 'work from home' setup in a number of industries and we believe that a significant portion of employees will prefer to work at least in a hybrid setup (eg three days in the office, two days working at home) even after the pandemic. This may encourage companies to reduce their leased office space which could dampen office demand going forward. A good example is DWS which recently reached an agreement with the works council that allows it to reduce office space per employee by 30%. The impact could be exacerbated by a potential economic downturn once government support is phased out. We also note that employee expectations towards office design may change (eg in favour of a blend of private offices and open space). This may reduce the demand for existing office space that does not meet these requirements and may force owners to incur additional refurbishment expenses. However, S Immo's management does not envisage any major impact on its office portfolio, given that it does not have offices leased to very large tenants (average space per tenant is c 500 sqm) and it offers

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prime locations at rental levels visibly below those typical for top 'skyscraper' districts (eg Canary Wharf in London).

- **Rise in interest rates:** continued inflationary pressure could force major central banks (including ECB) to raise interest rates, which could have an adverse impact on property values. Moreover, it would trigger an increase in market rates and in turn a higher cost of variable-rate debt. In this context, we note that all of S Immo's corporate bonds have a fixed rate and are thus not subject to interest rate risk. While 85% of S Immo's loans were floating rate at end-March 2021, most of the exposure was hedged through swaps and caps. Still, each increase in the three-month EURIBOR by 100bp should translate into an increase in S Immo's cost of funding by 2bp, according to the stress test results disclosed in the company's 2020 annual report.
- **Ernst Vejdovszky's departure:** S Immo's 'founding father' and longstanding successful CEO left the management board in March 2021. Given that part of the credit for S Immo's strong historical NAV total return (TR) goes to him, there is a certain risk that S Immo will not be able to repeat the stellar performance seen in recent years. Having said that, we note that Ernst Vejdovszky's successor, Dr Bruno Ettenauer, has extensive experience in the real estate sector and in the period 2006–2015 was CEO of CA Immo. Moreover, Friedrich Wachernig who has been board member at S Immo since November 2007, remains on the board providing a certain degree of continuity.
- **Possible strategy change following a successful takeover:** Given that IMMOFINANZ's core segments are office and retail, S Immo's investment mandate (in particular towards residential and hotel properties) may be altered upon the successful completion of the takeover. This may influence its ability to benefit from accurate anticipation of property cycles across real estate segments and geographies (especially after the departure of the company's former CEO, see above). Here, it is worth noting the disparity in historical total returns in EPRA NAV per share, with S Immo's 10-year and five-year average to end-2020 at 13.3% and 18.4% pa respectively compared to IMMOFINANZ's -2.7% and -4.3% pa respectively (according to our calculations).
- **Re-deployment of proceeds from the sale of minority stakes:** As discussed above, S Immo is considering selling its stakes in CA Immo and IMMOFINANZ in case of a failed takeover bid from IMMOFINANZ. We estimate that based on the stock prices at end-March 2021, these were valued at c €516m and represented c 17% of S Immo's total property investments at end-March 2021. A persistent low-interest rate environment and continued macroeconomic recovery would keep investor demand for real estate high and could slow down the redeployment of the proceeds, resulting in a certain cash drag on S Immo's near- to medium-term NAV TR.

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