EDISON

Scale research report - Update

Consus Real Estate

Real estate

24 October 2018

Full commitment to residential real estate

In H118 Consus completed its transformation into a pure-play, residential real estate developer focused on the forward sale operating model. It keeps a stable share of forward sold investments within its portfolio at c 26%, despite expanding its gross development value (GDV) by 37.4% ytd to €6.2bn. The company has implemented IFRS 15 into its accounting policies to better reflect recognition of income from property development. Ability to deliver results in line with the expected significant bottom line improvement is crucial for the company's future market valuation, which has been volatile in recent months.

H118 results: Growth driven by property development

Recent changes to group structure make it difficult to conduct a y-o-y results comparison. Consus reported an overall performance of €242.2m (see Exhibit 1), driven in particular by development income from VauVau projects in Cologne, Dresden and Leipzig. The adoption of IFRS 15 added €23.5m to both top-line and net earnings. Further improvements should be assisted by the recent DIPLAN acquisition, as digitalisation of the planning and construction process will result in significant cost savings and reduced development timeframes.

Improving indebtedness structure

The company is targeting a net debt to EBIT pre-PPA multiplier of less than 3x by 2020. It aims to achieve it by simultaneously decreasing the level of indebtedness and increasing earnings generation. In H118, total net debt has been cut by €266m to €1.25bn (representing a decline in net loan-to-value to 86% from 90% at end-2017 on a comparable basis) and then further reduced to €1.09bn as at 30 September 2018. However, the H118 adjusted EBIT stands at €56m, which means that further significant improvement is required to meet the management guidance of €300m adjusted EBIT pre-PPA by FY20. The current pro-forma net debt figure does not account for the future payments for the additional stake in CG Gruppe.

Valuation: High premium changes to discount

As the future valuation of the company is highly dependent on its ability to deliver results in line with guidance, the share price has been volatile in the recent months. An expected significant bottom line improvement (as per current Bloomberg consensus) may change the current premium to peers of 119% (based on FY18 P/E) into a more than 52% discount based on FY20 estimates.

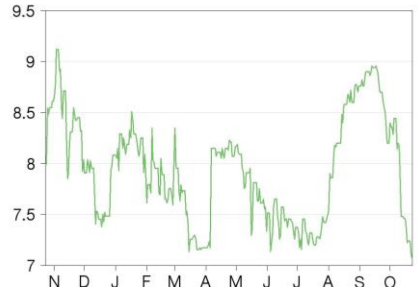
Consensus estimates

Year end	Revenue (€m)	EBITDA (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/17	215.0	6.4	0.01	0.0	N/A	N/A
12/18e	716.5	138.0	0.20	0.0	35.3	N/A
12/19e	1,109.0	173.5	0.57	0.0	12.4	N/A
12/20e	1,723.0	277.5	1.21	0.0	5.8	N/A

Source: Consus accounts and Bloomberg consensus as at 23 October 2018

Price	€7.06
Market cap	€757m

Share price graph



Share details

Code	CC1
Listing	Deutsche Börse Scale
Shares in issue	107.2m
Last reported net debt as at 30 June 2018	€1.25bn

Business description

Consus Real Estate, based in Berlin, is the leading, listed residential real estate developer in Germany. The company's development portfolio consists of 53 projects across nine cities with a gross development value of €6.2bn. It also owns a small commercial assets portfolio.

Bull

- Supply shortage in the German residential market.
- Cost-effective and lower-risk business model.
- Extensive development pipeline.

Bear

- Lower selling prices due to forward sale model.
- Bottlenecks in the German residential market.
- Dependency on institutional clients.

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Financials: Property development boost revenues

The transformation of Consus into a pure-play developer focused on residential real estate was driven by intense M&A activity, which distorts the y-o-y results comparison. The process started in H217 with the acquisition of CG Gruppe and was completed by the disposal of commercial assets portfolio and a sale of GxP in August 2018 (for more details please refer to Edison initiation report). The company's overall performance in H118 reached €242.4m on the back of full consolidation of CG Gruppe, which contributed €236.6m (97.6%) to the group's revenue. The 66.7% q-o-q increase in overall performance (€151.5m in Q218 vs €90.9m in Q118), which includes a seasonal effect, has been particularly driven by development income from VauVau projects in Cologne, Dresden and Leipzig. The results have been also assisted by the adoption of IFRS 15 'Revenue from contracts with customers' effective from 1 January 2018. Instead of recognising the income when the risk and rewards related to the property in its entirety were transferred to the customer, it is recorded in proportion to the stage of completion. The new methodology is optimised for the initial forward sale recognition, which is a key part of Consus's lower-risk development model, as it removes the time lag between cash inflow from prepayment and the corresponding revenue recognition. The revised accounting policy introduced a new income category, income from property development, which in H118 made 81.3% of overall performance. The total impact of introducing the IFRS 15 stands at a positive €23.5m in revenues as well as net income, which amounted to €2.8m in H118 (including €1.4m from discontinued operations).

Although GxP was sold after the balance sheet date, it was not consolidated in the income statement but its stake of €176.2m has been already reclassified from investment property to held for sale assets as at 30 June 2018. The 58.1% decrease since 31 December 2017 in investment property to €220.7m reflects also the divestment of eight commercial assets from the Consus's portfolio. As IFRS 15 was introduced in 1 January 2018, the new balance sheet category (contract assets) has been included in both current and non-current assets, which reflects already recognised revenue from the ongoing projects minus prepayments.

Exhibit 1: Results highlights

€000s	H118	H117	Q218	Q118*	q-o-q
Income from letting activities	15,062	1,052	7,007	8,055	-13.0%
Income from real estate inventory disposed of	11,054		11,054	-	
Change in project related inventory	16,302		27,371	(11,069)	N/M
Income from property development	197,020		106,115	90,905	16.7%
Overall performance	**242,438**	**1,052**	**151,548**	**90,890**	**66.7%**
Expenses from letting activities	(6,724)	(1,557)	(3,795)	(2,929)	29.6%
Cost of materials	(151,083)		(113,463)	(37,620)	201.6%
Valuation result		10,421		-	
Other operating income	4,639	7	3,685	954	286.3%
Personnel expenses	(14,383)	(106)	(7,695)	(6,688)	15.1%
Other operating expenses	(33,431)	(3,458)	(21,760)	(11,671)	86.4%
EBITDA	**41,456**	**6,359**	**8,520**	**32,936**	**-74.1%**
D&A	(853)	(6,564)	(444)	(409)	8.6%
EBIT	**40,603**	**(205)**	**8,076**	**32,527**	**-75.2%**
Financial income	5,781		(140)	5,921	N/M
Financial expenses	(44,396)	(359)	(21,866)	(22,530)	-2.9%
EBT	**1,989**	**(564)**	**(13,929)**	**15,918**	**N/M**
Income tax expenses	(597)	(3,640)	2,214	(2,811)	N/M
Net income from continuing operations	**1,392**	**(4,205)**	**(11,716)**	**13,108**	**N/M**

Source: Consus accounts. Note: *Edison calculations based on reported H118 and Q218 figures.

In H118, Consus recorded an adjusted EBIT pre-PPA of €56m, which on an annualised basis would stand at c €112m (however, this does not take into account seasonal patterns). The company has reconfirmed the management guidance of mid-term EBIT pre-PPA at €300m by 2020 on the back of the significant increase in development revenues. Management confirmed also that due to divestments within commercial real estate portfolio, the previous guidance of €32m from letting activities in FY18 will not be fulfilled.

Continued balance sheet deleveraging

To achieve the management guidance of less than 3x net debt to EBIT pre-PPA multiplier by 2020, the company continues its efforts to deleverage its business. In H118 the total net debt was cut by €266m to €1.25bn as total prepayments received in conjunction with forward sales in the period amounting to €244m. As the group held €31m cash as of 30 June 2018, the total Consus debt stands at €1.28bn with a relatively high average interest rate of 6.8%. This is mostly attributable to CG Gruppe debt (€946m or 73.7% share) which has an interest rate of 7.6%. Management intends to benefit from the current low interest rate environment and refinance it to significantly reduce interest expense (we estimate the current annual run rate at c €87m). The refinancing could also enhance the company's debt maturity structure as currently c €400m matures within next 12 months. The remaining part of Consus debt as at 30 June 2018 included a €200m convertible bond (€6m conversion requests executed so far), a €150m straight bond (further €85m bond buyback post reporting date) and €31m in other debt. Although reported improvement in the net loan-to-value ratio in the period seems immaterial as it has dropped from 87% in at end-2017 to 86%, it would reach 4ppt if the GxP debt were excluded from the end-2017 numbers. The further post balance sheet decline in net debt to €1.09bn as at 30 September 2018 on a pro-forma basis was driven by the capital increase amounting to €131m (completed on 24 July 2018) as well as transaction related cash income. However, the figure does not include the consideration for the additional stake in CG Gruppe which is payable in stages.

New projects increase average sales price

Following a 37.4% ytd increase, the investment portfolio of Consus reached €6.2bn of GDV and 1.6m sqm of total net floor area (33.8% increase ytd) as at 30 September 2018. The company is benefiting from a broad range of identified targets exceeding €4.8bn GDV (as at end-September 2018), which allowed it to complete four acquisitions recently, putting the total number of projects at 53. The most significant one was the purchase of GEM, a leading regional real estate developer in Karlsruhe and Stuttgart area with a portfolio of c €450m. The other transactions include Billwerded Deich district in Hamburg (€232m GDV) and Forum Pankow in Berlin (€135m). These strengthen the company's presence in these three cities, which now represent 35% of total GDV as at end-September compared with a 28% share at end-March 2018.

The geographic distribution of the portfolio investments is of high importance as three out of four cities with lowest average sales price per square metre are located in eastern Germany. This list includes Leipzig, where the largest part of the company's portfolio is located, 17 projects valued at €1.3bn, constituting 20.4% of total GDV and representing a net floor area at 534k sqm (33.5% of group). The sales price per square metre, however, sits at €2,390, 39% below portfolio average. On the contrary, the average price per square metre in the Frankfurt/Offenbach region stands at €6,573, boosted by premium projects such as the Grand Ouest. The recent property price increases in the German housing market translated into an average sales price in Consus's development portfolio of €3,920 per square metre at end-September 2018 compared with €3,817 at end-2017. This has also been assisted by the c 403k sqm of new net floor area at an average sales price at €4,371 per sqm.

As Consus's strategy embraces the district development approach, residential real estate represents 56% of the overall net floor area, with another 34% of space attributable to office, hotel and retail real estate (896.6k and 548.9k sqm respectively). Further segment split reveals that almost 85% of the portfolio constitute multi-family homes within the residential sector, with the remaining part being social and boarding housing.

Exhibit 2: Portfolio geographic diversification

	Projects	GDV (€m)	Total net floor area	Avg. sales price	% of total GDV
Leipzig	17	1,276.7	534,227	2,390	20.4
Cologne	5	999.0	209,362	4,772	16.0
Frankfurt/Offenbach	6	977.1	148,662	6,573	15.6
Hamburg	4	904.6	189,648	4,770	14.5
Berlin	7	692.1	200,257	3,456	11.1
Stuttgart	4	613.6	154,131	3,981	9.8
Dresden	6	415.9	92,513	4,496	6.7
Dusseldorf	4	368.8	64,871	5,685	5.9
Total	**53**	**6,247.80**	**1,593,671**	**3,920**	**100**

Source: Consus accounts

Valuation

The limited number of domestic comparators for Consus has guided us towards including international peers in our analysis. This is not a strict comparison and should only be taken as a guide. There are differences among the companies displayed below, but the essential nature of business, in that land is bought, developed and then resold with a profit, remains the same. It is worth noting that although Consus is sensitive to the global macroeconomic climate similarly to the peers below, its forward sale agreements with staggered payments provide significant revenue and cash flow visibility over the medium term.

As the company begins the revenue-generating construction phase of its project lifecycle, both market consensus and management guidance expect significant bottom-line improvement, resulting in a widening discount to peers in both P/E and EV/EBITDA ratios. The superior revenue growth prospects implied by the current Bloomberg consensus are expected to change the current premium to peers of 119% into a slight discount based on FY19 estimates and a more than 52% discount based on FY20 estimates. This is also visible at the EV/EBITDA ratio level. Since the future valuation of the company is highly dependent on management's ability to deliver on the high growth expectations, the share price can be (and has been in recent months) quite volatile.

Exhibit 3: Peer group comparison

	Market cap	P/E (x)			EV/EBITDA (x)		
	LCYm	2018e	2019e	2020e	2018e	2019e	2020e
Instone	833.53	40.28	13.28	9.69	23.97	10.17	7.67
Bonava	11,825.45	9.36	9.90	9.58	9.26	9.53	9.23
Helma	139.60	8.79	7.60	6.90	10.95	9.57	8.67
Taylor Wimpey	5,231.21	7.05	6.89	6.51	5.07	4.89	4.66
Barratt Development	5,145.35	7.11	6.72	6.25	4.66	4.41	4.12
Mucklow	337.36	19.34	19.13	19.13	20.00	19.61	n/a
Norwegian Property	5,758.69	19.15	20.68	22.13	20.62	21.95	23.30
ADO Properties	2,139.73	19.02	16.76	15.33	36.90	32.28	28.84
Castellum	41,144.10	15.04	15.05	14.43	21.46	20.29	19.43
Average:		**16.13**	**12.89**	**12.22**	**16.99**	**14.74**	**13.24**
Consus	756.59	35.30	12.43	5.82	13.36	10.63	6.64
Premium/Discount to peers		**118.9%**	**-3.6%**	**-52.4%**	**-21.4%**	**-27.9%**	**-49.8%**

Source: Bloomberg consensus priced at 23 October 2018

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