EDISON

Scale research report - Update

Consus Real Estate

Real estate

13 May 2020

Deleveraging as COVID-19 delays expansion

Consus Real Estate's investment portfolio has more than doubled over the last two years, to a €12.3bn gross development value (GDV) at the end of FY19. This period included the end-2018 acquisition of SSN, contributing to the high end 2019 net debt of €2.7bn. While management states in its annual report that the coronavirus outbreak may not have a material impact on its business, it is, nonetheless, focusing efforts on deleveraging and restructuring the relatively expensive debt. Consequently, Consus has delayed all further purchases for the year and agreed to sell 17 projects with a GDV amounting to €2.3bn, for €690m, representing a double-digit premium to market values as at end-December 2019.

Financials: Overall performance improved by 80%

FY19 includes the first full year consolidation of the SSN Group, which almost doubled the size of the company's business. On the back of successful development activity, and a significant positive change in project related inventory, Consus improved overall performance by over 80% y-o-y. Operating and financing costs increased proportionately to the income; nonetheless profit before tax swung to a positive €11.5m in FY19 from a loss of €14.8m in FY18.

ADO has an option to buy a majority stake

In December 2019, ADO Properties (ADO) acquired a c 22% stake in Consus, which together with shares held by Adler Real Estate (also recently merged with ADO) represents a 25% stake in the company. As part of the deal, ADO received a call option for the purchase of an additional 51% stake in Consus from Aggregate Holdings until mid-2021, which ADO intends to exercise, according to its annual report. We note that the share price parity of Consus vs ADO currently stands at 0.19 (at close on 12 May), compared to contractually agreed parity of 0.2390.

Valuation: Trading at a discount to peers

Consus, which used to trade at a diminishing premium to peers, now (according to Refinitiv consensus figures) trades at a c 32% discount based on P/E multiples for 2020e, which slightly expands to 37% on 2021e earnings. Based on the EV/EBITDA multiple for 2020e (calculated on consensus EBITDA of €344m vs €450m management guidance), Consus trades at only a slight discount to peers, which turns into a premium for 2021e figures. However, the valuation will currently be skewed by the possibility of Consus being absorbed into ADO.

Consensus estimates

Year end	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/18	466.5	(14.8)	(0.17)	0.00	N/A	N/A
12/19	863.8	11.5	(0.15)	0.00	N/A	N/A
12/20e	2,224.6	156.1	0.65	0.00	7.8	N/A
12/21e	2,137.2	258.1	1.10	0.07	4.6	1.4

Source: Consus accounts, Refinitiv consensus as at 12 May 2020.

Price	**€5.09**
Market cap	**€695m**

Share price graph

Share details

Code	CC1
Listing	Deutsche Börse Scale
Shares in issue	136.6m
Last reported net debt as at 31 December 2019	€2.7bn

Business description

Consus Real Estate, based in Berlin, is the leading listed residential real estate developer in the nine largest cities in Germany. Following acquisition of SSN Group and the recent disposal of 17 projects, the company's portfolio consists of 48 projects with a gross development value of c €10bn.

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.
- Relatively high leverage level.
- Dependency on institutional clients.

Analysts

Milosz Papst	+44 (0) 20 3077 5700
Michal Mierzwiak	+44 (0) 20 3077 5700

financials@edisongroup.com

Edison profile page

EDISON

Financials: Revenue expansion offset by financing cost

FY19 was the first full year of consolidation of the SSN Group, acquired at end 2018 resulting in a significant shift in the scale of business activity. The company reported over 38% y-o-y improvement in total income (see Exhibit 1), reaching €671m, with Consus RE Group (former CG Group) contributing €600.1m (89.4%) and Consus Swiss Finance Group (former SSN Group) adding €71.0m (10.6%) to the 2019 total income. The increase was mainly driven by successful property development activity, contributing €402m against €279m in 2018, and disposals of real estate inventory – €205m against €164m in 2018. It is worth noting, however, that in FY19 Consus amended its accounting policy for forward sales of development projects, separating it into sale of land and work performed on the development of property. Consequently, prior year income from property development has been reduced, boosting the reported change in project related inventory. Out of 65 projects held as at end-2019, 33 realisations in the development phase were already contributing to the former revenue stream. Overall performance improved even more, reaching €864m in FY19 against €466m in FY18, driven by the €193m increase in project related inventory. This figure includes both project acquisitions and developments as well as capitalisation of interest expenses for projects that are not yet sold under forward sales agreements.

As the SSN integration process is still underway, the economies of scale have not yet been fully reflected, resulting in a proportionate increase in operating costs. The 85% sales improvement generated similar growth in cost of materials (84%) and personnel expenses (82%), with the group headcount growing from 782 at year end 2018 to 975 at end 2019. An almost 54% y-o-y increase in other operating income was driven by €3.3m reversal of allowances and €2.1m negative difference from purchase price allocation (PPA). Consus continued to bear significant consulting and audit fees of €17.1m (€17.8m in FY18), mainly due to portfolio transactions, capital market activities and other project related work. Total other operating expenses reached €78.5m in FY19 (€65.3m in prior year), driven by a c €13m increase in other taxes, mainly non-deductible VAT.

The increased business activity volume, combined with project realisations entering the earning generating phase, resulted in Consus more than doubling EBITDA and EBIT in FY19, to €236m and €228m, respectively. The positive operating result, however, was fully offset by an almost doubling of debt financing costs and a swing to income tax expenses after a credit in FY18, which led to a reported net loss for the period amounting to €5.0m in FY19 against €2.6m in FY18.

Exhibit 1: Financial highlights

€000s, unless otherwise stated	FY19	FY18	y-o-y
Income from letting activities	21,340	32,796	-34.9%
Income from real estate inventory disposed of	204,541	163,515	25.1%
Income from property development	401,621	278,992	44.0%
Income from service, maintenance and management activities	43,613	10,199	327.6%
Total income	**671,115**	**485,502**	**38.2%**
Change in project related inventory	192,700	(19,003)	NM
Overall performance	**863,815**	**466,499**	**85.2%**
Expenses from letting activities	(8,894)	(16,083)	-44.7%
Cost of materials	(525,215)	(285,600)	83.9%
Net income from the remeasurement of investment properties	31,943	25,631	24.6%
Other operating income	20,360	13,241	53.8%
Personnel expenses	(67,024)	(36,911)	81.6%
Other operating expenses	(78,551)	(65,338)	20.2%
EBITDA	**236,434**	**101,439**	**133.1%**
Depreciation and amortization	(8,443)	(2,175)	288.2%
EBIT	**227,991**	**99,264**	**129.7%**
Financial income	28,160	9,001	212.9%
Financial expenses	(244,666)	(123,090)	98.8%
EBT	**11,485**	**(14,825)**	**NM**
Income tax expenses	(16,521)	12,198	NM
Net income from continued operations	**(5,036)**	**(2,627)**	**91.7%**

Source: Consus Real Estate accounts, Edison Investment Research

As the residential real estate segment seems quite resilient to the impact of the coronavirus outbreak, management has not significantly revised the guidance it has held since the SSN Group acquisition. We note, however, that Consus, operating as a developer rather than investor, is bearing more risk, due to high leverage and a project intensive business model. The company still targets 2020 EBITDA adjusted for PPA and one-off expenses to reach €450m (€344m in FY19) on c 20% margin. Even though currently the ratio of net debt to adjusted EBITDA sits at c 7.8x, management aims to cut it to just 3.0x in the medium term. This would be achieved through both debt reduction and improvement of operating earnings, driven by a high forward sales level.

ADO Properties acquires a c 25% stake in Consus

In December 2019 ADO Properties, a Berlin-focused residential real estate company, acquired a c 22% stake in Consus for €294m in cash (€9.72 per share), which together with shares held by its recently acquired subsidiary Adler Real Estate totals to a 25% stake in the company. As part of the deal, ADO received an option for the purchase of an additional 51% stake in Consus from Aggregate Holdings until mid-2021, which would be settled in new ADO shares (0.2390 per Consus share). According to ADO's annual report published on 31 March 2020, it intends to execute the option. We note, however, that at the day of the annual report publication, the ratio of the Consus share price to ADO stood at c 0.25, while it fell to 0.19 at close on 12 May.

Coronavirus may delay market expansion

Expansion in the German residential real estate market continued in FY19, with a 4% y-o-y increase in building approvals, which reached 360.6k, according to the Federal Statistical Office (Destatis), and completions amounted to 300k units (4.9% y-o-y improvement) as per the Central Association of the German Construction Industry and the Ifo Institute for Economic Research estimates. This figure is still over 12% below the annual demand estimated by the German Economic Institute of 342k, which was forecast to drop to 260.2k in 2021–25 and to 245.4k in 2026–30. Due to favourable demand-supply dynamics, resulting in a continued housing deficit, the overall price level in the residential real estate segment recorded a 10.2% y-o-y increase (per JLL).

However, early 2020 brought significant uncertainty to the market with the coronavirus outbreak, forcing governments to impose severe restrictions to limit the spread of the pandemic. In Germany, these measures included closing land borders, a ban on recreational movement and suspending non-essential business activity, among others. Even though the construction works of Consus were continued on all sites, the company suffered initially from limited availability of certain building materials and labour forces from Eastern Europe. Both institutional and individual clients continue to make their contractual payments and prepayments, and existing forward sales (€2.8bn) remain intact, and no related late delivery penalties are expected by the company.

Thanks to its operating focus on the residential real estate segment, broadly considered as more resilient to market downturns, Consus expects any negative impact to be short term, and sees the potential to benefit from reduced construction costs pressures in the medium term. Having said that, all new forward sales negotiations have been put on hold as institutions are currently evaluating the impact of the pandemic. Similarly, individual buyer activity has reduced, which negatively affects condominium sales. Finally, even though the company is still receiving interest in well priced upfront sales of its projects to other developers, the timing of closing such transactions is uncertain. Therefore, Consus took several actions to mitigate the negative implications of the pandemic, including cost cutting programmes based on full integration of all operations and postponing all non-essential expenditures and recruitment. Importantly, the company not only decided to stop expansion of the portfolio through project acquisitions, but also announced on 8 May 2020 divestment of 17 projects with a GDV of €2.3bn, to Gröner Group, controlled by

Christoph Gröner – former CEO of CG Gruppe. In addition, the acquisition of the remaining 25% minority stake in Consus RE (previously CG Gruppe) from him has been agreed, primarily against new shares in Consus and a cash component. Both trades should close not later than in Q320.

Net debt to GAV ratio at 75%

Over the last two years Consus continued to expand its portfolio through both organic growth and intense acquisition activity, taking total GDV to €12.3bn as at end-December 2019 against just €4.6bn at end-2017. Along with new projects, the company assumed new debt, lifting end FY19 net debt to c €2.7bn, including over €350m increase related to eight purchases completed over the year. Consequently, even though the market gross asset value (GAV) improved from c €3.0bn in 2018 to over €3.6bn as at end-2019, leverage remained relatively high with a net debt to GAV ratio of 75%. In the same period, the net debt multiple against EBITDA adjusted for purchase price allocation and one-off expenses fell from 8.7x to 7.8x. This figure is especially important, bearing in mind the fact, that c €1.2bn (44% of net debt) is repayable within 12 months.

As we have already stressed in our previous notes, the company's indebtedness is not only high, but also relatively expensive, with the average interest rate at the end of 2019 amounting to 7.8%. This mainly reflects the SSN acquisition in late 2018, which added c €685m liabilities with an average interest rate of 11.3%. Consequently, financial expenses in FY19 increased by c €121.5m (99% y-o-y), with €84.5m attributable to SSN's debt. Consus continues to improve its debt structure and consequently lower the average interest rate level, targeting 6.0% in the medium term. However, this may take time; its average interest rate at the end of 2018 was 8.1% and in 2020 it should fall to c 7.5% based on management estimations. The first step in the deleveraging process taken in FY20 was the aforementioned divestment of 17 projects. Consus will reduce its project finance debt by around €475m on the back of this transaction and receive a material cash payment.

Valuation

Consus used to trade at a premium to peers due to superior earnings growth consensus forecast. The recent decision to suspend further portfolio expansion and to sell projects with c 16% of GDV, in order to improve its debt structure, resulted in the revision of consensus forecasts. Between September 2019 and May 2020, the consensus EPS for 2020e and 2021e fell by c 19% and 5%, respectively. The company's peers are expected to rebound earlier and stronger, which may explain why Consus, based on P/E multiples for 2020e and 2021e figures, trades at more than a 30% discount to peers. On an EV/EBITDA 2020e basis, the company trades at only an 8.6% discount. However, it is worth noting that consensus data forecasts FY20 EBITDA to remain broadly flat vs the FY19 reported figure of €344m, while management guides to €450m. If guidance is met, the EV/EBITDA multiple would sit at 7.5x against current 9.8x. In any case, the valuation perception may be distorted by the possibility of Consus being absorbed into ADO.

Exhibit 2: Peer group comparison

Company	Market cap (LCYm)	P/E (x)		EV/EBITDA (x)	
		2020e	2021e	2020e	2021e
Instone Real Estate	694	16.3	6.3	12.6	6.8
Helma Eigenheimbau	128	17.3	9.3	15.9	10.9
UBM Development	280	6.7	5.4	10.1	8.6
Barrat Development*	5,224	10.7	10.2	7.2	7.2
Taylor Wimpey	4,976	9.8	8.8	6.8	6.1
Bonava	4,792	8.5	3.7	11.7	5.4
Peer group average		**11.6**	**7.3**	**10.7**	**7.5**
Consus Real Estate	699	7.8	4.6	9.8	8.1
Premium/(discount) to peers		**(32.1%)**	**(36.6%)**	**(8.6%)**	**8.1%**

Source: Refinitiv consensus as at 12 May 2020

EDISON

General disclaimer and copyright

Australia

New Zealand

United Kingdom

United States

Frankfurt +49 (0)69 78 8076 960	London +44 (0)20 3077 5700	New York +1 646 653 7026	Sydney +61 (0)2 8249 8342
Schumannstrasse 34b	280 High Holborn	1,185 Avenue of the Americas	Level 4, Office 1205
60325 Frankfurt	London, WC1V 7EE	3rd Floor, New York, NY 10036	95 Pitt Street, Sydney
Germany	United Kingdom	United States of America	NSW 2000, Australia