RCM Beteiligungs

Real estate

23 June 2017

Real estate assets in Dresden

RCM Beteiligungs (RCM) is primarily a residential property developer focusing on the refurbishment of assets in the area of Dresden, Saxony. Additionally it invests in financial assets. RCM acquires low to medium value residential multi-family homes and modernises them. The objective is to achieve rent increases and an appreciation of the asset value. RCM realises value by selling the asset and re-investing in new real estate assets and opportunistic financial participations. While the real estate business accounted for 89% of revenues and represented 70% of the balance sheet total of €55m in 2016, the financial holdings and participation business represented 11% of revenues and tripled in value to €5.5m.

RCM exploits deep knowledge of the Dresden market

RCM's property business is focused on the Dresden area, but it also holds some legacy assets in other selected locations. RCM adds value through sourcing attractive assets with the potential for profitable refurbishment and reduction in vacancies. Valuation improvements are crystallised through asset sales, with cash largely being recycled into new opportunities. In addition to real estate assets, RCM acquires shares and financial investments it considers to be undervalued.

RCM develops different income streams

RCM has diversified its real estate income streams, which comprise recurring rental income and income from asset sales, with income from valuation gains from its financial investments and dividend income. The combination of the business activities allows RCM to exploit opportunities in both segments. Its significant shareholding in KST Beteiligungs follows a similar 'value approach' in the capital market as RCM does in the Dresden real estate market. The diversification has led to stable EBIT margins of more than 35% since 2014.

Valuation

RCM is trading at a trailing P/E ratio of 24x, which is a premium to the peer group. We suggest RCM's current valuation reflects an improved outlook given the recent stability of its operating model and the net profit progression over the last three years. RCM now needs to confirm these expectations. On a P/BV multiple, RCM trades at a discount to the peer group, which, we believe, is due to a significant difference in the size of the company.

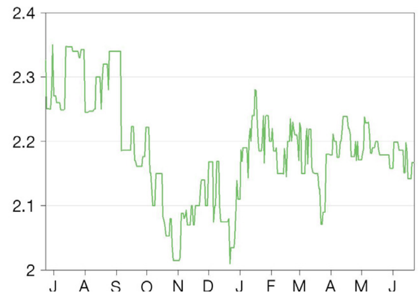
Historical financials

Year end	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/13	2.1	0.3	0.02	0.03	72.7	1.4
12/14	12.6	1.0	0.02	0.03	72.7	1.4
12/15	14.5	1.3	0.05	0.04	43.6	1.8
12/16	11.9	1.8	0.09	0.04	24.2	1.8

Source: RCM Beteiligungs accounts

Price	**€2.18**
Market cap	**€32m**

Share price graph



Share details

Code	RCMN
Listing	Deutsche Börse Scale
Shares in issue	14.7m
Last reported net debt as at 31 December 2016	€27.5m

Business description

RCM Beteiligungs is a property developer, acquiring rental income producing assets in and around Dresden and investing in refurbishment with the aim of improving the tenant mix to enhance value. RCM also invests in financial assets. It is a large shareholder in KST Beteiligungs, a financial investor.

Bull

- Low unemployment levels in Dresden.
- Focus on a defined region leads to greater understanding of opportunities.
- Established business concept and strong partner network in the region.

Bear

- Small company, largely dependent on development of the region of Dresden.
- Low interest rate environment might end.
- Dependency on positive macro environment in the region and attractive sourcing potential.

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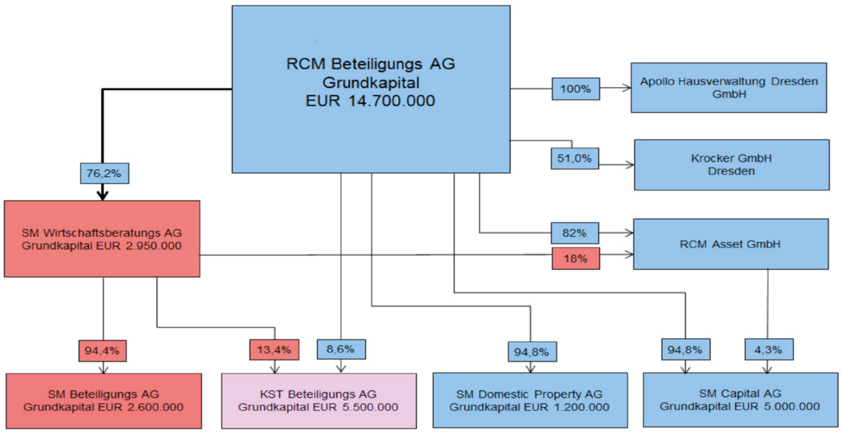
Company description: Real estate values

RCM is a real estate developer with a focus on Dresden. It owns around 50,700 square metres of residential assets in the region, with a balance sheet book value of €35m (HGB accounting, excluding impairments, 93% of all real estate assets). The statutes of the company also permit acquisition of assets outside that region to a maximum of 15% of total real estate assets on the balance sheet. In addition, it acts as a holding company, owning participations in real estate orientated and value orientated companies. The company's investment guidelines require that no holding exceeds 15% of the entire portfolio value at the time of the acquisition. RCM is located in Sindelfingen near Stuttgart.

The focus of the business is on the real estate segment, which is managed by RCM and its fully consolidated subsidiary SM Wirtschaftsberatungs AG (SMAG).

In addition, RCM invests opportunistically in value orientated financial assets. Currently, it directly and indirectly owns companies that support its real estate activities (eg facility management, realtor services) as well as an 18.8% stake in KST Beteiligungs AG, a value orientated, listed financial asset manager in Stuttgart (market cap €6.3m as of end of 2016). RCM board member Reinhard Voss is also sole board member of KST, while RCM board member Martin Schmitt is head of the supervisory board of KST; and RCM supervisory board member Peter Steinbrenner is also a supervisory board member of KST. KST is directly and indirectly majority controlled by RCM representatives. RCM's strategy is to be active in its holdings in order to uncover their hidden value.

Exhibit 1: Corporate structure, April 2017



Source: RCM

Business model: Value enhancement

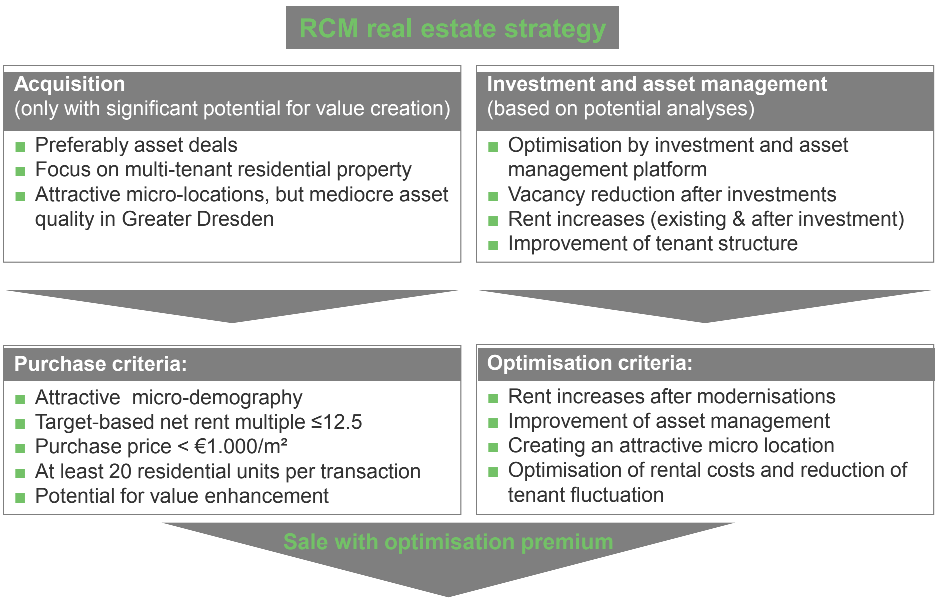
Real estate operations: RCM focuses on real estate assets in the low- to medium-value range in the area around Dresden, it's so called 'Saxony portfolio'. Dresden is a core centre of Saxony with 295,278 residential units, with a vacancy rate of 6.5% (at December 2015, source: Dresden.de). The city saw an increase in inhabitants of 63,700 in the 10 years until 2013 (most recent data). RCM's business model is based on value enhancement of mismanaged and/or undervalued real estate assets due to lack of management of rent increases and re-rental activities and postponed investments. The objective is to raise ROI (which is net rental income after rental costs) on these investments through improved management and investments, leading to vacancy reduction and improved rents per square metre. The geographical focus is on B-areas of high population density in Dresden and surrounding areas, where the potential to create prime micro-locations has been identified. The process occurs via modernisations and the restoration of buildings, their surroundings and selected single units. The company embarks on active asset management through its own in-house asset and facility management operations, aiming for rental increases and subsequent revaluations. The aim is to realise the later by the sale of the asset to financial investors, primarily via block transactions.

RCM effectively offers everything under one roof – all value enhancements are managed in-house. Apollo Hausverwaltung is the facility manager while SM Domestic Property GmbH, which invests in Dresden using the same investment principles as RCM acts as the group's in-house asset managers. The intention is to create a lean and cost-efficient organisational structure, with flexibility for future growth. The focus on a single area – Dresden – also helps to reduce costs. RCM has 37 employees (2016), three less than in 2015, albeit managing the same asset base. Total salaries are 16% of revenues.

The essential idea is to acquire 'incomplete assets' standing on a valuation discount to comparably well managed assets in the near vicinity. NAV enhancements are potentially realised through rent increases (vacancy reduction, re-letting) following the modernisation. These enhancements are then monetised by the sale of the asset.

RCM substantially re-invests its proceeds, but also distributes some profits via its dividend. The focus, however, is on re-investing into value creating, yielding assets.

Exhibit 2: Business cycle



Source: Edison Investment Research

Financial holdings: RCM's financial holding strategy is similar to its real estate operations. It aims to acquire financial assets that offer optimisation potential. Essentially, RCM's management aims to achieve a position on the supervisory and/or executive board, pursuing an improved organisational structure aiming to reveal 'hidden value'. RCM aims to divest these holdings, once its return goal (which is individually defined) has been reached. Currently, the holding in KST is its main focus: after averting a liquidation case (settlement on pension liabilities with the ex CEO removed), RCM has restructured the group and achieved positive earnings in 2016 for the second consecutive year. Under the RCM management, KST invests primarily in liquid shares and high yielding bonds. The aim is to achieve positive cash returns, allowing KST to benefit from a €9m income tax shelter borne out of a forward carried loss asset. The current NAV of KST is €1.55/share (source: KST Q1 2017 report) against a share price of €1.33 (8 June 2017). RCM's management roots are in the financial markets, where both Schmitt and Voss were active before 2000. The opportunistic approach requires investments to have a yield potential of at least 20% ROI.

Real estate acquisition procedure – assets with appreciation potential

RCM acquires assets or portfolios with 20 to 200 residential units of low to average quality in the Dresden area. These assets need to provide ‘optimisation’ potential, ie they could be improved by investment. Typically, the assets were built in the 1950s to 1980s, ie in the ex-GDR period. RCM has a good, established network of attorneys, realtors, local real estate owners, the city and other communal and private asset owners, which function as its pool of asset providers. RCM benefits from its financial power (€4.9m in cash as at December 2016) enabling it to make quick decisions without lengthy discussions with financing banks. RCM typical finances its acquisitions with 25% equity and 75% debt, which is non-recourse short-term debt financed by the local banks.

Optimisation – creating value

RCM typically sells its assets as ‘block’ transactions (entire multi-tenant houses) to long-term investors (pension companies, foundations, wealthy private investors), rather than through privatisation (individual units sold to tenants or private financial investors). However, the streamlining of the portfolio to focus on Dresden should allow RCM to benefit from increased interest in city locations instead of assets in rural areas. Therefore, private sales might increase as a proportion of total sales in the future, with positive effects on sales margins. RCM typically invests €100-250/sqm in assets for block sales against €250-400/sqm for privatisation assets. The main investments are energy efficiency modernisation, increasing rental space through creating new apartments in previously unutilised roofs, selected unit renovation and investments in the surroundings of an asset. Here, RCM differentiates from typical long-term asset holders (annual maintenance approximately €50/sqm) and pure new asset developers (average costs €1,800-3,000/sqm). Aside from the ‘technical’ investment, RCM’s in-house asset management optimises the tenant structure, aiming to ‘reposition’ the asset. The entire optimisation process aims to increase rental multiples from 12-13x (at acquisition) to about 15-18x on an increased rental level after 36 to 48 months, depending on the location of the asset.

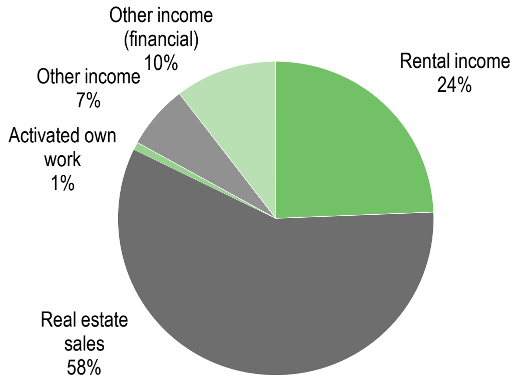
Disposal – cashing in on investments and improvements

RCM is not a typical long-term asset holder such as Deutsche Wohnen, as on completion of the investments it aims to sell optimised assets to re-invest into new opportunities. RCM aims at overall disposal margins, based on acquisition plus investment costs, of 20-30%. In 2016, overall gross activities (revenues from asset sales and rental revenues, plus changes in asset base and investments), was approximately €7m with a reported EBITDA of €2.98m, and a margin of 43%. Net rental income was €3.1m (ie rental income booked with RCM, before €437k of rental costs) while the sales margin reached 22%, or €1.6m, in line with RCM’s sales margin target range.

Rental income – risk mitigation and cost coverage

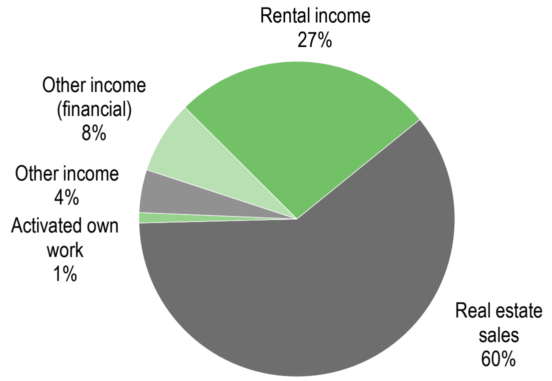
RCM acquires occupied residential assets, the benefit of which is that the assets generally yield rental income from day one of the acquisition. With the increase in the asset base from €33m in 2012 to almost €37.3m in 2016, RCM’s annual net rental income rose from €760k in 2013 to €3.1m. In 2016 this income covered interest costs twice. Following further growth in the portfolio, RCM aims to achieve a gross rental income level that should lead to self-financing of its operations including the secured interest costs through net rental income.

Exhibit 3: Performance by segment 2016



Source: RCM 2016 accounts

Exhibit 4: Performance by segment 2014



Source: RCM 2014 accounts

2016 business review and outlook

2016 was the third year in a row with gross performance of more than €6.5m and EBITDA of more than €2.5m. Lower interest costs, streamlined operating costs and better sales margins, however, boosted net attributable income by 64% to €1.3m. A major reason was the increased focus of the portfolio by selling the last assets in Eilenburg and Riesa, two distant locations from the Dresden core area. Now, RCM has 15 locations in its group portfolio, of which four are in the vicinity of Dresden and four others (each with one asset) are being sold as part of the streamlining process. The effects of the streamlining can be seen in the development of rental costs: in 2014 these were €801k of €3.5m net rental income (ie 23%), as RCM had to manage assets in various locations. In 2016, these costs were €437k of €3.1m net rental income (14%). A further focus on Dresden should lower this ratio further, as rent increases are easier to push through in densely populated areas.

The consolidation of SM Beteiligungs AG as a result of the increase in the holding to 94% (in 2017) results in a small increased asset base and higher rental income as well as more assets in the attractive Erfurt area (200km west of Dresden). This might emerge as a second core location for RCM due to the fact that Erfurt is part of the new ICE train initiative of Deutsche Bahn and will become a key ICE connection point.

Any increase in the proportion of recurring rental income should help mitigate earnings volatility. RCM expects the overall environment to remain positive, following a strong first quarter of the year.

Recent newsflow and upcoming catalysts

RCM started positively in 2017. Pre-tax profits grew slightly (2%) from €381k (Q116) to €388k. A main driver in Q117 was a significant reduction in interest costs. Net financials halved to -€160k in Q117, supported by a 30% decline in interest costs to €281k and a doubling in interest income to €121k. In the absence of asset sales in Q117, revenues halved to €2.2m, chiefly from rental income and other financial income. Essentially, pre-tax margins doubled from 8.6% in Q116 to 17.6% in Q117. The result is also a function of further streamlining of the portfolio: in Q117, the only remaining asset in Bautzen was sold, allowing RCM to exit this distant location. The overall positive start of the year has led the management of RCM to predict a strong increase in net profits for 2017, which would be the sixth consecutive net profit increase in the company's recent history.

RCM will hold its AGM on 26 June 2017, followed by the payment of the dividend three working days later. It will issue its half year results on 11 August 2017.

Market overview and outlook

The German residential market is still a tenant market, with an ownership ratio of just 45.5% (source: Destatis 2016, based on Zensus 2014). Market surveys suggest that the ratio will rise above 55% in the next 10 years. RCM focuses on assets, which were built around 50 years ago.

Exhibit 5: Ownership and age of assets in different locations

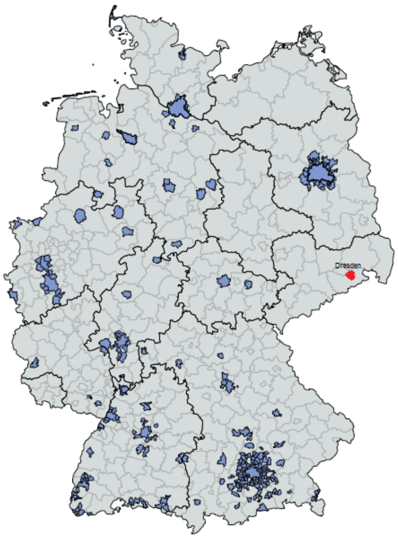
Year	Total units	Germany	West Germany	East Germany	City states*
Average	**100%**	**46%**	**50%**	**46%**	**13%**
1950-59	12%	37%	39%	39%	16%
1960-69	16%	39%	44%	15%	19%
1970-79	16%	48%	54%	20%	22%
1980-89	11%	52%	60%	28%	20%

Source: Destatis 2016, Zensus 2014. Note:*City states – Berlin, Bremen, Hamburg.

The table above shows that average home ownership rates appear to be similar between East and West Germany at 46-50%. However, ownership rates are dramatically lower for units built since 1960 in the former East Germany, which are typical of the type of investments targeted by RCM.

With the focus on Dresden, the macro- and micro economic data for this region – and Saxony as a whole – are relevant for RCM.

Exhibit 6: Rent levels



Dresden is not one of Germany's top seven locations. However, it is a core city in Saxony and attracts new inhabitants. In Dresden, the unemployment rate had fallen by June 2016 to the lowest level since the re-unification, underlining the attractiveness of Dresden. The increase in employment and the strong demand for skilled labour makes Dresden an area with further rent increase and vacancy reduction potential. In densely occupied areas, the so called 'Mietpreisbremse' (rent increase restriction) applies. In Dresden, these restrictions are not applicable.

Source: Edison Investment Research. Note: Dark blue: rent increase restrictions apply. Dresden area: red dot.

Exhibit 7: Development of rents in Dresden, Saxony and Germany (60sqm apartment)

Year	Dresden	Saxony	Germany
2011	€5.67	€4.83	€5.56
2012	€5.98	€4.85	€5.69
2013	€6.23	€4.97	€5.93
2014	€6.63	€5.11	€6.12
2015	€6.78	€5.32	€6.56
2016	€7.09	€5.66	€7.34
Q117	€7.75	€5.73	€7.32

Source: www.wohnungsboerse.net/mietspiegel-Dresden/7351. Note: per square metre

As at Q117, Dresden rents stand approximately €2.00/square metre higher than Saxony rents. Rents have been higher in Dresden than in Saxony and Germany for most of the past six years. However, in late 2016, rents in the top seven cities jumped, leaving Dresden behind. This has now changed and in Q117, Dresden rents picked up significantly. We suggest that the positive trend is likely to continue, as the 'Mietpreisbremse' has not yet been introduced in the city.

In 2015, official data of Dresden (www.dresen.de) show that the purchasing power per inhabitant was around €19,500, just 10% short of that of Hannover and just 20% short of Stuttgart. While in

Stuttgart, 2016 purchase power was 20% higher than in Dresden, the average rent (for a 60sqm apartment) was €14.17/sqm (source: www.wohnungsboerse.net/mietspiegel-Stuttgart/972), ie 100% higher than in Dresden, underpinning the rent level upside over time.

Management: Slim structures

CEO: Martin Schmitt (DIPL.-KFM) founded of SM Wirtschaftsberatungs AG in 1996. The company acted in similar areas as RCM. RCM was a holding of SM and took over SM in 2000. Schmitt then moved to become CEO of RCM.

CFO: Reinhard Voss (DIPL. – INFOKFM) started his career in the financial markets, working as a trader for several German banks at the Frankfurt Stock Exchange between 1985 and 2000. He then moved to KST and became a manager for SM Wirtschaftsberatungs AG in 2005. Since 2007 he has been with RCM, now serving as CFO.

Head of the supervisory board: Professor Dr Peter Steinbrenner has been involved with SM since the beginning in 1996, serving as its supervisory board member. He is the dean of the School of Management and Finance/Real Estate at the Nürtingen-Geislingen University (south-east of Stuttgart) and has written several books on real estate and option pricing.

Shareholders and free float

RCM's share capital is divided into 14.7m ordinary voting shares. Based on its most recent survey of shareholders, the shares are mostly held by German institutions (50.1%), followed by private investors (domestic and foreign) with 32.1%. Foreign institutions hold 16.2% of RCM's stock. The company itself owns 1.6% of its shares as treasury stock (all data as of 31 May 2017; source: RCM). The company' shares are listed in Scale segment of Deutsche Börse AG, Frankfurt. This segment does not require disclosure of holdings of less than 25% in a company. RCM is not aware of any major single holders, which includes the management. Against this background, 100% of its shares are considered to be free float.

Financials

RCM reports are prepared under HGB standards. Unlike IFRS, HGB does not use mark-to-market valuations or annual impairments. This implies that all asset sales revenues are booked at the time of the disposal and therefore are cash earnings. Gains achieved on recent sales suggest that hidden reserves are building as a result of optimisation and rent multiple expansions. In IFRS accounts, these value increases would appear as valuation uplifts that flow directly through to equity or NAV. Based on the company's latest sales success with a real estate margin of 22%, the current asset base (€37.3m as of December 2016) implies a potential hidden reserve of €8.2m, or 47% of stated equity. It should be noted that RCM has streamlined its portfolio towards city areas in Dresden, where higher margins as a result of higher market prices should be achieved. The main reason is that assets within Dresden can be better developed, for example through higher-margin private sales.

Total real estate revenues (against total performance, which included change in asset base) amounted to €10.5m in 2016, of which €3.1m was rental income. For the past three years, rental income accounted for approximately 30% of total real estate revenues, underlining the company's policy to achieve recurring income streams. Lower interest costs helped the overall profitability, as interest costs declined from €1.6m in 2014 to €1.4m in 2016. Also, the re-focus on Dresden reduced rental costs significantly from €801k in 2014 to €437k in 2016 (-45%), while rental income declined by only 12% to €3.1m in that period.

On the balance sheet side, real estate investments account for approximately 70% of the balance sheet total (, 2014: €41.5m of €55.4m, 2015: €39m of €56.3m ,2016: €37.3m of €54.8m) over the past three years, while the business segment 'securities' almost tripled to €5.5m, now representing approximately 10% of total assets. A high cash level is part of the business model. In the past three years, liquidity accounted for 7-9% of total assets. This gives the company flexibility and helps accelerate the acquisition process.

Equity has risen constantly for the past three years and currently accounts for 31% of the balance sheet total. This development was also supported by a 10% capital increase in 2015, raising nominal capital (equal to number of shares) to €14.7m. RCM's liability side is divided into bank loans, accounting for approximately 58% (or €32m) of the balance sheet total, and bonds, now amounting to €3m. RCM issued a convertible bond with a 4% coupon in 2014, allowing bondholders to convert the bond into RCM shares at a price of €2.15/share (which will be adjusted to €2.11 following the payment of the 2016 dividend at the end of June 2017). The bond expires in April 2018. Should the share price remain at or above the current share price (of €2.18), it is likely that the shares will be exercised, which would lead to an increase in the number of shares of 1.32m and a cash inflow of €2.97m.

RCM's net debt stood at €27.6m at the end of 2016 and represents 74% of the real estate assets on the balance sheet (not IFRS adjusted). This indicates that all remaining assets are self/equity financed. Also, the real estate related debt is fully secured by the asset itself.

RCM maintains a strong cash position in relation to its size: its year-end cash was €4.9m, leading to a 'core liquidity ratio' of 167% (cash/short-term debentures) and an extended liquidity ratio of 188% (cash+short-term receivables/short-term debentures). Ratios above 100% are considered to be 'strong' in terms of liquidity.

RCM has paid dividends since 2012 (the first dividend was €0.10/share); thereafter, it paid €0.03 for two years, followed by €0.04 for 2015 and 2016. In 2016, the payout ratio was 44%, while it was higher in the previous year (73%). Before 2015, RCM paid out more than its cash earnings in dividends.

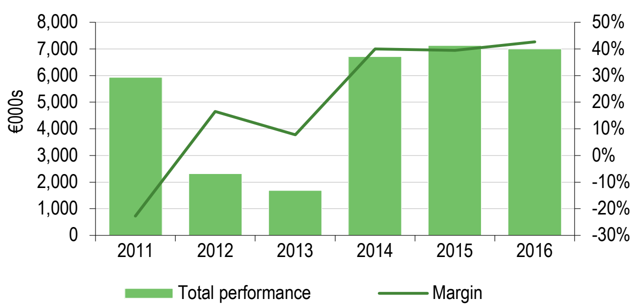
Exhibit 8: Financial summary

	€000s	2011	2012	2013	2014	2015	2016
Year end 31 December		HGB	HGB	HGB	HGB	HGB	HGB
Income statement							
Revenues		20,721	4,358	2,075	12,583	14,489	11,860
Real estate – sales		16,273	2,858	729	8,044	10,095	7,407
Real estate – rental income		2,529	939	759	3,548	3,607	3,119
Financial income		1,920	562	587	991	787	1,334
Change in assets		(15,361)	(2,427)	(668)	(6,602)	(8,372)	(5,802)
Gross total performance*		5,931	2,316	1,686	6,709	7,123	6,999
EBITDA		(1,349)	383	130	2,684	2,810	2,982
Profit Before Tax (as reported)		(3,160)	959	281	1,042	1,333	1,829
Net income (as reported)		(3,032)	962	279	308	808	1,326
EPS (as reported) – (€)		(0.23)	0.07	0.02	0.02	0.05	0.09
Dividend per share (€)		-	0.10	0.03	0.03	0.04	0.04
Balance sheet							
Total non-current assets		59,048	10,262	9,224	6,609	11,205	11,813
Total current assets		12,369	43,273	48,782	48,826	45,113	42,963
Total assets		71,454	53,686	58,082	55,512	56,383	54,922
Total non-current liabilities		38,159	37,367	40,554	38,287	36,676	36,159
Total current liabilities		4,008	564	451	719	1,681	452
Total liabilities		42,167	37,931	41,005	39,006	38,357	36,611
Net assets		29,287	15,754	17,077	16,506	18,027	18,311
Net debt		33,194	24,197	30,692	30,923	30,391	27,550
Shareholder equity		29,176	15,087	16,434	15,874	17,383	17,420
Cash flow statement							
Net cash from operating activities		4,791	5,103	(4,222)	2,439	5,956	3,200
Net cash from investing activities		(2,017)	128	(957)	2,663	(3,260)	301
Net cash from financing activities		(3,837)	(3,717)	2,038	(4,200)	(2,581)	(2,315)
Net cash flow		(1,063)	1,528	(3,117)	902	115	1,186
Cash & cash equivalent end of year		4,183	5,711	2,619	3,641	3,756	4,940

Source: RCM annual reports 2011 – 2016. Note: 'HGB' = German GAAP. *Revenues plus change in assets and financial income.

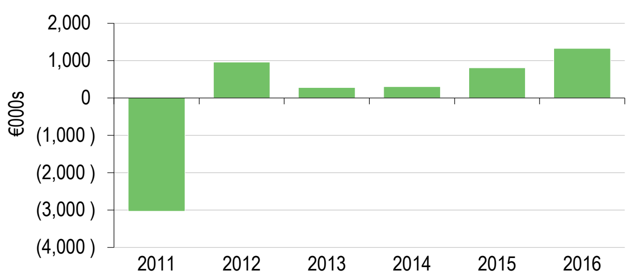
RCM was successful in the past three years in maintaining a strong operating margin (EBITDA) of approximately 40%, rising to 43% in 2016. Given the strong start to the year (EBITDA margin 24%, despite the absence of trading income), management expects a similar margin for 2017. Total group performance stabilised at around €7m in the past three years, as asset sales in non-core regions were replaced by assets in the core Dresden region. Rental income and the asset level have remained almost stable, while asset administration costs have been reduced, contributing to a strongly rising net income over the last three years. The in reduction interest costs has also been a contributory factor.

Exhibit 9: Revenue and margin progression



Source: RCM accounts

Exhibit 10: Net profit progression



Source: RCM accounts

Valuation

RCM's business model sits between that of an asset holder and that of a developer, making direct comparisons to listed companies rather difficult. We have identified the following groups:

- BUWOG AG, a listed spin-off of IMMOFINANZ in Austria. It is focused on asset holding and privatisation. Most of its assets are in Germany. It had sales of €400m in 2015/16.
- Patrizia Immobilien, a real estate company with activities across Europe and in all real estate segments. It started in the residential segment, where it created funds to sell assets to institutional investors. In 2016, it had sales of €818m.
- Publity AG, a commercial real estate group. It follows a 'manage-to-core' approach, ie optimising the assets to achieve a high-end level ahead of disposal or improving rental income. In 2016, the parent company reported revenues of €42m.

Exhibit 11: Comparable companies

	Market cap	P/E (x)			P/BV (x)		
	(€m)	2016	2017e	2018e	2016	2017e	2018e
PUBLITY AG	256	9.76	5.67	5.36	4.03	2.51	2.01
BUWOG (A) AG	2,780	10.42	29.44	22.52	1.38	1.24	1.13
Patrizia Immobilien	1,480	6.63	21.32	17.15	1.77		
Peer group average		**8.94**	**18.81**	**15.01**	**2.39**		
RCM Beteiligungs AG	33	23.50			1.83		
Premium/(discount) to peer group		162.90%			-23.51%		

Source: Bloomberg, RCM accounts. Note: 2016 P/E valuations based on year-end prices.

RCM is trading at a premium to the peer group in terms of historic P/E multiples. A main reason is a strong performance of Patrizia, which experienced a jump in profits that has not been reflected in the share price, as, we suggest, analysts foresee a normalisation in the coming years. On a P/BV multiple, RCM trades at a discount to the peer group, which, we believe, is due to a significant difference in the size of the company. It should be noted that RCM issues reports under German GAAP (HGB accounting), ie eliminating 'mark-to-market' valuation of its assets. This is particularly important when comparing P/BV or P/NAV within the sector. We understand that larger companies, such as Patrizia or BUWOG, use IFRS accounting standards. Nevertheless, our sample of companies should provide a base for comparison.

Exhibit 12: Sector valuation

Item	RCM Beteiligungs*	Industry	Sector
Return on assets (TTM)	5.43	3.89	2.48
Return on assets – five year average	0.24	6.6	2.89
Return on investment (TTM)		5.41	0.43
Return on investment – five year average	0.27	9.47	0.55
Return on equity (TTM)	9.48	7.78	15.6
Return on equity – five year average	0.15	12.85	20.3

Source: Reuters. Note: All items multiples. Industry: financials; sector: Real estate development & operations. *RCM TTM: 2016. TTM = trailing 12 months.

The table above shows that RCM's performance has in the past trailed the development of the industry and the sector. RCM's current valuation appears to reflect an improved outlook given the stability of RCM's operating model and the net profit progression over the last three years. RCM now needs to confirm these expectations.

Sensitivities

RCM's business is – in terms of the equity base – highly leveraged compared to property asset holders (typical leverage between 45% and 60%, REITs below 50%). As Germany's pure developers are not listed, their leverage ratios can only be estimated, but we believe is most likely at or above RCM's level. The main difference is that RCM's debt is secured by income creating assets, while developers' is not. Nevertheless, fast changes in interest rates could affect the group's results significantly. Based on the 2016 results, a 1pp change in interest rates would alter the profit before tax by 17% (€320k). A rise in interest rates would also affect the projected sales multiple on the important asset sales business. Assuming a 14.5x exit rent multiple (6.8%) as a base, an increase by 1pp to 7.8% would reduce the multiple to 12.8x. On the basis of the assets for sale at the end of 2016 (€37.3m) and the projected 30% margin, the sales profit would decline by €5.7m, reducing the margin to 14.7%. The impact on estimated NAV (ie including sales margin calculation similar to IFRS) would reduce the potential 'hidden reserve' by a similar amount, ie from €7.4m to around €2m.

Macro issues

The main risk is a rapid and strong change in interest rates, as this affects the value of assets held and improved for disposal. A gradual change should have a weaker impact as this would lead to a 'cost averaging' on the purchase side (lower acquisition costs). In Germany more than 90% of mortgage finance is at fixed rates and typically fixed for over 10 years.

RCM benefits from the trend towards 'cities' instead of 'rural areas'. Dresden has 552,856 inhabitants (31 March 2017) against 512,546 10 years ago (source: www.dresden.de). This implies that demand for apartments is rising as well. Given the migration, demand for affordable living space is typically rising faster than demand for high-end accommodation. RCM is active precisely in this market segment.

People coming from surrounding areas into Dresden have paid lower rents than in Dresden. Moving into the city is therefore a cost burden, hence the availability of affordable living space is an important factor. Dresden's 8% rise in population over the past 10 years represents an increase more than twice the level of Chemnitz (+3%). If the trend were to change, it would suggest that RCM would no longer be able to dispose of assets at prices that more than fully reflect its investments. Given the short period of holding investments and asset improvement, we regard this risk as low.

Larger real estate companies could become interested in the higher yielding market in secondary locations, particularly in growing cities such as Dresden. The consolidation trend in the mainstream property industry has created large, nationwide operating companies, which might find it more economic to manage secondary locations, given their overall size. These companies could make it more difficult for RCM to acquire attractive assets despite RCM's strong and established network.

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