ADLER Real Estate AG

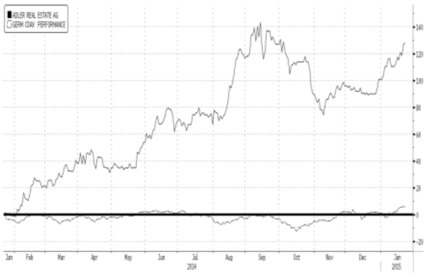
BUY (BUY) | Target 12.00 EUR (12.00 EUR)

Price (last closing price) : **8.47 EUR**| Upside : 42 %

Est. change	2014e	2015e
FFOIPS	5%	-17%

Still an attractive underowned growth vehicle in ‘German Resi’ sector

Friday, 23 January 2015



Capital		
ADL GY | ADLG.DE		
Market Cap (EURm)		270
Enterprise value (EURm)		1,093
Extrema 12 months	9.20 -	3.58
Free Float (%)		38.0%

Performance (%)	1m	3m	12m
Absolute	15.1	5.6	127.8
Perf. rel. "sector"	6.7	-14.5	56.4
Perf. rel. CDAX	8.7	-9.5	112.0

P&L	12/14e	12/15e	12/16e
NRI (EURm)	74	123	146
EBIT (EURm)	173	131	135
Attr. net profit (EURm)	118.6	68.0	63.5
EPS (EUR)	5.07	2.15	2.01
FFOI ps (EUR)	0.42	0.71	0.96
Dividend (EUR)	0.00	0.00	0.00
P/E (x)	1.7	3.9	4.2
P/NAV (x)	0.85	0.70	0.60
P/EPRA NAV (x)	0.75	0.62	0.54
FFOI yield (%)	5.0	8.4	11.4
Dividend yield (%)	0.0	0.0	0.0
ROE (%)	58.9	19.4	15.3
Net LTV (%)	71.9	71.8	70.5
NAVPS (EUR)	9.98	12.13	14.14
EPRA NAVPS (EUR)	11.25	13.63	15.77

Next Events	
FY14 report	30 April 2015

Delivering on both growth and selling legacy assets

Adler real estate AG (ADL) consistently met its 2014 targets and provided confidence to the market. Recently (ADL) successfully disposed Estavis's commercial assets at a moderate book profit and was able to monetise its legacy assets of McKinney (USA) and Offenbach with the latter scoring prices above book value. Additionally, ADL is in advanced negotiations to sell its Frankfurt-Herriotstr property. Gross proceeds of EUR 7-8m are expected to contribute to 2015 earnings. In terms of growth, ADL has reached a critical size with 32k units (target for FY 2014 stood at 25k units) and is aiming for additional growth to 45-50k units by the end of 2016.

ACCENTRO – a valuable bottom line contributor

After the rebranding of ESTAVIS into ACCENTRO Real Estate AG, ADL has set up a clear structure and strategy for its privatisation business. ACCENTRO privatises single condominium out of own stake and as service for third parties. As bottom line contributor, the high margin business should be extended backed by promising market fundamentals and high pricing especially in metropolitan areas. For FY14e we assume ACCENTRO will deliver approx. EUR 8-10m free cash not including the cash contribution from the sale of the commercial assets. On top it will help optimising ADL´s rental portfolio by selling non-core assets.

Short and mid-term share price catalysts

i. Further progress in the monetisation of legacy assets and presenting further milestones in deleveraging and driving LTV towards the target of 55-60% is crucial over the next two years.
ii. In our view ADL will continue to be the growth vehicle in the German resi market and will remain an active buyer in the market. We are confident to see additional acquisitions conforming to their profile at attractive prices; ADL has a proven track record in sourcing special situation deals. Additionally the existing asset management capacities can stand further growth up to 40k units.
iii. Portfolio optimisation through vacancy reduction and increasing in-place rents.
iv. Reducing WACD of presently 4.7%, which can trigger enormous annual savings. We assume 15e year-end WACD of 4.0% as plausible, translating to EUR 6/7m annual savings.
v. Deep value idea - Compared to industry peers which have reached to NAV premia, ADL trades at a discount of approx. 25% to our estimated 14e EPRA NAV.
vi. Asset class ‘German Resis’ remains attractive for international investors underpinned by macro backdrop and the Annington/Gagfah merger.
vii. The company targets to start paying a dividend from 2016 earnings.

Getting the metrics right - becoming a FFO/dividend story - BUY

ADL is on track to becoming an FFO/dividend story and is following a disciplined approach of getting the metrics right. ADL represents an attractive growth opportunity and currently trades at ~25% discount to our 14e EPRA NAV. Most industry peers have rerated to NAV premia due to a more mature FFO generation and dividend payments. However, we assume that the large discount is overdone and should narrow. We stick to our PT of EUR 12/BUY recommendation (based on our NAV model), which is still below our estimated 15e EPRA NAV of EUR 13.63.

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(1)What happened recently?

ADL recently announced measurable success in the selling off its legacy assets, attaining a much clearer business focus of the group. 1) ADL sold its JV in McKinney, Texas scoring a book profit of EUR 1.4m. Gross proceeds amounted to EUR 5.3m and will contribute to results in 4Q14e. 2) The sale of the Offenbach plot was conducted at the end of 2014, generating gross proceeds of EUR 6.1m, which was also booked in 4Q14e. ADL reached a slight book profit. And 3) ADL could successfully dispose the ESTAVIS commercial portfolio at the end of December 2014 also achieving a moderate profit on the book value. Gross proceeds after redemption of loans amounted to EUR 16.4m.

Legacy assets are now summing up to approx. EUR 13m in book value, consisting of 1) development plots (in Großbeeren and Dallgow-Döberitz); estimated finalising in 2015e/2016e, 2) JV in Luxemburg (Airport Center) – to be disposed, 3) opportunistic properties either for development and sale afterwards or sale of undeveloped land (Dresden-Trachau, Berlin-Späthstr. & Frankfurt-Herriotstr). Bottom line, we assume that ADL will benefit from these properties in terms of book profits and that we will see an equity inflow.

Worth mentioning is the fact that ADL is not burdened by the legacy assets in terms of negative cash flow contribution. The strategy is to wait for the proper time in order to sell the assets to a reasonable price. We assume that Berlin-Späthstr as well as Dresden-Trachau bearing hidden reserves.

ADL consistently met its targets and successfully sold legacy and commercial assets. Particularly, the disposal of ESTAVIS´ commercial assets was an important step as these assets were one reason for ESTAVIS being massively undervalued (large discount to NAV).

In terms of cash inflow, ADL will receive proceeds of around EUR 28.3m through the disposals, which will be used for 1) further acquisitions of FFO accretive core assets extending ADLs rental portfolio, and 2) funding the expansion of ACCENTROs privatisation portfolio circulating in current assets.

In the course of further growth, ADL recently conducted a tap issue of its 6% corporate bond 2014/2019 by additional EUR 30m to EUR 130m. The issue price was 102%. Funds will be used for additional growth.

(2)Gaining new revenue pillar with ACCENTRO

ADL recently announced the rebranding of ESTAVIS AG into **ACCENTRO Real Estate AG** and merging all privatisation and retail trading activities of ESTAVIS and ACCENTRO under one entity. We welcome this step and the setting up of a clear corporate structure in which ADL is managing the optimisation and expansion of its residential rental portfolio and ACCENTRO being responsible for the privatisation portfolio.

ACCENTRO has a proven track record in Germany and acquired an excellent reputation in the market. In 2014, the company sold 1,029 units and we assume a free cash contribution to range at around EUR 8-10m (excluding the sale proceeds of ESTAVIS commercial assets). The business should be extended successively by increasing the amount of units to be sold privately out of own stake (by ACCENTRO Real Estate AG) as well as the privatisation as service for third parties (by ACCENTRO GmbH). Furthermore, ACCENTRO has major framework agreements with third parties (i.e. GSW) and aims to acquire additional mandates.

We assume ADL to benefit from ACCENTRO on several levels: 1) the streamlining and optimisation of the existing rental portfolio by selling off non-core portfolio locations which will also improve the manageability of the rental portfolio enhancing FFO generation, and 2) generating reasonable cash for further growth of the rental portfolio.

ACCENTRO functions as a bottom line contributor and operates a high margin business by selling single units to all kind of investors. Especially foreign investors are one important client group. Facing the current market metrics and the price development over recent years, we like the idea of increasing the privatisation business the years to come. The management pointed out to source units in Berlin, Hamburg, Rhine-Main and other metropolitan areas.

(3)Getting the metrics right – deleveraging & WACD

ADL has flagged that it will be deleveraging and reaching a LTV target of 55-60% by the end of 2016 by various measures including loan amortisation, use of proceeds in connection with monetisation of non-core and legacy assets as well as free cash flow. One part of driving that direction is the monetisation of all legacy assets where initial success has already been achieved through the above mentioned sale of ESTAVIS commercial assets and some legacy assets. Especially legacy assets are mostly unencumbered assets, freeing equity.

A further option would be the use of corporate action as well as the outstanding convertible bonds could be converted, which are deeply in the money (convertible bonds summing up to around EUR 21m).

ADL currently operates on a relatively high WACD of around 4.7% compared to its peers. As the company grows it is likely to be able to contract cheaper financing both in regards to banking loans as well as capital market instruments. Reducing the WACD to a level of around 4.0% would generate savings in the amount of approx. EUR 6/7m pa. We value this as a trigger for the future; delivering on the above would increase ADL´s profitability and FFO generation massively. Otherwise the funds could be added to annual loan amortisation, accelerating the pace of deleveraging.

(4)Growth targets

ADL has delivered on both ends - growth and selling off legacy assets - and provided confidence to the market. The company has reached a critical size with 32k units and is aiming for additional growth to 45-50k units by the end of 2016. ADL currently can benefit from different strategies going forward in order to achieve this target.

(5)'German Resi' sector remains an attractive asset class

In our view the 'German Resi' sector will remain an attractive asset class in 2015. Residential real estate will continue to be the favoured property type of investors, according to a study from E&Y. Another trigger for the sector is the increasing demand from abroad.

Macro backdrop is strong

The underlying market fundamentals support growth stories of the German residential companies. We are facing an ongoing low interest rate environment, positive GDP growth and a relatively low unemployment rate in Germany. A limited supply of affordable new housing units in metropolitan areas is facing a growing demand especially for one/two-room apartments as well as an ongoing urbanisation trend. This is supporting the growth of rents and prices especially in metropolitan areas.

High transaction volume

Even though the transaction volume in 2014 vs 2013 has slightly decreased, we assume the consolidation and the need for size of listed resi companies to remain crucial in 2015. In our view size will be rewarded by the capital markets, underpinned by the takeover of GSW through Deutsche Wohnen. Deutsche Annington recently presented an offer for GAGFAH. The goal of the merger is to significantly benefit from economies of scale and saving costs on operational and financing side.

The transaction volume for 2015 (comprising residential and commercial real estate) is expected to moderately exceed 2014 figures of EUR 52.7bn. The following table depicts the largest single transactions in the resi sector, which were conducted by mostly listed companies.

Figure 1 : largest single transactions in 2014

Quarter	Acquirer	Seller	Target	Units	Price (EURm)
Q3	Deutsche Annington Immobilien	Round Hill Capital et. Al	Vitus (residential portfolio with allocation in NRW)	30,000	1,400
Q2	Deutsche Annington Immobilien	Archstone German Funds	Dewag (residential portfolio Southern Germany and Rhin	11,500	970
Q2	BUWOG	Prelios / Deutsche Asset & Wealth Management	Residential portfolio Northern Germany	18,000	892
Q4	LEG Immobilien	Deutsche Annington Immobilien	Residential portfolio NRW	9,600	484
Q3	Westgrund	Berlinovo	Residential portfolio Northern Germany	13,300	390
Q2	Adler Real Estate	Corestate Capital	Residential portfolio Saxony, Saxony-Anhalt and NRW	6,300	Not published
Q3	Deutsche Annington Immobilien	CitCor Residential Group / Corpus Sireo	Residential portfolio with location in Berlin	5,000	310
Q1	Deutsche Asset & Wealth Management	Corpus Sireo	Residential portfolio with location in Berlin	3,604	310
Q2	Immeo	Topdanmark	Residential portfolio Berlin and Dresden	3,400	240
Q4	HOWOGE	TAG Immobilien	Residential portfolio Berlin-Marzahn	2,600	170

Source: E&Y, Oddo Seydler Bank AG

IFRS EURm	2011	2012	2013	2014e	2015e	2016e
Sales	**7.6**	**5.7**	**19.2**	**102.1**	**188.0**	**246.9**
YoY growth	500.1%	-24.8%	236.3%	430.9%	84.1%	31.3%
therof rental revenues	-	*0.4*	*16.8*	*74.1*	*123.2*	*146.3*
thereof revenues from sales	-	*5.3*	*2.0*	*28.0*	*64.8*	*100.7*
Change in inventories	-5.8	-3.1	-0.8	-23.7	-53.2	-83.4
Other operating income	1.6	2.2	0.2	25.9	1.2	1.5
IAS 40 fair value valuation	0.0	1.1	59.6	120.0	55.0	35.0
Total revenues	**3.4**	**5.8**	**78.2**	**224.4**	**191.1**	**200.0**
COGS	-0.7	-1.4	-10.2	-40.6	-50.1	-52.8
in % of sales	-9.5%	-23.6%	-53.2%	-39.7%	-26.6%	-21.4%
Gross income	**2.6**	**4.5**	**68.0**	**183.8**	**141.0**	**147.2**
in % of sales	34.8%	78.6%	353.5%	180.0%	75.0%	59.6%
Personnel expenses	-1.0	-0.9	-1.2	-3.5	-4.2	-4.6
in % of sales	-12.9%	-16.5%	-6.2%	-3.5%	-2.2%	-1.9%
Other operating expenses	-1.1	-1.1	-2.4	-7.4	-6.2	-7.3
in % of sales	-14.8%	-19.8%	-12.5%	-7.3%	-3.3%	-3.0%
Results from at-equity	-0.3	-1.3	6.6	0.0	0.0	0.0
in % of sales	-3.5%	-23.2%	34.1%	0.0%	0.0%	0.0%
Expenses of IAS 40 valuation	0.0	-0.1	-0.1	0.0	0.0	0.0
in % of sales	0.0%	-1.8%	-0.4%	0.0%	0.0%	0.0%
EBITDA	**0.3**	**1.0**	**70.9**	**172.9**	**130.6**	**135.3**
in % of sales	3.6%	17.3%	368.6%	169.3%	69.5%	54.8%
Depreciation and amortisation	0.0	0.0	0.0	0.0	0.0	0.0
in % of sales	-0.1%	-0.2%	-0.1%	0.0%	0.0%	0.0%
EBIT	**0.3**	**1.0**	**70.9**	**172.8**	**130.6**	**135.3**
in % of sales	3.6%	17.1%	368.6%	169.2%	69.5%	54.8%
Financial result	-0.1	0.0	-7.9	-33.0	-45.3	-52.1
EBT	**0.2**	**0.9**	**63.0**	**139.9**	**85.3**	**83.2**
in % of sales	2.1%	16.6%	327.6%	137.0%	45.4%	33.7%
Taxes	-0.1	-0.5	-16.1	-16.2	-17.3	-19.7
as % of EBT	-54.4%	-52.5%	-25.6%	-11.6%	-20.3%	-23.7%
Net income including minorities	**0.1**	**0.5**	**46.9**	**123.7**	**68.0**	**63.5**
Minority interests	0.0	0.0	-8.1	-5.1	0.0	0.0
Net income attributable to shareholders	**0.1**	**0.4**	**38.8**	**118.6**	**68.0**	**63.5**
as % of EBT	1.6%	6.9%	201.5%	116.1%	36.1%	25.7%
Shares outstanding (in millions)	15.0	15.0	15.1	23.4	31.6	31.6
Earnings per share (EUR)	**0.01**	**0.03**	**2.57**	**5.07**	**2.15**	**2.01**
Diluted numbers of shares (in millions)	15.0	15.0	17.4	39.4	39.4	39.4
Earnings per share (EUR), diluted	**0.01**	**0.03**	**2.23**	**3.01**	**1.73**	**1.61**
FFO I per share (EUR)	**0.02**	**0.05**	**-1.27**	**0.42**	**0.71**	**0.96**
FFO I yield	0.3%	0.6%	-15.0%	5.0%	8.4%	11.4%

Source: Company Data, Oddo Seydler Bank AG

IFRS EURm	2011	2012	2013	2014e	2015e	2016e
Assets						
Noncurrent assets	**7.3**	**20.6**	**423.1**	**1,236.3**	**1,562.0**	**1,766.2**
as % of total assets	21.1%	47.1%	91.8%	92.3%	96.2%	96.7%
Intangible assets	0.0	0.0	0.0	29.2	29.2	29.2
PPE	0.0	0.0	0.0	0.4	0.4	0.4
Financial assets available for sale	0.0	0.0	0.0	0.0	0.0	0.0
Loans to participations	2.6	1.6	1.1	1.1	1.1	1.1
Interest in associated companies	3.8	3.7	3.5	9.5	9.5	9.5
Investment properties	0.6	14.5	417.9	1,195.5	1,521.2	1,725.4
Deferred tax assets	0.4	0.9	0.6	0.6	0.6	0.6
Current assets	**27.4**	**23.1**	**37.8**	**103.1**	**61.4**	**60.3**
as % of total assets	78.9%	52.9%	8.2%	7.7%	3.8%	3.3%
Inventories	22.0	19.6	18.8	71.9	43.1	34.5
Accounts receivables	0.6	2.2	3.4	3.4	3.4	3.4
Deferred income taxes	0.0	0.0	0.0	0.0	0.0	0.0
Other receivables and other assets	0.2	0.3	9.7	9.7	9.7	9.7
Cash and cash equivalents	4.5	1.1	5.9	18.1	5.1	12.7
Total Assets	**34.7**	**43.8**	**460.9**	**1,339.4**	**1,623.4**	**1,826.5**
Total equity and liabilities						
Total equity	**26.1**	**26.4**	**86.9**	**315.7**	**383.6**	**447.1**
as % of total equity and liabilities	75.3%	60.4%	18.9%	23.6%	23.6%	24.5%
Capital stock	15.0	15.0	16.5	31.6	31.6	31.6
Own shares	-0.1	-0.8	0.0	0.0	0.0	0.0
Capital reserve	7.7	8.3	13.1	97.9	97.9	97.9
Retained earnings	3.5	3.9	42.7	166.4	234.3	297.8
Minorities	0.0	0.1	14.6	19.7	19.7	19.7
Noncurrent liabilities	**4.7**	**10.6**	**340.9**	**945.1**	**1,147.4**	**1,274.1**
as % of total equity and liabilities	13.4%	24.1%	74.0%	70.6%	70.7%	69.8%
Pension provision	0.8	0.8	0.7	3.2	3.2	3.2
Other liabilities	0.1	0.1	0.1	1.4	1.5	1.7
Financial liabilities	3.8	9.3	323.2	905.4	1,099.3	1,220.7
Deferred tax liabilities	0.0	0.4	15.6	33.6	41.8	47.1
Current liabilities	**3.9**	**6.8**	**33.0**	**78.6**	**92.3**	**105.3**
as % of total equity and liabilities	11.3%	15.4%	7.2%	5.9%	5.7%	5.8%
Other provisions	1.6	0.2	0.2	3.1	3.4	3.8
Income tax payables	0.0	0.4	0.4	2.1	2.1	2.1
Financial liabilities	1.1	5.0	3.7	28.0	34.0	37.8
Trade accounts payables	0.4	0.7	6.0	6.0	6.0	6.0
Other current liabilities	0.8	0.5	20.4	37.1	44.5	53.4
Total equity and liabilities	**34.7**	**43.8**	**460.9**	**1,339.4**	**1,623.4**	**1,826.5**

Source: Company Data, Oddo Seydler Bank AG

IFRS EURm	2011	2012	2013	2014e	2015e	2016e
EBIT	0.3	1.0	70.9	172.8	130.6	135.3
Depreciation and amortisation	0.0	0.0	0.0	0.0	0.0	0.0
IAS 40 fair value valuation	0.0	0.0	-58.6	-145.9	-55.0	-35.0
Other non-cash items	-0.1	-1.6	0.0	5.1	0.0	0.0
Change in long term provisions	-0.1	-0.1	-0.2	2.4	0.0	0.0
Change in inventories, trade receivables & other assets	5.4	1.3	-0.2	-53.1	28.8	8.6
Change in trade payables and other liabilities	-0.1	0.1	-1.0	22.6	7.9	9.4
Interest income	0.0	0.0	0.0	2.0	5.6	2.0
Interest expenses	-0.3	-0.4	0.0	-35.0	-50.9	-54.1
Paid taxes	0.0	-0.3	0.0	1.8	-9.1	-14.4
Cash flow from operating activities	**5.1**	**0.1**	**10.9**	**-27.1**	**57.9**	**51.7**
Change in fixed assets	0.0	0.0	0.0	-0.4	0.0	0.0
Investment in intangible assets	0.0	0.0	0.0	-29.2	0.0	0.0
Change in financial assets and receivables	0.3	-1.2	-90.1	-6.0	0.0	0.0
Investment in financial assets	-0.4	0.0	0.0	0.0	0.0	0.0
Expenses for acquisition & modernisation of inv. prop.	0.0	-2.3	-0.4	-631.7	-270.7	-169.2
Cash flow from investing activities	**0.3**	**-3.5**	**-94.2**	**-667.3**	**-270.7**	**-169.2**
Change in equity, non cash items	0.0	0.0	0.0	0.0	0.0	0.0
Change in group of consolidated companies	0.0	0.0	0.0	0.0	0.0	0.0
Outflows for the purchase of treasury stock	0.0	-1.0	0.0	0.0	0.0	0.0
Net borrowings/retirements of financial debt	-1.4	1.1	31.1	634.9	199.9	125.1
Cash inflow from capital increase	0.0	0.0	3.5	21.5	0.0	0.0
Cash flow from financing activities	**-1.4**	**0.1**	**88.1**	**706.6**	**199.9**	**125.1**
Total change in cash and cash equivalents	**4.0**	**-3.4**	**4.8**	**12.2**	**-13.0**	**7.6**
Currency effects	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
Cash and cash equivalents at the start of the period	0.5	4.5	1.1	5.9	18.1	5.1
Cash and cash equivalents at the end of the period	**4.5**	**1.1**	**5.9**	**18.1**	**5.1**	**12.7**

Source: Company Data, Oddo Seydler Bank AG

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Recommendation System:
Oddo Seydler uses a 3-level absolute share rating system. The ratings pertain to a time horizon of up to 12 months:

BUY: The expected performance of the share price is above +10%.
HOLD: The expected performance of the share price is between 0% and +10%.
SELL: The expected performance of the share price is below 0%.

This rating system is only a guideline. Therefore, deviations from this system may apply.

Recommendation history over the last 12 months for the company analysed in this report:

Date	Recommendation	Price at change date	Price target
23 January 2014	BUY	EUR 8.47	EUR 12.00
21 November 2014	BUY	EUR 7.27	EUR 12.00
24 October 2014	BUY	EUR 8.00	EUR 12.00
08 September 2014	BUY	EUR 8.66	EUR 12.00
14 July 2014	BUY	EUR 6.22	EUR 10.00

The following valuation methods are used when valuing companies: Multiplier models (price/earnings, price/cash flow, price/book value, EV/Sales, EV/EBIT, EV/EBITA, EV/EBITDA), peer group comparisons, historical valuation approaches, discounting models (DCF, DDM), break-up value approaches or asset valuation approaches. The valuation models are dependent upon macroeconomic measures such as interest, currencies, raw materials and assumptions concerning the economy. In addition, market moods influence the valuation of companies.

The figures taken from the income statement, the cash flow statement and the balance sheet upon which the evaluation of companies is based are estimates referring to given dates and therefore subject to risks. These may change at any time without prior notice.

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