

### Scope assigns BB- rating to Adler Real Estate AG – unchanged from previously issued update

The BB- Corporate Issuer Credit Rating (CICR) for Adler Real Estate AG (ADLER) is driven primarily by an adequate business risk profile, which benefits from the size achieved in the fragmented and low-risk German residential real estate industry, and is characterised by a fairly diversified portfolio in regard to geographies and tenants.

Negative rating factors include ADLER's relatively high leverage and low free cash flows, which substantially increase the dependency on external refinancing.

#### KEY RATING DRIVERS

**Low industry risk.** ADLER benefits from currently stable tenant demand resulting from its exposure to the less cyclical residential real estate industry in Germany. Scope sees the potential for tenant demand to grow further in 2016 and 2017, supported by the influx of refugees in 2015 and 2016 and by a robust German economy bolstered through continuously positive market conditions. Together with the growing investor demand, as well as the constantly low interest rates, the prices of residential real estate in Germany have increased by 30% since 2013, which Scope believes will continue in 2016, positively influencing the company's leverage.

**Medium-sized real estate company, dependent on external financing.** With EUR 3bn of assets, ADLER is a medium-sized property company in the fragmented European real estate industry. ADLER doubled its total assets in 2015, which was financed foremost by debt, allowing it to reach a size that should further support access to external financing. The company depends on the latter as a consequence of its comparatively weak cash flows, as measured by funds from operations (FFO) or free cash flows (FCF) in 2015 of EUR 17m and negative EUR 59m respectively. However, both should improve going forward with the company's focus set on consolidation and organic growth instead of further dynamic growth.

**Good geographical diversification, but risk of declining demand.** ADLER's portfolio is well balanced across Germany, with the top five markets representing 85% of its total portfolio. However, a significant share of ADLER's markets show weak fundamentals, with market declines expected going forward. ADLER is therefore exposed to markets in which customers have high price elasticity, thus the potential for rent increases is rather limited. The downside risk for ADLER should be somewhat mitigated by its average rent per square metre – lower compared to market rents in those regions.

**Assets mainly in 'B' and 'C' cities; some capex also required.** ADLER's current property portfolio has assets mainly located in 'B' and 'C' locations, such as Wilhelmshaven and Duisburg, which tend to be less liquid than properties in 'A' locations. This increases the risk of potential price haircuts in a distressed sales scenario. In addition, some of the properties need capex as the portfolio's average

age is above 50 years. As a result ADLER aims to invest EUR 15m in the next 18 months to improve lettability of the 1,500 apartments. Scope believes this supports the company's targeted growth in occupancy from an adequate 89% at Q1 2016 to above 90% by YE 2016.

**Improving profitability, with EBITDA margin of 42% in 2015.** EBITDA margin, excluding sales activity, stood at 42% in 2015, up from 20% in 2014. Though driven by the portfolio's strong growth during the year, it is still weaker than that of peers, which have margins of more than 50% excluding sales. However, with reduced portfolio growth rates, the overall trend of improving profitability should remain stable in the coming years, with adjusted EBITDA margins targeted between 45% and 50%. The increase in profitability should benefit from an expected increase in (i) occupancy and (ii) economies of scale, both reducing operational expenses that cannot be passed to tenants.

**Weak FFO fixed-charge cover of 1.2x expected to remain above 1.0x going forward.** ADLER's FFO fixed-charge cover in 2015 is weak at 1.2x, but Scope expects this to increase above 1.5x in the next two years. This should be particularly driven by an expected (i) further reduction in the weighted average cost of debt, which stood at 3.99% at Q1 2016, down from 4.70% at YE 2014, and (ii) the portfolio optimisation as described above.

**Relatively high leverage set to continue.** Due to ADLER's aggressive growth strategy loan-to-value ratio (LTV) jumped to 72% in 2013. High leverage continued in 2014 and 2015 with a small improvement of LTV by YE 2015 down to 70%. By YE 2017 Scope expects this to fall under 65%, due to additional valuation uplifts thanks to positive German market conditions, a further shift of refinancing with capital market equity, positive free cash flows and the expected streamlining of the portfolio.

## LIQUIDITY AND DEBT STRUCTURE

ADLER's expected liquidity ratio stood above 100% as debt due in August 2016, obtained by acquiring 22.4% of shares in Conwert Immobilien Invest SE (Conwert) was successfully financed in July 2016. In detail, ADLER has now to extend or repay EUR 48m of debt in the next 12 months, which represents around 2% of its total debt. Repayment should be covered by EUR 40m-50m of expected FCF for the same period and an unrestricted cash position of EUR 59m at Q1 2016.

## OUTLOOK

The Outlook for ADLER is Stable and incorporates Scope's expectation of a gradual reduction of debt as measured by LTV and improving profitability in the medium term.

A negative rating action would be considered if the company's debt protection, as measured by FFO fixed charge, were to decrease below 1.0x from about 1.2x currently or if the company's access to external financing weakened. Scope highlights that in the short to medium term, uncertainties over ADLER's future policy on mergers and acquisitions could also put downward pressure on the assigned rating.

A positive rating action is tied to a meaningful improvement in the company's financial risk profile, i.e. if FFO fixed charge increases above 1.7x and LTV reduces below 60%, both on a continuing basis.

# REGULATORY AND LEGAL DISCLOSURES

## Important information

Information pursuant to Regulation (EC) No 1060/2009 on credit rating agencies, as amended by Regulations (EU) No. 513/2011 and (EU) No. 462/2013

## Responsibility

The party responsible for the dissemination of the financial analysis is Scope Ratings AG, Berlin, District Court for Berlin (Charlottenburg) HRB 161306 B, Executive Board: Torsten Hinrichs (CEO), Dr. Stefan Bund, Dr. Sven Janssen.

The rating analysis has been prepared by Philipp Wass, Lead Analyst  
Responsible for approving the rating: Olaf Tölke, Committee Chair

## Rating History - ADLER Real Estate AG (Date | Rating action | Rating)

25 July 2016 | Initial Rating | BB- | Stable

The rating outlook indicates the most likely direction of the rating if the rating were to change within the next 12 to 18 months. A rating change is, however, not automatically ensured.

## Information on interests and conflicts of interest

The rating was prepared independently by Scope Ratings but for a fee based on a mandate of the rated entity.

As at the time of the analysis, neither Scope Ratings AG nor companies affiliated with it hold any interests in the rated entity or in companies directly or indirectly affiliated to it. Likewise, neither the rated entity nor companies directly or indirectly affiliated with it hold any interests in Scope Ratings AG or any companies affiliated to it. Neither the rating agency, the rating analysts who participated in this rating, nor any other persons who participated in the provision of the rating and/or its approval hold, either directly or indirectly, any shares in the rated entity or in third parties affiliated to it. Notwithstanding this, it is permitted for the above-mentioned persons to hold interests through shares in diversified undertakings for collective investment, including managed funds such as pension funds or life insurance companies, pursuant to EU Rating Regulation (EC) No 1060/2009. Neither Scope Ratings nor companies affiliated with it are involved in the brokering or distribution of capital investment products. In principle, there is a possibility that family relationships may exist between the personnel of Scope Ratings and that of the rated entity. However, no persons for whom a conflict of interests could exist due to family relationships or other close relationships will participate in the preparation or approval of a rating.

## Key sources of information for the rating

- Website of the rated entity
- Valuation reports
- Annual financial statements
- Annual reports/semi-annual reports of the rated entity
- Information provided on request
- Data provided by external data providers
- External market reports
- Press reports / other public information
- Interview with the rated entity

Scope Ratings considers the quality of the available information on the evaluated company to be satisfactory. Scope ensured as far as possible that the sources are reliable before drawing upon them, but did not verify each item of information specified in the sources independently.

## Examination of the rating by the rated entity prior to publication

Prior to publication, the rated entity was given the opportunity to examine the rating and the rating drivers, including the principal grounds on which the credit rating or rating outlook is based. The rated entity was subsequently provided with at least one full working day, to point out any factual errors, or to appeal the rating decision and deliver additional material information. Following that examination, the rating was not modified.

## Methodology

The methodologies applicable for this rating (Corporate Rating Methodology, Rating Methodology - European Real Estate Corporates) are available on [www.scooperatings.com](http://www.scooperatings.com). The historical default rates of Scope Ratings can be viewed on the central platform (CEREP) of the European Securities and Markets Authority (ESMA): <http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml>. A comprehensive clarification of Scope's default rating, definitions of rating notations and further information on the analysis components of a rating can be found in the documents on methodologies on the rating agency's website.

## Conditions of use / exclusion of liability

© 2016 Scope Corporation AG and all its subsidiaries including Scope Ratings AG, Scope Analysis GmbH, Scope Investor Services GmbH (collectively, Scope). All rights reserved. The information and data supporting Scope's ratings, rating reports, rating opinions and related research and credit opinions originate from sources Scope considers to be reliable and accurate. Scope cannot, however, independently verify the reliability and accuracy of the information and data. Scope's ratings, rating reports, rating opinions, or related research and credit opinions are provided "as is" without any representation or warranty of any kind. In no circumstance shall Scope or its directors, officers, employees and other representatives be liable to any party for any direct, indirect, incidental or otherwise damages, expenses of any kind, or losses arising from any use of Scope's ratings, rating reports, rating opinions, related research or credit opinions. Ratings and other related credit opinions issued by Scope are, and have to be viewed by any party, as opinions on relative credit risk and not as a statement of fact or recommendation to purchase, hold or sell securities. Past performance does not necessarily predict future results. Any report issued by Scope is not a prospectus or similar document related to a debt security or issuing entity. Scope issues credit ratings and related research and opinions with the understanding and expectation that parties using them will assess independently the suitability of each security for investment or transaction purposes. Scope's credit ratings address relative credit risk, they do not address other risks such as market, liquidity, legal, or volatility. The information and data included herein is protected by copyright and other laws. To reproduce, transmit, transfer, disseminate, translate, resell, or store for subsequent use for any such purpose the information and data contained herein, contact Scope Ratings AG at Lennéstraße 5 D-10785 Berlin.

## Rating issued by

Scope Ratings AG, Lennéstrasse 5, 10785 Berlin