

Adler Real Estate AG (ADL GR)

Buy: Faster-than-expected debt restructuring

- ▶ Cash offer by Vonovia (VNA GR) added EUR422m to Adler's pocket for its 26% stake in Conwert (CWI AV)
- ▶ Cost saving on indicated debt repayment boosts 2017e FFO – we are looking for 65.4% yoy growth in FFO
- ▶ Reiterate Buy, TP at EUR21 (from EUR20.90)

Vonovia's cash settlement (18 Jan 2017) for Conwert shares more than welcome. At the time of the take-over offer to all Conwert (CWI AV) shareholders by Vonovia (VNA GR), the cash offer which is mandatory under the Austrian law looked unattractive but became increasingly attractive with the sector share weakness in Q3/Q416. ADL as main shareholder of Conwert also used the cash settlement for its 26% stake, which added a total of EUR422m to Adler's pocket (18 January 2017). This now gives ADL the liquidity to optimize its debt structure, which we see as a key discount driver (stock currently trades at 21% below spot NAVp/s). Adler might target particularly the higher yielding outstanding bonds with a call options (eg. 2014/19 bond, EUR130m, coupon of 6%) and will likely improve its 2017 FFO by cEUR10.5m with the repayment (+42% on top of 2016 FFO target). The repayment of outstanding bonds and the margin loan (cEUR200m to fund the Conwert shares) will lead to a reduced LTV (towards 50%). The total average CoD might decline substantially in 2017 which gives ADL increasingly a competitive profile.

Insourcing of property management could be completed by end of 2017: the termination of contracts with external service providers will likely be completed by end-2017 and will improve substantially the corporate governance in our view and the operational efficiency long term. However the insourcing will go along with rising personnel costs (but ADL will save the 19% VAT) but it will then have full control which might lead to strong rent growth and lower vacancy rates mid to long term.

Secondary assets showing decent yield compression going forward in our view: With the significant increase in property prices in the core metropolitan regions in Germany, we expect the dynamic to spread to the fringe and regional towns. Yield compression is lagging behind the cities /city centres but we see increasing demand due to the substantial yield difference. Additionally we see supporting demographics with respect to migration changes towards the regional towns with good transport connections.

2017/18 FFO outlook looks strong: ADL has FFO guidance for 2016 with at least EUR25m FFO. Including the EUR10.5m FFO contribution from the interest costs savings on the back of the aforementioned debt repayment plus further operational improvement, we expect the FFO could go up to cEUR43.3m (+65.4% yoy) (old: HSBCe at EUR33.5m for 2017e). Thus the stock trades at an inexpensive 15.5x FFO for 2017e and 13.5x for 2018e. Based on our slightly revised EPRA NAV estimate for 2017e, the stock trades at a hefty discount of 32.5% (cheapest stock within the German residential coverage based on P/NAV relation).

EQUITIES REAL ESTATE

Germany



MAINTAIN BUY

TARGET PRICE (EUR)

21.00

PREVIOUS TARGET (EUR)

20.90

SHARE PRICE (EUR)

13.84

(as of 20 Jan 2017)

UPSIDE/DOWNSIDE

+51.7%

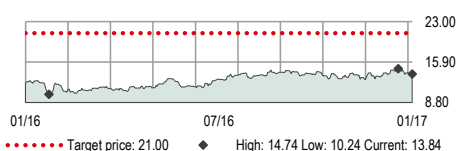
MARKET DATA

Market cap (EURm)	660	Free float	47%
Market cap (USDm)	705	BBG	ADL GR
3m ADTV (USDm)	1	RIC	ADLG.DE

FINANCIALS AND RATIOS (EUR)

Year to	12/2015a	12/2016e	12/2017e	12/2018e
HSBC EPS	0.74	0.99	1.22	1.53
HSBC EPS (prev)	-	0.06	0.40	0.40
Change (%)	-	1,629	206	279
Consensus EPS	1.95	2.39	1.67	1.80
PE (x)	18.7	14.0	11.3	9.1
Dividend yield (%)	0.0	0.0	0.0	1.1
Price to NAV (adj)	0.8	0.7	0.7	0.6
Acct'g prof rtn (%)	-1.5	-0.2	0.1	0.8

52-WEEK PRICE (EUR)



Source: Thomson Reuters IBES, HSBC estimates

Thomas Martin*

Analyst
HSBC Trinkaus & Burkhardt AG
thomas.martin@hsbc.de
+49 211 910 3276

Stephen Bramley-Jackson*

Analyst
HSBC Bank plc
stephen.bramley-jackson@hsbcib.com
+44 20 7992 3102

Stéphanie Dossmann*

Analyst
HSBC Bank plc, Paris branch
stephanie.dossmann@hsbc.com
+33 1 5652 4301

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Financials & valuation: Adler Real Estate AG

Buy

Financial statements

Year to	12/2015a	12/2016e	12/2017e	12/2018e
Profit & loss summary (EURm)				
Revenue	217	264	272	283
EBITDA	119	129	138	143
Depreciation & amortisation	0	-1	-2	-2
Operating profit/EBIT	119	128	136	141
Net interest	-82	-78	-75	-65
PBT	95	205	186	202
HSBC PBT	36	50	61	77
Taxation	-17	-65	-50	-51
Net profit	78	139	136	150
HSBC net profit	34	47	58	73

Cash flow summary (EURm)

Cash flow from operations	38	40	71	67
Capex	-25	-28	-30	-32
FCF enterprise	77	35	58	60
Cash flow from investment	-240	-98	250	-57
Dividends	0	0	0	-7
Change in net debt	1,146	43	-321	1
FCF equity	-5	-43	-17	-5

Balance sheet summary (EURm)

Tangible fixed assets	2,270	2,518	2,668	2,846
Current assets	317	363	509	441
Cash & others	50	95	95	95
Total assets	3,076	3,350	3,201	3,321
Gross debt	2,228	2,316	1,996	1,996
Net debt	2,179	2,221	1,901	1,901
Shareholders' funds	719	868	1,022	1,165
Invested capital	2,597	2,942	3,207	3,317

Ratio, growth and per share analysis

Year to	12/2015a	12/2016e	12/2017e	12/2018e
Y-o-y % change				
Revenue	158.3	22.0	3.0	3.9
EBITDA	212.5	8.4	7.5	3.6
EBIT	212.5	7.4	6.9	3.7
PBT	-27.6	115.8	-8.9	8.3
HSBC EPS		33.3	23.7	25.2

Ratios (%)

Revenue/IC (x)	0.1	0.1	0.1	0.1
ROIC	4.9	3.9	3.8	3.7
ROE	6.8	5.9	6.2	6.7
ROA	-1.5	-0.2	0.1	0.8
EBITDA margin	54.8	48.7	50.8	50.6
Operating profit margin	54.8	48.2	50.1	49.9
EBITDA/net interest (x)	1.5	1.7	1.8	2.2
Net debt/equity	280.1	239.8	175.9	159.8
Net debt/EBITDA (x)	18.3	17.3	13.7	13.3
CF from operations/net debt	1.7	1.8	3.7	3.5

Per share data (EUR)

EPS Rep (diluted)	1.70	2.92	2.86	3.15
HSBC EPS	0.74	0.99	1.22	1.53
DPS	0.00	0.00	0.00	0.15
NAV (Book Value)	15.61	18.19	21.43	24.41
NAV (adjusted)	18.31	18.56	20.44	23.10

Valuation data

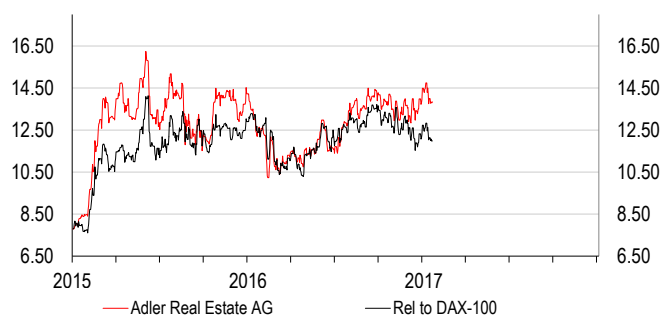
Year to	12/2015a	12/2016e	12/2017e	12/2018e
Price to NAV (BV)	0.9	0.8	0.6	0.6
Price to NAV (adj)	0.8	0.7	0.7	0.6
PE*	18.7	14.0	11.3	9.1
FFO yield (%)	-0.7	-6.4	-2.5	-0.7
Dividend yield (%)	0.0	0.0	0.0	1.1

* Based on HSBC EPS (diluted)

Issuer information

Share price (EUR)	13.84	Free float	47%
Target price (EUR)	21.00	Sector	Real Estate
Reuters (Equity)	ADLG.DE	Country	Germany
Bloomberg (Equity)	ADL GR	Analyst	Thomas Martin
Market cap (USDm)	705	Contact	+49 211 910 3276

Price relative



Source: HSBC

Note: Priced at close of 20 Jan 2017

Estimate changes 2016-2018e

EURm		2016e	2017e	2018e
FFO 1	Old	25.8	33.6	38.3
	New	26.2	43.3	47.4
	Diff in %	2%	29%	24%
EPRA NAV (EUR)	Old	16.10	17.81	19.34
	New	18.56	20.44	23.10
	Diff in %	15%	15%	19%
FFO yield		4.0%	6.6%	7.2%
NAV discount (%)		-25.7%	-32.5%	-40.3%

Source: HSBC estimates

As explained on the front page, thanks to the gained liquidity from the cash settlement by Vonovia for Adler's stake in Conwert (26% stake), management is targeting the repayment of some outstanding high yielding bonds to optimize the debt structure (lowering the average CoD and the LTV). The repayment might contribute cEUR10.5m cost savings to the running FFO generation. In total we are looking for a FFO of cEUR43.3m for 2017e which equates to a strong increase by c65% based on our 2016e FFO. For 2016e we are looking for a FFO of EUR26.2m, a touch above the minimum target of EUR25m. The debt repayment leads to a competitive structure and cash flow profile, in our view. We are expecting that some concrete information on the debt repayment plan will be disclosed with the 2016 FY earnings release. Based on our 2017e and 2018e FFO estimates, the stock trades at an attractive 18.3-16.8x multiple. This is still a touch higher valued than some larger peers like LEG Immobilien and Vonovia; however Adler is not at the end of its efficiency path. The insourcing of the property management and the further debt restructuring supported by an ongoing low interest rate environment will further positively affect the cash flow generation, we believe, in addition to an unchanged positive trend in the underlying rental market. Considering Adler Real Estate will be able to bring some key parameters (CoD, vacancy rate, cost per managed housing unit, etc.) more in line with the larger peers which is our expectation, we see the potential for a comparable FFO margin (FFO1/net cold rent) of around 45-50%. Given a 9m16 reported net cold rent of EUR125.7m which equates to around EUR170m net cold on an annualized basis, there is potential to grow the business to cEUR85m FFO run rate. Based on such a long term scenario the stock would trade at 9.3x FFO multiple (implied 10.6% FFO yield). Our EPS changes significantly due to changes in deferred tax (on portfolio valuation gains), non-cash financial items and portfolio valuation movement (forecasting IFRS EPS is challenging due to different non-cash items that are difficult to predict, thus we focus on recurring cash flow measured by FFO).

Valuation and risks (reiterate Buy, TP at EUR21)

We reiterate our Buy rating on Adler Real Estate, with a new fair value target price of EUR21 (from EUR20.9). Our target price is derived from a weighted blend of DCF (75%) and NAV (25%). Due to still higher-than-sector average leverage of the company, we apply unchanged a company-specific discount of 10% to our 24-month rolling NAV. Our adjusted NAV amounts to EUR21.4 (from EUR21.1) mainly due to model roll-over effect. Our DCF value stands at EUR20.9 (from EUR21.8). Our key DCF assumptions are: beta of 1.1 (unchanged), CoE at 9.1% (from 9.65%), RFR 2.5% (from 3%), ERP at 6% (unchanged). Our WACC changed mainly on a changed weighting of debt (to 50% from 60%) and equity (to 50% from 40%). As a result the WACC increased to 5.9% from 5.2%. The average of the two values gives us a fair value target price of (rounded) EUR21 which implies upside of 52.2% and we reiterate our Buy.

Downside risks: 1) Capital raises at the current share price level would be highly dilutive for the EPRA NAV. 2) Higher-than-expected personnel and admin costs due insourcing the property management team. 3) Fast rising interest rates.

Disclosure appendix

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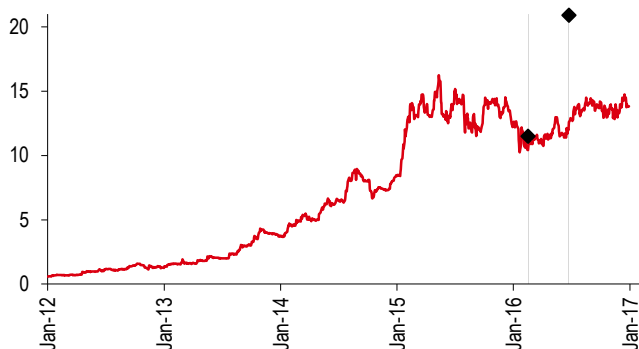
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Hold	41%	(27% of these provided with Investment Banking Services)
Sell	15%	(20% of these provided with Investment Banking Services)

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Share price and rating changes for long-term investment opportunities**Adler Real Estate AG (ADLG.DE) share price performance EUR Vs HSBC rating history**

Source: HSBC

Rating & target price history

From	To	Date	Analyst
N/A	Hold	09 Mar 2016	Thomas Martin
Hold	Buy	15 Jul 2016	Thomas Martin
Target price	Value	Date	Analyst
Price 1	11.50	09 Mar 2016	Thomas Martin
Price 2	20.90	15 Jul 2016	Thomas Martin

Source: HSBC

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Company	Ticker	Recent price	Price date	Disclosure
ADLER REAL ESTATE AG	ADLG.DE	13.84	20 Jan 2017	6, 7, 11

Source: HSBC

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Issuer of report

HSBC Trinkaus & Burkhardt AG
Königsallee 21/23
D-40212 Düsseldorf
Germany
Telephone: +49 211 910-0
Fax: +49 211 910-98091
Website: www.research.hsbc.com

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