EDISON

Scale research report - Update

Consus Real Estate

Real estate

30 April 2019

Ready for take-off

In FY18 Consus completed its transformation into the largest listed pure-play residential real estate developer in the top nine cities in Germany and will now focus on optimising its operations. With a relatively young portfolio representing €9.6bn of gross development value (GDV), Consus expects a significant increase in earnings as key projects progress beyond the planning stage. The strong forecast consensus earnings growth in 2019–2021 should be further assisted by improving rental income multiples at which projects are sold and ongoing digitalisation. This is illustrated both in the management guidance and current market consensus.

Financials: Mid-term guidance confirmed

Consus reported adjusted EBITDA (pre-purchase price allocation (PPA) and excluding one-offs) of €204m in FY18, which on a pro forma basis reached €253m. Management confirmed it is targeting adjusted EBITDA of €450m in 2020, which implies significant operational improvement in the upcoming periods. According to management, earnings momentum should be an important contributor to leverage moderation, with the company's targeted mid-term net debt to adjusted EBITDA multiple of c 3.0x (vs 8.3x in pro forma FY18). Moreover, debt refinancing measures should provide material benefits for interest expense from FY20.

Successful forward-sale strategy boosts cash flows

At end-2018, the company had already forward sold projects amounting to €2.5bn GDV, which represents 24% of the entire portfolio. This includes letters of intent (LOI) already signed or under negotiation. It translated into €356m prepayments received, which resulted in strong operating cash flow of €132m. In Q119, Consus completed three further forward sales with a GDV of €170m and is negotiating another two LOIs. Two transactions were done to rebalance the portfolio and reduce the higher-cost debt.

Valuation: Discount implied by bottom-line growth

The superior earnings growth prospects implied by the current Refinitiv consensus translate into an FY19e P/E premium to peers of 34%, changing to a c 35% and 45% discount based on FY20 and FY21 estimates, respectively. Based on the EV/EBITDA ratio for FY20 and FY21, Consus trades broadly in line with its peers. The difference against P/E ratio may be associated with Consus's higher leverage than the market average.

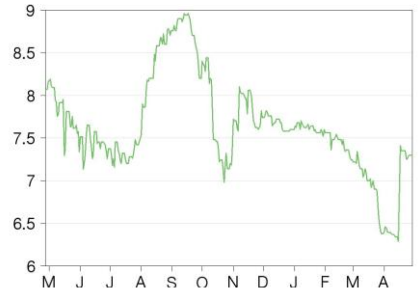
Consensus estimates

Year end	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/18	467.6	(11.5)	0.02	0.0	N/A	N/A
12/19e	1,077.2	104.4	0.53	0.0	13.9	N/A
12/20e	1,915.5	250.3	1.22	0.0	6.0	N/A
12/21e	1,867.8	342.7	1.64	0.0	4.5	N/A

Source: Consus accounts, Refinitiv consensus as at 24 April 2019

Price	€7.35
Market cap	€989m

Share price graph



Share details

Code	CC1
Listing	Deutsche Börse Scale
Shares in issue	134.5m
Last reported net debt at 31 December 2018	€2,104m

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, the company's portfolio consists of 64 projects with a gross development value of €9.6bn.

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.
- High degree of financial leverage.
- Dependency on institutional clients.

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Financials: Earnings reflect early-stage portfolio

As FY18 was a period of transformation into a pure-play residential real estate developer, there are no reliable comparable data available for Consus. The transformation involved consolidation of CG Gruppe, the acquisition of SSN Group and the disposal of Consus's commercial portfolio. Consus recorded total revenue of €467.6m in FY18, with €445.1m from CG Gruppe and €16.7m from SSN Group, which represents one month of sales as full consolidation was effective from December 2018. EBITDA reached €107.9m, which translates into a 23.1% margin. This includes the impact of PPA and one-offs such as consulting and advisory fees related to the latest M&A activity. EBITDA adjusted for these charges amounted to €203.7m (43.6% margin).

However, the company reported a modest net loss of €0.3m. This is due to a combination of the relatively early stage of Consus's key projects (as its portfolio is still in ramp-up phase, see our comment below) and the company's high leverage level. Consus's total gross debt (including SSN Group) at end-December 2018 was €2,196m at an average rate of 8.1% (net debt was €2.1bn). Importantly, the management aims for significant lowering of interest expense, targeting up to 2pp average interest rate reduction. However, we understand that the refinancing benefits may not be visible until 2020. Until now, Consus's efforts to limit financing expenses resulted in a steady q-o-q decline of total debt excluding SSN Group. When we compare the total gross debt (excluding SSN Group) of €1.19bn with group equity at the end of FY18 of €1.16bn, we arrive at the equity ratio of 102%, which compares with 155% at end-June 2018 and 195% at end-December 2017. We believe the company's focus on deleveraging is illustrated by the appointment of Theo Gorens as chief risk officer. He is a risk-management, finance and financing specialist who previously served as a member of the executive board at SSN Group and has been on the extended management board at Consus since the end of 2018.

Consus has provided pro forma figures for FY18 that assume the above-mentioned group changes from 1 January 2018 (no comparable data provided). Pro forma sales reached €656m and adjusted EBITDA stood at €253m after removing €15.5m of one-off costs on advisory fees related to the above. As SSN Group holds even more expensive debt than CG Gruppe (11.3% vs 7.6% as of November 2018), the pro forma financial expense exceeded €200m, putting pre-tax loss and net loss at €45.9m and €24.3m respectively.

Exhibit 1: Financial highlights

€000s, unless otherwise stated	2018	2017	Pro forma 2018
Income from letting activities	32,796	7,691	29,659
Income from real estate inventory disposed of	163,515	-	163,515
Income from property development	408,461	-	443,830
Income from service, maintenance and management activities	10,199		18,565
Total income	**614,971**	**7,691**	**655,569**
Change in project related inventory	(147,352)	-	(31,464)
Overall performance	**467,619**	**7,691**	**624,104**
Other operating income	38,872	15,344	40,273
Operating expense	(398,591)	(18,337)	(508,907)
EBITDA (earnings before interest, taxes, depreciation and amortization)	**107,901**	**4,697**	**155,470**
Depreciation and amortization	(2,175)	-	(3,026)
EBIT (earnings before interest and taxes)	**105,726**	**4,697**	**152,444**
Financial income	4,620	445	11,467
Financial expenses	(121,834)	(7,864)	(209,783)
Share of profit or loss of associates accounted for using the equity method	-	(1,198)	
EBT (earnings before taxes)	**(11,488)**	**(3,920)**	**(45,872)**
Income tax expenses	11,192	(5,214)	21,617
Net income (earnings after taxes) from continued operations	**(296)**	**(9,134)**	**(24,255)**
Net income (earnings after taxes) from discontinued operations	1,464	1,188	
Consolidated net income	**1,168**	**(7,946)**	**(24,255)**

Source: Consus accounts, Edison Investment Research

Process enhancement through Diplan and new plant

Consus holds a portfolio of 64 projects with €9.6bn of GDV, up by €5.0bn vs end-2017, with €3.5bn attributable to the SSN Group acquisition. According to management guidance, GDV should remain stable throughout FY19. The portfolio is spread across the nine largest cities in Germany, with the largest markets by GDV Hamburg (20%), Stuttgart (18%), Leipzig (13%) and Frankfurt (13%). Even though c 10% of total GDV is located in smaller cities in the metropolitan areas of the larger cities, the company has no intention to visibly increase exposure to tier-two cities and will remain focused on its core markets. In terms of portfolio concentration, it is worth highlighting that Consus's largest project represents 10% of total GDV and the share of top 10 investments exceeds 50%. Importantly, two have already entered the construction stage, although the others are not expected to do so until 2020. This means the latter are yet to fully contribute to the company's earnings, as only a smaller part of total project EBITDA is recognised at forward-sale agreement signing. Overall, only 30% of Consus's portfolio by GDV is under construction, compared with the company's target of 40–50%.

Consus also has made steady progress in executing its forward sale strategy, which is expected to be 80% of the current GDV. At end-2018 €2.5bn had been already forward sold, including LOI under negotiations and pre-sold condominiums. A further €1.8bn was subject to outright sale at the pre-construction stage, which means more than half of the target has been already achieved. In Q119, Consus has already signed three forward sale agreements for a total GDV of €170m as well as one letter of intent. The company also sold a development project in Leipzig and is negotiating another six or seven material forward sales. Consus is benefitting from strong conditions in the German real estate market (see the market outlook section below), which allows the company to sign new agreements at better terms with respect to transaction multiples. Recent forward sale transactions were executed at multiples from 22.8x (Ernst-Reuter-Platz) to 25.9x (Cologneo I Corpus), which compares with the range of 20–25x targeted by the management.

Following the acquisition of the proptech company Diplan, Consus is looking to leverage its competitive advantages through extensive process digitalisation based on the building information model (BMI), which enhances the construction processes by means of a six-dimensional approach. Apart from 3D digital planning, it covers dimensions such as time, cost and the project lifecycle. BMI has been already implemented in 20 projects and will be introduced in all new ones. Together with the automated pre-fabrication plant in Erfurt (with the start of production scheduled for 2020), it should enable Consus to improve its construction processes. The plant's capacity will facilitate pre-fabricating wall and ceiling units for c 1,950 residential units per year. As per management estimations, the plant should allow Consus to save up to six months in the development timeline, reduce labour costs and produce wall units at a cost 30% below market prices.

Market benefits sustainable in the medium term

In the German real estate market, high demand combined with supply shortages drives up rents in the residential sector – 5% y-o-y increase in newly completed and 3.5% in existing homes. Strong demographic expansion increases the gap between housing demand and supply, despite the number of completions improving on a yearly basis (going from 188,000 in 2013 to 245,000 in 2018). Moreover, the divergence between residential projects approved and the actual number dwellings completed is still widening. There is no indication of conditions easing in the upcoming months as building land is becoming scarcer and capacity in the construction sector has been largely exhausted. As a result, social discontent is growing, leading to protests against housing policies becoming more frequent and intense. According to DZ Bank, the key issues include a lack of designated building land, the long-winded planning permission process, speculative investments in building plots and limited spare capacity in the construction sector. As a result, approvals for residential buildings in Germany increased by just 2.0% in 2018. It is important to note this was driven exclusively by multi-family housing (+4.7% y-o-y), whereas approvals for detached and semi-detached houses declined by 1.0% and 6.5% y-o-y respectively. Consus is exclusively engaged in multi-family housing projects.

The real estate market in Germany is less cyclical than in other European countries due to the large share of rental properties and conservative financing practices, which makes it more resilient to property bubbles. The residential rental price index by Destatis shows no decline in rental pricing over the last 20 years, even though the global economy clearly suffered from downturns in this period. We believe the current structural housing deficit in conjunction with the limited cyclicality of the German housing market offers an attractive risk-reward profile. Further growth potential comes from the relatively high affordability of German housing. The price-to-salary multiple stands at 5.0x compared to 9.8x in the UK, while the share of rent in disposable income stood at 20.6% compared to the EU average of 23.8% (data from 2017; 2018 not available yet). Consus believes its focus on affordable housing translates into a defensive profile as demand in this segment in the top nine cities in Germany is not expected to decline in the medium term.

Valuation: Extending discount to peers

The limited number of domestic comparators for Consus has guided us towards including international peers in our analysis. This is not a strict comparison and should only be taken as a guide. There are differences between the companies shown below, but the essential nature of business in that land is bought, developed and then resold with a profit remains the same. It is worth noting that although Consus is sensitive to the global macroeconomic climate, similar to the peers below, its forward sale agreements with staggered payments provide significant revenue and cash flow visibility over the medium term.

Both market consensus and management guidance imply significant bottom-line improvement, resulting in a reduction in the premium or a widening discount to peers in both the P/E and EV/EBITDA ratios for FY20e and FY21e in comparison to FY19e figures. At the P/E ratio level, the superior earnings growth prospects implied by the current Refinitiv consensus translate into the FY19e premium to peers of 34% changing to a 35% and 45% discount based on FY20e and FY21e numbers. Based on the EV/EBITDA ratios for FY20 and FY21, Consus trades broadly in line with its peers. The difference against P/E ratio may be associated with higher leverage level than market average. We note that the FY21 EV/EBITDA peer average does not include UBD Development data due to a lack of consensus estimates. Because the future valuation of the company is highly dependent on management's ability to deliver on the high growth expectations, the share price can be quite volatile (and has been in recent months).

Exhibit 2: Peer group comparison

Company	Market cap (mLCY)	P/E (x) 2019e	P/E (x) 2020e	P/E (x) 2021e	EV/EBITDA (x) 2019e	EV/EBITDA (x) 2020e	EV/EBITDA (x) 2021e
Instone Real Estate	799	15.7	11.9	6.7	10.3	8.2	5.1
Helma Eigenheimbau	156	9.1	8.0	7.4	11.1	10.0	9.3
UBM Development	304	7.8	6.9	n/a	11.5	11.2	n/a
Barrat Development	6,229	8.8	8.7	8.2	6.1	6.0	5.7
Taylor Wimpey	6,272	9.3	9.1	8.8	6.6	6.5	6.3
Bonava	13,892	11.5	10.8	9.7	11.5	11.0	10.1
Peer group average		**10.3**	**9.2**	**8.1**	**9.5**	**8.8**	**7.3**
Consus Real Estate	989	13.9	6.0	4.5	16.5	8.5	8.2
Premium/(discount) to peers		**34.0%**	**(34.7%)**	**(44.9%)**	**73.8%**	**(3.5%)**	**12.7%**

Source: Refinitiv consensus at 24 April 2019.

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