EDISON Scale research report - Update

Noratis

Real estate

14 May 2019

Price	€22.60
Market cap	€81m

Share price graph

Share details

Code	NUVA
Listing	Deutsche Börse Scale
Shares in issue	3.6m
Net debt at end December 2018	€141m

Business description

Noratis is a specialised asset developer, acquiring residential rental income-producing assets in secondary locations with optimisation potential. Investing in the asset base and improving the tenant mix creates value, which Noratis exploits during well-structured asset sales, either through individual or block sales.

Bull

- Strong experience operating in Germany's non-core areas.
- Focused investment and asset management approach to boost yields and asset values.
- Established business concept and strong partner network across Germany.

Bear

- Smaller company in a very competitive market.
- Low interest-rate environment may end.
- Dependence on attractive portfolio opportunities.

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Strong pipeline

Noratis remains firmly on a growth path. Accelerating development of its asset base (stock book value up by over half in H218 at €176m) has been followed by news that fundraising options for further expansion are under review. While this should underpin strong long-term prospects, a typical two-year lead time for asset value enhancement explains apparently measured guidance for 2019 (maintained EBIT on higher revenue). Timing was also a factor last year as H2 bias of high-margin asset sales drove a 30% rise in adjusted EBIT, more than making up for a first-half shortfall. A generous dividend policy is being maintained despite growth ambitions.

H218 delivers

As expected, the second half saw the majority of planned 2018 asset disposals (notably Frankfurt) and at a much superior y-o-y margin (gross profit 37% vs 29%). This was supplemented by a sharp increase in rental income as a result of higher levels of stock at the start of the period. Such buoyancy remedied H1 setbacks, driving a small rise in full-year adjusted EBIT and PBT (see Exhibit 2 on page 2) in line with guidance. This allowed a dividend of €1.30, given the company's policy of a c 50% payout (the reduction on 2017's €1.50 was due to the May 2018 capital increase).

Continuing to invest

Guidance is for EBIT and PBT to hold steady in 2019 on higher revenue as margins normalise from last year's high. This may seem at odds with the recent step-change in the asset base (book value up over 75% in 2018), fuelling growth prospects, but the lead time for investment projects can be at least two years. Management has newly reiterated its intention to remain a net buyer and is considering funding options. Net debt more than doubled in 2018 to €141m.

Valuation: Long-term appeal

Sitting between asset holder and developer makes for difficult comparison with listed peers but Noratis is at a notable discount to RCM Beteiligungs, which has a similar model (trailing P/E ratio of 23x). At 9x prospective P/E and with a P/BV (2018) ratio of 1.6x, the company offers an attractive yield (almost 6% prospective), backed by a positive outlook and dividend commitment.

Consensus estimates

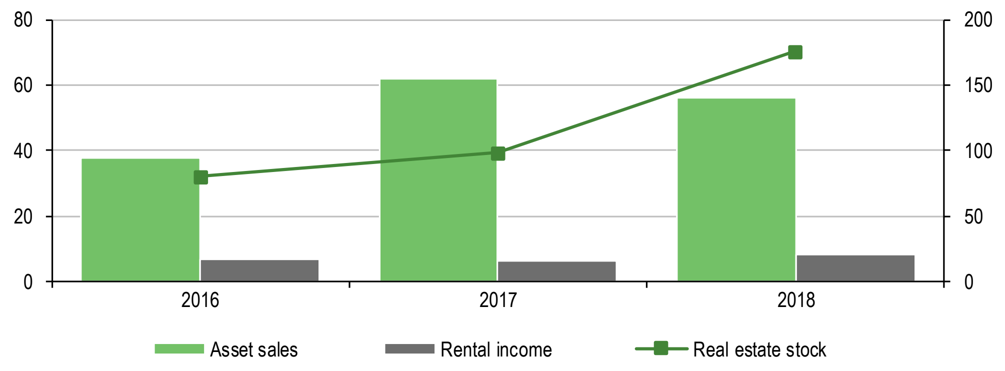
Year end	Revenue (€m)	EBIT (€m)	EPS*** (€)	DPS (€)	P/E (x)	Yield (%)
12/17	68.0	15.2*	3.0	1.5	7.5	6.6
12/18	56.1	15.6**	2.6	1.3	8.7	5.8
12/19e	73.4	16.3	2.5	1.3	9.0	5.8
12/20e	80.3	17.9	2.7	1.3	8.4	5.8

Source: Noratis accounts, Refinitiv. consensus estimates. Note: *After €1.5m IPO costs. **After €0.8m capital increase costs. ***Based on 2.9m shares in 2017 and 3.6m shares in 2018.

Review of 2018 results

The Noratis model of upgrading and selling allows financial periods to be seen as either acquisition or disposal years. Exhibit 1 shows 2018 to have been markedly the former, predominantly because of investment (expansion was promised at its May fundraising) but also thanks to a reduction in sale proceeds. Year-end stock was up by over 75% in terms of book value (€176m against €99m) and by c 50% in terms of units (1791 against 1194), which lays a strong base. A highlight was the H1 purchase of three portfolios, mainly in Celle (252 of 365 units), which meet usual acquisition requirements, ie older buildings (mainly from 1960s) with significant value potential on modernisation and reduction of 10% vacancy rate. This followed the purchase of 161 units in Frankfurt and Ratingen – slightly newer properties but with scope for higher rent on expiry of social housing agreements. Q3 saw a mid-double digit €m block purchase in Frankfurt (363 residential and commercial units). In turn, 100 units in Frankfurt-Niederrad, a block in Schwarzenbek (99 units) and residual 48 units at Dormagen accounted for the bulk of disposals (overall 294 units sold).

Exhibit 1: Revenue and year-end real estate stock (€m)



Source: Noratis accounts

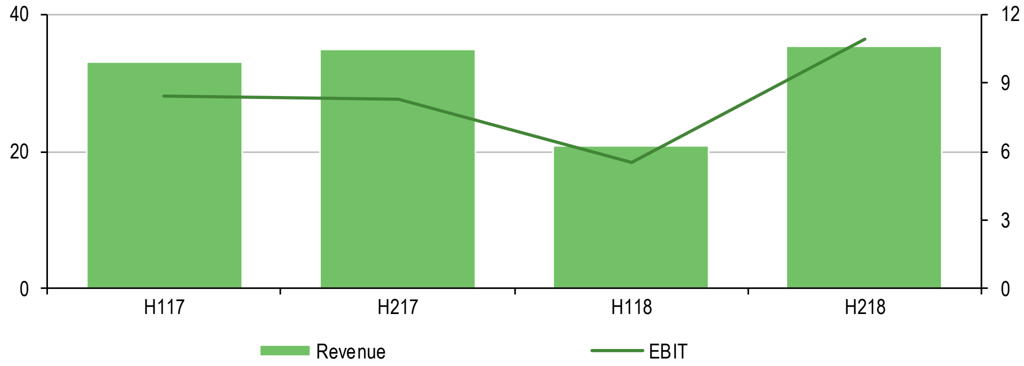
Noratis's financial performance in 2018 (see Exhibit 2) reflected this trading pattern as 2017 asset sales, up by two-thirds and epitomised by the bumper Dormagen disposal, proved a hard act to follow. The impact of lower asset sale proceeds was at least mitigated by an impressively higher gross margin (36% vs 29%), hence broadly steady gross profit. Rental income was up by a third, endorsing the focus on acquiring largely occupied residential assets, which yield immediate income.

Exhibit 2: Financial performance

Year-end December (€m), HGB	H117	H217	FY17	H118	H218	FY18
Revenue						
Asset sales	30.4	31.5	61.9	17.5	30.7	48.2
Change	+116%	+33%	+64%	-42%	-3%	-22%
Rental	2.7	3.4	6.1	3.3	4.6	7.98
Change	-21%	+3%	-9%	+27%	+35%	+30%
Total	**33.1**	**34.9**	**68.0**	**20.8**	**35.3**	**56.1**
Change	**+89%**	**+29%**	**+52%**	**-37%**	**+1%**	**-18%**
Gross profit						
Asset sales	8.5	9.2	17.7	6.0	11.3	17.3
Margin	28%	29%	29%	34%	37%	36%
Rental	1.5	2.3	3.8	1.7	2.7	4.3
Total	**10.1**	**11.5**	**21.5**	**7.7**	**14.0**	**21.7**
EBIT	**8.4**	**8.3**	**16.7**	**5.5**	**10.9**	**16.4**
Net interest	(1.5)	(1.5)	(3.0)	(1.2)	(1.6)	(2.8)
Pre-tax profit – adjusted	**6.9**	**6.8**	**13.7**	**4.3**	**9.3**	**13.6**
Exceptional items*	(1.5)	-	(1.5)	(0.8)	-	(0.8)
Pre-tax profit – reported	5.4	6.8	12.2	3.5	9.3	12.8
Net profit	**3.3**	**5.4**	**8.7**	**2.6**	**6.6**	**9.2**

Source: Noratis accounts. Note: *Stock market costs (H117 IPO and H118 capital increase).

Exhibit 3: Revenue and EBIT (€m)



Source: Noratis accounts

Contrasting half-yearly performances apart (a matter of timing, as discussed), a flat outturn at the gross profit level was matched at EBIT (see Exhibit 3) as a near-doubling of labour costs owing to expansion and bonuses was offset by a 30% fall in other operating costs. This is after adjusting EBIT for one-off costs: €1.5m IPO expenses in 2017 and €0.8m capital increase costs in 2018. Net interest fell slightly for the year as acquisition payments were due only late in the period.

Such ambitious investment (notably Frankfurt Ginnheim) drove a doubling of net debt to €141m in 2018. However, the equity ratio at year end is unchanged (23%) on 2017. It represents 80% of the book value of land and buildings held for sale (€176.7m) at December 2018. The properties are shown fully in current assets as they are acquired with the aim of being sold after successful development. This gearing is exacerbated by Noratis's accounts preparation under HGB standards. Unlike IFRS, HGB does not use mark-to-market valuations or annual impairments. This implies that all Noratis's asset sales revenues are booked at the time of the disposal and are therefore cash earnings. On the balance sheet, this implies that hidden reserves are building due to optimisation and rent multiple expansions. In IFRS accounts, these value increases would be seen as profits and typically are then seen in equity. Based on the valuation by an international RICS appraiser, Noratis's hidden reserves were c €21m at end 2017, ie asset value of €120m against book value of €99m.

30% of the net debt has a term to maturity of over five years. Management has recently stated that it is examining options for borrowing, including the issue of an unsecured bond.

Set fair

For 2019, guidance is for EBIT and PBT to hold at the high level of the last two years. However, this is against an outturn, depressed by €0.8m capital increase costs. On an adjusted basis, consensus EBIT forecasts of €16.2m compare with €16.4m in 2018. Given expectation of higher asset sales, even on a demanding H2 margin comparative, such a forecast may appear cautious.

Further out, Noratis has secured a substantial base for medium-term disposal at a likely high gross margin (2018 36%). Expansion is on the cards, given recent management comment and market opportunity (c 70% of apartments in Germany date from the 1920s to mid-80s) and continued positive conditions.

Valuation

Sitting between asset holder and developer makes for difficult comparison with listed peers but Noratis's P/E ratio is at a notable discount to RCM Beteiligungs, which has a similar model (trailing 23x). However, its P/BV (2018) ratio is higher at 1.6x, against 1.3x (2017).

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