

## Noratis

**Real estate**
**21 May 2021**

### New capital to fuel portfolio growth

After a year of limited asset disposals following the announcement of Noratis's decision in March 2020 to focus on net portfolio expansion, management expects a significant rise in property sales in FY21 and guides to much higher EBIT and PBT compared to FY20. Meanwhile, the company plans to further grow its portfolio, which it will support with c €22m raised through equity issues in FY20, a €30m corporate bond placed in the period and long-term funding from its anchor shareholder, Merz, which in March 2020 agreed to inject up to €50m in Noratis until the end of 2024.

### FY20 earnings down, NAVPS up 16% y-o-y

Noratis posted a 48% y-o-y drop in EBIT to €8.2m and a 64% y-o-y fall in PBT to €4.2m in FY20, largely due to lower asset disposals (€12.0m in FY20 versus €63.0m in FY19). At the same time, a c 40% increase in the number of portfolio units to over 3k at end-FY20 led to a 29% y-o-y rise in rental revenues to €16.7m in FY20. The €375m market value of Noratis's properties (calculated by an external appraiser) at end-FY20 was 15% above their carrying value and consequently, its net asset value per share (NAVPS) increased by 16% y-o-y to €22.8 at end-FY20.

### Growth plans supported by equity from Merz

Noratis plans to grow its portfolio further in FY21, aiming to become profitable from rental income alone in the future. That said, property sales will remain an integral part of its strategy and earnings driver over the longer term, according to management. Noratis's net loan to value (LTV) of c 67% at end-FY20 (versus 64% at end-FY19 and the maximum level of 75% set by management) may look relatively high, but we believe that agreed funding from its anchor shareholder Merz should be supportive of its balance sheet and strategy (we estimate it may still invest up to c €36m equity in Noratis until the end of 2024, in line with the existing agreement). Moreover, Noratis's business profile (acquiring properties with optimisation potential) may affect the LTV ratio amid the ongoing portfolio growth.

### Valuation: Trading at a discount to NAVPS

While the company's FY21e P/E of 16.3x is higher than that of its closest peers, Accentro (13.5x) and Peach Property (10.4x), based on consensus it falls to 9.5x in FY22e, slightly below peers. Notably, Noratis's shares are trading at a c 11% discount to its NAVPS of €22.8 at end-FY20 compared to a 1% premium for Peach Property (data for Accentro not available). The company's dividend yield for 2021 and 2022 (based on Refinitiv consensus) remains attractive compared to its peers.

#### Consensus estimates

Year end	Revenue (€m)	EBIT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/19	76.0	15.8	2.3	0.8	8.9	3.9
12/20	28.7	8.2	0.7	0.5	29.6	2.5
12/21e	70.0	15.5	1.3	0.6	16.3	3.1
12/22e	100.4	22.6	2.2	1.1	9.5	5.3

Source: Noratis, Refinitiv consensus at 21 May 2021

<b>Price</b>	<b>€20.4</b>
<b>Market cap</b>	<b>€98m</b>

#### Share price graph



#### Share details

Code	NUVA
Listing	Deutsche Börse Scale
Shares in issue	4.8m
Last reported net debt at end-FY20	€256.5m

#### 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 it exploits in well-structured asset sales through individual or block sales.

#### Bull

- Management guidance assumes higher EBIT and PBT in 2021.
- Portfolio expansion may bring greater stability to sales and earnings.
- Strong experience operating in Germany's non-core areas.

#### Bear

- Small company in a very competitive market.
- Dependence on attractive portfolio opportunities.
- Relatively high leverage (LTV at c 67% at end-FY20).

#### Analysts

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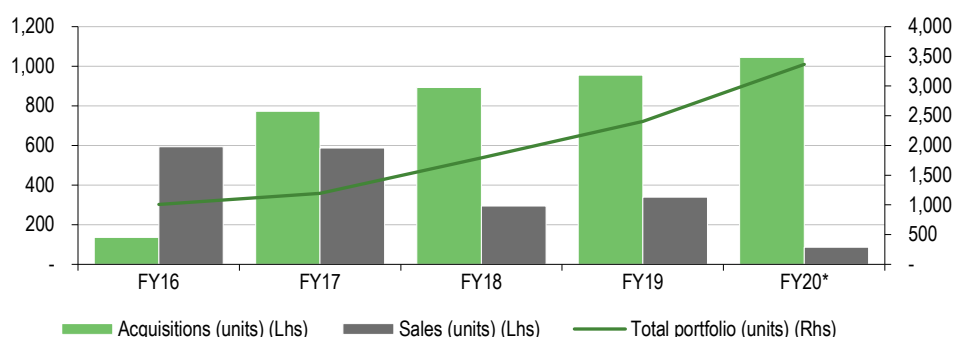
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## FY20 results reflect postponement of asset sales

Noratis reported a significant decline in EBIT and PBT in FY20, in line with its guidance, which reflected the management decision announced in March 2020 to reduce asset disposals in the period and instead focus on portfolio expansion. As a result, total revenues fell to €28.7m in FY20 from €76.0m in FY19, with sales from asset disposals at a modest €12.0m, compared with €63.0m a year earlier. Noratis sold 86 units in FY20 (vs 339 in FY19), generating a margin on sales of 41% (23%).

At the same time, rental revenues increased 29% y-o-y to €16.7m, assisted by an improvement in rental margin (c 60% in FY20 versus c 55% in FY19) and, most notably, expansion of the portfolio from 2,407 units at end-FY19 to 3,366 units at end-FY20 (or 3,632 units including properties that have already been contractually secured, but not yet recognised at end-FY20). In the period, Noratis acquired 1,045 units (1,311 units), compared to 955 units in FY19, with new additions coming from regions where it has been present for some time (ie Rhine-Ruhr, Rhine-Main, Leipzig, the Hannover-Braunschweig-Göttingen-Wolfsburg metropolitan area and the greater Münster area), as well as new locations such as Emden and Cuxhaven in northern Germany and the Upper Palatinate in southern Germany. Post period end, Noratis announced the purchase of 150 flats in Gelsenkirchen in the North Rhine-Westphalia region.

**Exhibit 1: Portfolio development**



Source: Noratis accounts, Edison Investment Research. Note: \*Includes only acquisitions already completed in FY20.

Portfolio expansion was coupled with an increase in headcount, with new recruitment taking place mostly in Q420 (hence the average number of employees of 53 in FY20 was only slightly above the 50 in FY19). This translated into a 23% y-o-y increase in personnel expenses to €5.0m in FY20. Management plans to further expand the team in 2021, depending on the acquisition pipeline and the resulting increase in inventories.

EBIT declined to €8.2m in FY20 from €15.8m in FY19, in line with management expectations for a significant y-o-y fall. Despite an increase in bank liabilities amid portfolio expansion (see more details below), net finance costs declined slightly to €4.1m in FY20 from €4.3m in FY19, supported by lower expenses for interest rate hedges (the latter stood at less than €0.1m in FY20 vs €0.8m in FY19). As a result, PBT was €4.2m in FY20 (vs €11.5m in FY19) and EPS declined to €0.69 (versus €2.29 in FY19). The company highlights that pandemic-related rent losses or risks from rent receivables were low and of minor importance for the course of business in the period. Based on our conversation with management, we understand that the vacancy rate increased to c 10% at end-FY20 from c 6% at end-FY19, but we believe it may be at least partially due to the ongoing portfolio expansion (vacancies tend to rise in the first months after a takeover) as well as the continuing optimisation of the existing portfolio (when flats are deliberately not re-let before disposals or where renovations have started).

Management recommended a dividend of €0.50 per share, which includes c 50% of FY20 profits (in line with the company's dividend policy), with the remaining amount coming from the distribution reserve that it created last year due to the uncertainty posed by the COVID-19 pandemic. Noratis had a solid cash position of €31.0m at end-FY20 (versus €7.0m at end-FY19), but we understand that it will be used largely for property acquisitions.

It is noteworthy that Noratis switched to IFRS accounting standards in FY20 (from HGB previously), which it hopes will provide more transparency and comparability of figures with other real estate companies. Management highlights that this change had a limited impact on its results as its properties are still reflected in current assets and reported at cost (with no subsequent revaluations), as they are acquired with the aim of being sold after successful development.

<b>Exhibit 2: Financial results</b>			
<b>IFRS figures, €000s unless otherwise stated</b>	<b>FY20</b>	<b>FY19</b>	<b>y-o-y change</b>
<b>Total revenue</b>	<b>28,700</b>	<b>75,950</b>	<b>-62%</b>
Revenue from sales of inventory properties	12,032	63,009	-81%
Costs of sales of inventory properties	(7,039)	(48,577)	-86%
<b>Gross profit from sales</b>	<b>4,993</b>	<b>14,432</b>	<b>-65%</b>
Letting revenue	16,668	12,941	29%
Letting costs	(6,706)	(5,815)	15%
<b>Gross profit from letting</b>	<b>9,962</b>	<b>7,126</b>	<b>40%</b>
Other income	847	958	-12%
<b>Gross profit</b>	<b>15,802</b>	<b>22,516</b>	<b>-30%</b>
Personnel expenses	(4,986)	(4,057)	23%
Depreciation and amortisation	(423)	(400)	6%
Other operating costs and depreciation	(2,183)	(2,251)	-3%
<b>EBIT</b>	<b>8,210</b>	<b>15,808</b>	<b>-48%</b>
Profit/loss of equity-accounted entities	(1)	0	N/A
Finance income	205	150	37%
Finance costs	(4,259)	(4,419)	-4%
<b>PBT</b>	<b>4,155</b>	<b>11,539</b>	<b>-64%</b>
Income tax	(1,358)	(3,263)	-58%
<b>Net income</b>	<b>2,797</b>	<b>8,276</b>	<b>-66%</b>
Attributable to owners of the parent	2,784	8,255	-66%
Attributable to non-controlling interests	13	21	-38%
<b>EPS (€)</b>	<b>0.69</b>	<b>2.29</b>	<b>-70%</b>

Source: Noratis

Net debt reached c €257m in FY20 (versus c €177m at end-FY19) after liabilities to banks increased by c €79m to €257.9m at end-FY20 amid portfolio growth, and the company placed a €30m corporate bond (see more details below). Importantly, only c 1% (or c €3.6m) of its financial liabilities (ie the corporate bond, liabilities to banks and leasing) mature in the next 12 months, while the remaining exposure has a maturity of one to five years (75%) and over five years (24%).

The market value of Noratis's properties (calculated by an independent external appraiser) was €375m at end-FY20, c 15% above their carrying value, which implies a net LTV of 67.1% at end-FY20 (versus 63.9% in FY19 and the maximum level of 75% assumed by management). The latter figure is relatively high, but the company has secured long-term equity funding from Merz, which we estimate may still invest up to €36m in Noratis until end-FY24 and would support Noratis's balance sheet. We also note that Noratis buys properties with optimisation potential and aims to increase their value over time, which may result in a higher LTV ratio, in particular following a period of increased acquisition activity (such as recently). Its NAVPS, calculated with the real estate portfolio reflected at market value and equity adjusted for current income tax at 27.4%, increased c 16% year-on-year to €22.8 at end-FY20.

## Capital and financing measures to support growth

The company's prospective property acquisitions will be assisted by the financing measures it completed recently, as well as further equity funding from its long-term shareholder, Merz (whose stake in Noratis was c 49.1% at end-FY20), which agreed in March 2020 to invest up to €50m in the

company until the end of FY24 (see more details in our [May 2020 update note](#)). Subsequently, Noratis completed a €5.0m capital increase with Merz at a price of €19.80 per share in May 2020 (these shares are not entitled to the dividend paid out from FY19 profits). It also raised €16.9m in a capital increase in September 2020 by issuing c 964k shares at €17.55 per share. Merz contributed c €9.1m to this amount by acquiring c 517k shares that were not subscribed to in a public offering and the subsequent private placement. Based on the above, we estimate that Merz may still invest c €36m in Noratis until the end of 2024.

On top of that, Noratis issued a €30.0m unsubordinated and unsecured corporate bond recently, including €12.5m placed in November 2020, and follow-ups of €10.0m and €7.5m in December 2020. The bond has a five-year maturity and an interest rate of 5.50% per annum, which implies an annual interest expense of c €1.7m, according to our estimates.

## Management expects higher EBIT and EBT in 2021

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For 2021, Noratis guides to significantly higher EBIT and EBT compared to the previous year, supported by an increase in revenues from asset disposals. It also reaffirmed its plans to become profitable from recurring rental income alone in the future, which should be assisted by continuing portfolio growth (when we subtract gross profit on sales from FY20 PBT, we arrive at a loss of €0.8m). Management highlights that asset disposals will remain an integral part of its strategy, even if it decides to transfer individual properties to a standing portfolio at some point in the future.

Trends in the broader real estate market remain supportive of Noratis's business. Despite a relatively weak Q220 due to the COVID-19 outbreak, the German residential market posted a 12% y-o-y increase in transaction volumes to €19.7bn in 2020, the second highest amount of all time, according to Savills. Savills expects transaction volumes in 2021 to be above average again, potentially in line with 2020, highlighting the growing importance of residential properties during the pandemic, which could produce structural growth at a time when demand and valuation trends in the commercial property market are difficult to assess. In Q121, the 'living' sector (including residential, student housing, micro living and elderly care homes) further increased its share in overall transaction volumes to c 46% versus 31% in 2020 and 24% in 2019, which was mainly attributable to weakness in other market segments, according to Jones Lang LaSalle (JLL). Savills highlights that the pandemic might cause the workspace and residential markets increasingly to decouple geographically due the digitalisation of workspace. We believe this could create an opportunity for Noratis, which is focused on and has experience in acquiring and managing residential properties in German secondary locations.

## Valuation

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Noratis's position between asset holder and developer makes for a difficult comparison with listed companies. We believe that its closest peers are RCM Beteiligungs, a German property developer acquiring rental income-producing assets in and around Dresden and investing in refurbishment (for which no consensus are currently available), Accentro, a German residential property company focused on privatisation, and Peach Property Group, a company investing in high-yielding residential real estates, mainly in German secondary locations.

Based on Refinitiv consensus, Noratis is trading at an FY21e P/E of 16.3x (versus 13.5x for Accentro and 10.4x for Peach Property Group), with FY22e P/E declining to 9.5x (vs 10.5x and 9.7x, respectively). Noratis offers a healthy FY21e dividend yield of 3.1% (versus 1.8% for Accentro and 5.2% for Peach Property Group), which increases to 5.3% in FY22e (versus 2.3% and 5.0%, respectively). Importantly, Noratis's NAVPS at end-FY20 implies a discount of c 11% compared with a 1% premium for Peach Group Property (NAVPS for Accentro not available).

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