

Fair Value REIT

Q3 results

Guidance reiterated at nine months

Real estate

Fair Value REIT (FVI) has reported 9m14 results and reiterated full year guidance of €5.1m underlying (EPRA basis) consolidated net profits. On a proportionate basis, results ytd (€3.7m) are c 4% below the full year target, but improving occupancy should support the balance of the year despite management's guidance of a near-term increase in maintenance and leasing-related costs. Dividend guidance (€0.25 per share) is also reiterated, with the prospect of future growth. The (2013) step-up in dividends was made possible by the strategic repositioning of the portfolio over the past two years, reducing complexity and sustainably lifting distributable income. Yet despite the attractive prospective c 5% yield, the discount to NAV has remained above 40%.

Year end	Revenue (€m)	Adj net profit* (€m)	Adj EPS* (€)	DPS (€)	P/NAV (x)	Yield (%)
12/12	36.8	5.9	0.64	0.10	0.51	2.0
12/13	36.4	6.4	0.69	0.25	0.56	5.1
12/14e	29.5	5.0	0.54	0.25	0.54	5.1
12/15e	31.6	6.0	0.64	0.28	0.52	5.7

Note: *Net profit and EPS are normalised (fully diluted), excluding intangible amortisation, exceptional items and share-based payments. EPS and NAV are on an EPRA basis.

First nine months on track

There were no additions or disposals from the portfolio during Q3, although the earlier strategic positioning is still weighing on rental income (down 19% for the first nine months). Significantly reduced borrowing costs and administrative expense reductions largely offset this, limiting the EPRA net income decline to 8% (€3.7m). On a proportionate basis this is c 4% below management's €5.1m guidance, but the balance of the year will benefit from improving occupancy (partly offset by additional maintenance and rental costs). Our EPRA forecast reduction is little more than rounding, declining by €55k to €5,031k.

Signs of growth after portfolio simplification

Over the past two years, management has been shrinking the asset base so as to focus and simplify the group structure and increase distributable income. There is more to do, but Q3 shows the first sign that reinvestment may be near; a collateralised prepayment was made to secure an option on a possible €1.1m acquisition in Chemnitz. Small increases in ownership at a number of subsidiaries also continued throughout the year.

Valuation: Attractive yield with NAV support

FVI offers an attractive c 5% prospective yield (ahead of peers) with management guiding to further dividend growth. The greater than 40% discount to EPRA NAV provides additional support. NAV total return over the past five years is at least on a par with peers.

13 November 2014

Price €4.93
Market cap €46m

Net debt (€m) as at 30 September 2014 151.0
Shares in issue 9.3m
Free float 47.5%
Code FVI
Primary exchange Frankfurt
Secondary exchange Stuttgart, Berlin, Munich

Share price performance



%	1m	3m	12m
Abs	0.4	(0.5)	5.3
Rel (local)	(4.2)	(2.0)	3.8
52-week high/low	€6.2		€4.6

Business description

Fair Value REIT (FVI) is a real estate investment trust managing 368,000sqm at 44 commercial properties spread across Germany. It has a diversified portfolio of office and retail assets, with a focus on regional locations.

Next events

Full year 2014 results	26 March 2015
Q115 interim report	07 May 2015
AGM	19 May 2015

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Investment summary

Discount to NAV supports attractive yield

FVI is a real estate investment trust (REIT), which manages a portfolio of commercial office and retail properties in regional German locations, split between east and west. The group invests directly in real estate, as well as indirectly in real estate partnerships via participations. The portfolio is actively managed. As a REIT, FVI's strategy for shareholder returns is significantly focused on dividends; it has successfully restructured the group to support a more than doubling in DPS in 2013 to €0.25 per share, with a similar dividend forecast by management for 2014. As such, the group seeks to maintain an increased payout ratio of at least 45% of EPRA EPS (with a goal to increase this to 50% from 2016). At c 5%, FVI's dividend yield is attractive and derives further support from a larger than 40% discount to NAV.

The strategically driven portfolio restructuring of the past two years has seen smaller and non-core properties sold. Subsidiaries and participations have also been liquidated or exited to reduce the structural complexity of the group and reduce participation-based administrative expenses. While the property investment portfolio has declined by c 35% since the beginning of 2013, management continues to view commercial real estate market conditions as favourable and is likely to seek opportunities to grow its direct investments, particularly in the retail property sector.

The first nine months in brief

Despite the inevitable decline in rental income as a result of the (c 35%) strategically driven reduction in the investment property portfolio since the beginning of 2013, the impact on adjusted consolidated net income (on an EPRA basis) was limited to 8% (€3.7m for 9m14 vs 9m13: €4.0m). EPRA EPS was €0.39 vs €0.43 in the previous year, and EPRA NAV per share was slightly higher at €8.87 (31 December 2013: €8.86). EPRA NAV was €81.8m (€82.6m at December 2013), after €2.3m in dividend payments. Both gross and net rents declined by c 19%, but were broadly offset by cost reductions and the reduction in net interest expense that asset sales allowed, due to lower borrowing and reduced borrowing costs. The only remaining equity-accounted associate company (BBV09) was disposed of at the end of 2013, so following the adoption of IFRS10 there was no contribution at all from equity-accounted associates in the first nine months of 2014 (9m13: €2.1m). The former associate companies BBV02, BBV10, BBV14, IC12 and IC15 are all now fully consolidated. Management has reiterated its full year guidance of €5.1m underlying consolidated profit (EPRA basis), but notes that despite the positive impact of increasing occupancy for the remainder of the year, there will also be upward pressure on maintenance and rental costs. Dividend per share guidance of €0.25 has also been reiterated. Additional confidence in the payout is provided by the share capital consolidation (approved by the AGM and effective from 8 July) that effectively converted €28.2m of share capital into share premium), boosting distributable reserves. Our own estimates are updated for Q3 developments and show a slight reduction in our 2014 EPRA consolidated profit estimate to €5.0m (from €5.1m).

Full year estimates little changed

The changes to our estimates are little more than rounding. In the forecasts, revenues are slightly lower for 2014, taking into account the most recent data, but slightly higher in 2015 as recent lettings activity has a longer impact.

Exhibit 1: Earnings revisions

	Revenue (€m)			FFO/EPRA EPS (€)			EPRA NAV (€)			DPS (€)		
	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)
FY14e	29.7	29.5	(0.7)	0.55	0.54	(1.1)	9.12	9.12	0.1	0.25	0.25	0.0
FY15e	31.4	31.6	0.7	0.64	0.64	0.5	9.51	9.52	0.1	0.28	0.28	0.0

Source: Company data, Edison Investment Research

Portfolio update

The portfolio showed very little change during the quarter, with no change in the number of properties (44). The period of relative calm reflects the progress that has already been made in streamlining and simplifying the portfolio.

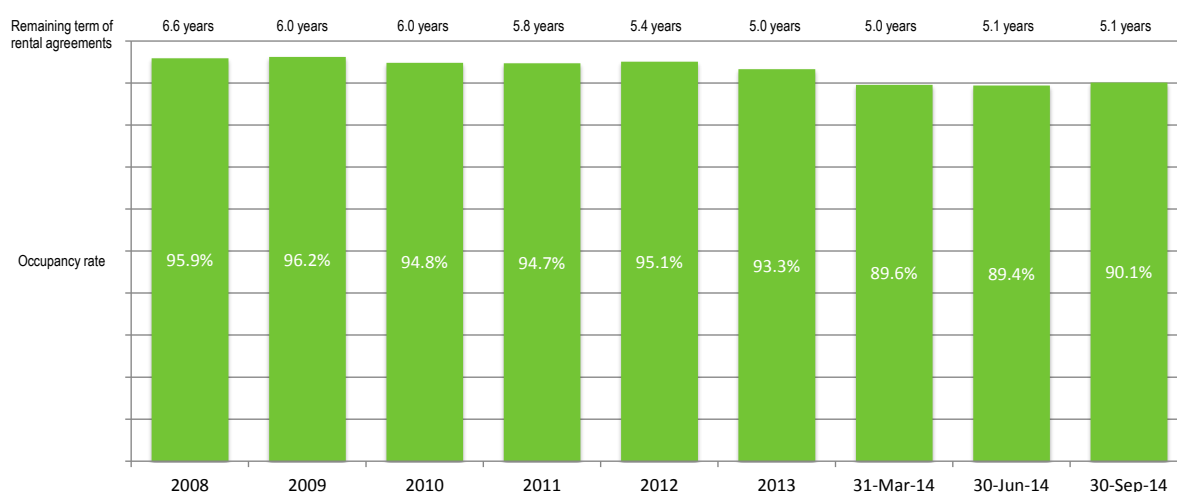
Exhibit 2: Overview of portfolio at 30 September 2014

	Total plot size (sqm)	Market value (E000's)*	WAULT (years)**	Contracted rental yield***	FVI share
Direct investments	40,038	37,102	9.1	7.1%	100.0%
Subsidiaries	327,682	251,658	4.4	8.3%	46.0%
Total	367,720	288,760	4.9	8.2%	53.0%

Source: Company data. Note: *Market values as 31 December 2013. **WAULT = weighted average unexpired lease term. ***Contracted rental yield is before costs.

The occupancy rate increased between Q2 and Q3 from 89.4% to 90.1%. The decline in Q1 was primarily due to the 31 January 2014 cancellation of a rental agreement on space at the Celle property by DIY chain Praktiker, due to insolvency. The completion of a rental agreement on the logistics property in Cologne, starting on 1 July 2014, drove the Q3 increase. Since the quarter end FVI has concluded a 10-year re-letting agreement in Celle with a franchisee of "hagaumarkt", effective from 1 December 2014. This will take occupancy close to 93.0% once more.

The weighted average unexpired lease term, at 4.9 years, was slightly lower than at the end of Q2 (5.1 years) and at the end of 2013 (5.0 years).

Exhibit 3: Trend in occupancy and unexpired lease length


Source: Company data, Edison Investment Research

While we believe that management has further non-core disposals to be made over time, we also expect reinvestment to begin soon. Q3 saw FVI make a collateralised advance payment of €450k for a possible acquisition in Chemnitz. In return, it has an exclusive right, until the end of this year, to examine and complete the acquisition of the property, with an investment value of €1.1m.

The German economy has recently softened, with the DIW now forecasting 1.3% GDP growth in the current year (rather than 1.8%). However, the German economy continues to perform ahead of the eurozone average. Unemployment is roughly half the eurozone average (4.9% in July 2014 vs the EU average of 11.5%, according to Eurostat) and planned increases in minimum wages should provide some additional support to disposable income and retail spending. Investment demand for German commercial property remained strong during the first nine months, although the occupier market for office space in the seven largest regional markets has shown increasing caution through the year. Over the first nine months of 2014 leasing turnover of 2.1m square meters was 7% lower than the same period of 2013. Retail space, favoured by FVI management, continues to show increasing leasing turnover. At 420,000 square meters, it was up 10% in the first nine months.

Financials

The 9m13 financials reflect the first-time adoption of IFRS10, which resulted in the previously equity-accounted former associate companies BBV02, BBV10, BBV14, IC12 and IC15 being fully consolidated. This was made possible by FVI having management control over each entity. Both the 9m14 and restated 9m13 financials are on this basis.

Exhibit 4: Summary of earnings development

	9m13	9m14	Change (%)
Gross rental income	22,137	17,961	(19)
Income from operating & incidental costs	4,813	4,001	(17)
Real estate related operating expenses	- 9,982	- 8,152	(18)
Net rental income	16,968	13,810	(19)
General administrative expenses	- 2,588	- 2,105	(19)
Net other operating income & expenses	263	371	41
Net result from sale of investment properties	327	- 304	n/m
Net valuation result	- 189	-	n/m
Operating result	14,781	11,772	(20)
Result from equity accounted investments	2,087	-	n/m
	166	-	
Net interest expense	- 6,686	- 3,942	(41)
Minority interests	- 5,033	- 4,386	(13)
Tax	- 22	-	n/m
Net attributable income (IFRS)	5,293	3,445	(35)
Net attributable income (EPRA)	3,968	3,653	(8)
EPS (EPRA)	0.43	0.39	(8)
NAV per share (EPRA)	8.86	8.87	0

Source: Company data, Edison Investment Research

H114 gross rental income of €18.0m was 19% lower than in H113, a similar trend to H1 and reflecting the c 35% reduction in the portfolio value since the beginning of 2013. Net rental income declined at a similar pace. At the gross level, Q3 was similar to Q2 as the diminishing impact of earlier disposals was offset by the occupancy recovery. The balance of 2014 will be supported by recent leasing progress, but the Celle agreement will largely affect 2015. The new lease carries rent at the higher of €396k pa (minimum) or 6% of annual turnover (6.5% on turnover above €8.0m). Between now and handover at the end of January 2015, there will be a need for renovation and maintenance expense (c €0.5m) plus other rental-related costs (c €0.6m). General administrative expenses also fell 19% to €2.1m, leaving FVI on track to meet management's target of a decline to €2.7m for the year (€3.3m in 2013).

As a result of IFRS10 adoption, there is no equity-accounted contribution through 2013. Realised gains on disposal are at a similar level to last year and there are no valuation movements at this interim stage. Other operating income and expenses are ahead of this stage in 2013.

An even greater offset to lower rental income is the decline in net interest expense, resulting from both lower borrowing and reduced interest and swap costs. At €3.9m, there was a 41% decline from €6.7m in the first nine months of 2013.

On an IFRS basis, 9m14 consolidated net income was €3.4m compared with €5.3m in the first nine months of 2013, a decline of €1.8m. On an underlying (EPRA) basis, the decline was significantly lower at €315k (from c €4.0m to c €3.7m). The difference between the IFRS movement y-o-y and the EPRA movement y-o-y is attributable to valuation movements; these are stripped out of the EPRA results, and the adjustment is different between this year and last year.

Our slightly revised €5.0m full year EPRA consolidated income forecast assumes no Q4 realised gains or valuation movements.

Shareholders' equity, together with minority interest, was €148.1m or 46.1% of total consolidated assets at 30 September 2014, compared with 42% at the end of 2013. As a REIT, FVI must have equity (including minority interests) of at least 45% of immovable assets (ie investment property and associate interests) and the ratio at 30 September 2014 was 51.2% compared with 46.9% at end 2013.

During the first nine months, FVI has continued to slightly increase its ownership of a number of its subsidiaries in the secondary market (BBV03 by 0.17%, IC12 by 0.02%, IC15 by 0.88%, and BBV02 by 0.07%). Using 30 September net asset values for these subsidiaries, we estimate that FVI has acquired c €174k of net assets at a cost of c €45k, or at a discount of c 74% to NAV. These numbers are relatively small, but at the margin are value creating for FVI shareholders and represent further small steps in FVI's simplification of its corporate structure. We note that the FVI strategy has already seen the successive liquidation of a number of subsidiaries.

Performance and valuation

As we have previously shown, over five years, on an IFRS basis (EPRA data are not available for the whole period), FVI's NAV compound total return performance has been broadly comparable with peers (a selection is shown in Exhibit 5 and only VIB Vermögen has produced a stronger annualised total return). As a result of its historical corporate structure, it has in the past paid lower dividends than peers. However, this has now changed, with the more than doubling dividend per share in 2013 likely to prove sustainable (management guidance is €0.25 per share again in 2015).

Exhibit 5: Peer NAV total return comparison

	IFRS NAV						DPS declared						Total DPD paid	Annualised total return
(€)	2008	2009	2010	2011	2012	2013	2008	2009	2010	2011	2012	2013	2009-13	
Alstria Office	13.03	11.32	11.24	10.71	10.51	10.63	0.52	0.50	0.44	0.44	0.50	0.50	2.40	0.0%
Hamborner REIT	10.51	10.31	8.74	8.77	8.17	8.25	0.37	0.37	0.37	0.40	0.40	0.40	1.91	-0.7%
VIB Vermögen	11.06	11.85	12.36	12.22	13.06	13.88	0.20	0.25	0.30	0.35	0.4	0.45	1.50	6.9%
Fair Value	8.16	7.78	9.21	9.25	9.58	8.86	0.00	0.00	0.10	0.10	0.10	0.25	0.30	2.3%

Source: Company data, Edison Investment Research.

We note that despite this comparable return performance and step-up in dividends, FVI continues to trade at a significant discount to NAV (c 40%), unlike peers. Not included in our analysis because of its recent history, Deutsche Office (a merger of Prime Office REIT with OCM Real Estate Holdings in early 2014), with a market capitalisation of c €535m, is trading at a c 35% discount to Q314 EPRA NAV per share. This is despite not being in a position to pay dividends until occupancy has been further improved.

Exhibit 6: Peer comparison

		Price (€)	NOS (m)	Mkt cap (€m)	P/NAV (EPRA)		Yield	
					2012	2013	2012	2013
AOX GR Equity	Alstria Office	9.80	79.0	773.43	0.93	0.92	5.1%	5.1%
HAB GR Equity	Hamborner REIT	8.15	45.5	355.53	1.00	0.99	4.9%	4.9%
VIH GR Equity	VIB Vermoegen	14.21	22.2	308.22	1.09	1.02	2.8%	3.2%
	Average				1.01	0.98	4.3%	4.4%
FVI GR Equity	Fair Value	4.95	9.3	46.2	0.52	0.56	2.0%	5.1%

Source: Company data, Bloomberg. Note: Prices as at 11 November 2014.

FVI is clearly smaller than peers and its concentrated shareholder base further restricts liquidity. Management has also been a seller of investment properties for the past two years, which may have given the impression that it is unenthusiastic about the prospects for German commercial real estate, although the sales have actually been part of a programme to simplify the business and increase dividend-paying capacity. We expect management to seek new investment opportunities in the near future, and with the corporate structure now simplified and a substantial increase in dividend-paying capacity achieved, we see the continuing discount to peers as anomalous.

Exhibit 7: Financial summary

Year ending December	€m	2012	2013	2014e	2015e
		IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS		Re-stated			
Revenue		36.8	36.4	29.5	31.6
Net property expenses		(11.5)	(13.3)	(10.9)	(11.4)
Net rental income		25.3	23.1	18.6	20.2
EBITDA		21.6	19.8	16.2	17.6
Intangible Amortisation		0.0	0.0	0.0	0.0
Revaluation of inv. Property		(9.7)	(14.0)	(0.1)	0.0
Gain on disposal of inv. Property		0.1	(0.7)	(0.3)	0.0
EBIT		11.9	5.0	15.9	17.6
Associates		(0.6)	1.5	0.0	0.0
Net Interest		(10.9)	(12.7)	(5.1)	(4.6)
Profit Before Tax (norm)		10.1	8.6	11.1	13.0
Profit Before Tax (IFRS)		0.4	(6.2)	10.7	13.0
Tax		0.0	0.0	0.0	0.0
Minority interests		(0.6)	0.9	(6.0)	(7.0)
EPRA Net income		5.9	6.4	5.0	6.0
Net income (IFRS)		(0.2)	(5.2)	4.7	6.0
Average Number of Shares Outstanding (m)		9.3	9.3	9.3	9.3
EPS - EPRA basis, normalised fully diluted (€)		0.64	0.69	0.54	0.64
EPS - (IFRS) (€)		(0.02)	(0.56)	0.51	0.64
Dividend per share (€)		0.10	0.25	0.25	0.28
BALANCE SHEET					
Fixed Assets		366.7	292.5	289.4	289.4
Investment property		355.9	292.3	289.3	289.3
Equity accounted investments		10.6	0.0	0.0	0.0
Other non-current assets		0.2	0.2	0.1	0.1
Current Assets		18.4	53.4	31.8	31.9
Trade receivables		1.8	33.5	13.7	13.7
Cash		14.2	17.4	15.9	16.1
Other		2.4	2.5	2.1	2.1
Current Liabilities		(61.1)	(70.9)	(33.3)	(32.4)
Trade payables		(1.7)	(2.2)	(1.0)	(1.0)
Short term borrowing		(55.9)	(64.6)	(28.3)	(27.4)
Other		(3.5)	(4.1)	(4.0)	(4.0)
Long Term Liabilities		(170.0)	(128.7)	(137.8)	(132.1)
Long-term debt		(160.8)	(126.6)	(136.7)	(131.0)
Provisions and other		(9.2)	(2.1)	(1.1)	(1.1)
Net Assets		154.0	146.3	150.1	156.8
Minorities		(73.6)	(65.6)	(66.9)	(70.0)
Shareholders' equity		80.4	80.7	83.2	86.8
IFRS NAV per share (€)		8.62	8.65	8.92	9.31
EPRA NAV per share (€)		9.58	8.86	9.12	9.52
CASH FLOW					
Operating Cash Flow		17.9	13.3	14.1	13.7
Net Interest		(10.2)	(12.0)	(5.7)	(4.6)
Tax		0.0	0.0	0.0	0.0
Capex		0.0	(0.0)	0.0	0.0
Acquisitions/disposals		3.3	29.1	21.9	0.0
Financing		0.1	(0.7)	(3.3)	(0.0)
Dividends		(0.7)	(0.9)	(2.3)	(2.3)
Net Cash Flow		10.3	28.7	24.7	6.7
Opening net debt/(cash)		212.9	202.6	173.8	149.0
Other		0.0	0.0	(0.0)	0.0
Closing net debt/(cash)		202.6	173.8	149.0	142.4

Source: Company data, Edison Investment Research

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