Fair Value REIT

H1 results

Simple yield attraction

Real estate

Fair Value REIT (FVI) reported robust half-year underlying profits and management has reiterated guidance of €5.1m underlying (EPRA basis) consolidated net profits for the full year. This supports maintenance of the significantly increased dividend (2013 DPS more than doubled on 2012), with the prospect of future growth. The dividend increase was made possible by the strategic repositioning of the portfolio over the past two years, reducing complexity and sustainably lifting distributable income. The shares have risen in absolute terms (c 20% over the past 12 months), yet the prospective c 5% yield remains attractive and the discount to NAV has remained much wider than for peers.

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	0.54	1.9
12/13	36.4	6.4	0.69	0.25	0.59	4.8
12/14e	29.7	5.1	0.55	0.25	0.57	4.8
12/15e	31.4	6.0	0.64	0.28	0.55	5.4

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.

On track to meet full-year expectations

Despite a c 35% strategically driven reduction in the property portfolio since the start of 2013, the decline in H1 adjusted profits was much smaller, as lower rent was broadly offset by lower administrative and net interest expense. On an EPRA basis, consolidated net income (of €2.45m) was 11% lower year-on-year and management has reiterated its full-year guidance of €5.1m on the same basis. H1 EPRA EPS was €0.26 vs €0.30 in the previous year, and EPRA NAV per share was €8.73. As the year progresses, we would expect earnings to benefit from an increase in occupancy, but for the benefit to be limited by the full impact of recent property disposals.

Seeking growth after portfolio simplification

Over the past two years, management has been focused on shedding non-strategic assets, simplifying the group structure and increasing distributable income. The result has been a more than doubling in dividends and a simplified reporting structure. We believe FVI is near the end of its portfolio simplification, and as commercial real estate market conditions remain favourable, we expect it to seek opportunities to grow its direct investments, particularly in retail.

Valuation: Attractive yield with NAV support

FVI offers an attractive c 5% prospective yield with management guiding to further dividend growth. NAV support is also strong and despite the shares rising c 20% over the past 12 months, they continue to trade at a c 40% discount to 2014e EPRA NAV, much larger than for peers (c 2% on average), despite a similar NAV total return over the past five years. Improved accounting transparency as a result of portfolio simplification and full consolidation of former associates should help to highlight this apparent anomaly and support a revaluation.

5 August 2014

Price	**€5.2**
Market cap	**€49m**
Net debt (€m) as at 30 June 2014	153.8
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	(4.4)	(10.0)	19.2
Rel (local)	4.6	(6.1)	9.5
52-week high/low		€6.19	€4.01

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

Presentation at Frankfurt real estate equities conference	16 October 2014
Q3 interim report	6 November 2014

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Edison profile page

Fair Value REIT is a research client of Edison Investment Research Limited

Investment summary

Attractive yield with NAV support

FVI is a real estate investment trust (REIT), which manages a portfolio of commercial office and retail properties in regional German locations, split equally between east and west. The group invests directly in real estate assets and indirectly through holdings in property companies, closed-end funds and partnerships. As a REIT, FVI's strategy for shareholder returns is significantly focused on dividends; having successfully restructured the group to support a more than doubling in DPS in 2013 (from €0.10, or 16% of EPRA EPS, to €0.25, or 36% of EPRA EPS) 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). The prospective dividend yield, on a forecast unchanged dividend for FY14 of €0.25 per share, is on a par with peers, yet the discount to NAV remains substantially larger (c 40% vs c 2% for peers) despite comparable NAV total returns over the past five years. The strategically driven portfolio restructuring has seen the property investment portfolio decline by c 35% since the beginning of 2013, but 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.

H1 in brief

Despite a c 35% strategically driven reduction in the investment property portfolio since the beginning of 2013, FVI reported a much smaller decline (11%) in adjusted consolidated net income (on an EPRA basis) of €2.45m for H114 (H113: €2.77m). EPRA EPS was €0.26 vs €0.30 in the previous year, and EPRA NAV per share was €8.73. EPRA NAV fell to €81.5m from €82.6m at December 2013, after €2.3m in dividend payments. As expected, the decline in rents that followed the portfolio reduction was 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 result for both years is on the new accounting basis adopted at the end of FY13, which, adopting IFRS10, now fully consolidates the former associate investments that were previously equity accounted. Management has reiterated its full-year guidance of €5.1m underlying consolidated profit (EPRA basis). Our own estimate (also €5.1m) remains unchanged. As the year progresses, we would expect earnings to benefit from an increase in occupancy, but for the benefit to be limited by the full impact of recent property disposals.

Full-year estimates little changed

We have made no material change to our overall full-year estimates as a result of the Q2 results and expect FVI to earn c €5.1m of adjusted (EPRA) net income. Within the forecasts, revenues are slightly lower, taking into account the most recent data and portfolio sales, but this is more than offset by real estate operating expenses running below the level previously forecast. As a result, our operating profit forecasts are higher on both an IFRS and an EPRA basis. Our 2014 IFRS estimate also benefits from positive derivative valuation movements (within net interest income), which does not affect EPRA earnings.

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	30.4	29.7	(2.6)	0.55	0.55	0.1	9.05	9.12	0.7	0.25	0.25	0.0
FY15e	31.9	31.4	(1.6)	0.63	0.64	1.8	9.38	9.51	1.4	0.28	0.28	0.0

Source: Company data, Edison Investment Research

Portfolio update

The portfolio reduction since the beginning of 2013 has been strategically driven with the aim of simplifying the overall portfolio structure (increasing the proportion of wholly owned properties) and reducing the share of smaller and other non-core properties. Disposals have also had the effect of increasing the share of retail property, an area management favours. Disposals have continued in 2014, with FVI continuing to take advantage of a positive property market environment. We believe there are more non-core assets to be disposed of, but note management is also keen to be able to once again begin to grow the portfolio, with a focus on directly owned properties, the retail sector and increasing exposure to faster-growing regions of the German economy. Disposals completed in 2014 amount to €22.4m (end-2013 portfolio value €311.9m, including €19.6m of properties held as available for sale). The majority of this relates to a hotel with office and commercial space in Hannover (€17m) plus four smaller properties. In aggregate, the disposals realised a small loss of €352k after transactions costs.

At the end of June, the portfolio consisted of 44 properties, down from 47 at the end of March and 49 at the end of 2013. None of the property assets are held as available for sale.

Exhibit 2: Overview of portfolio

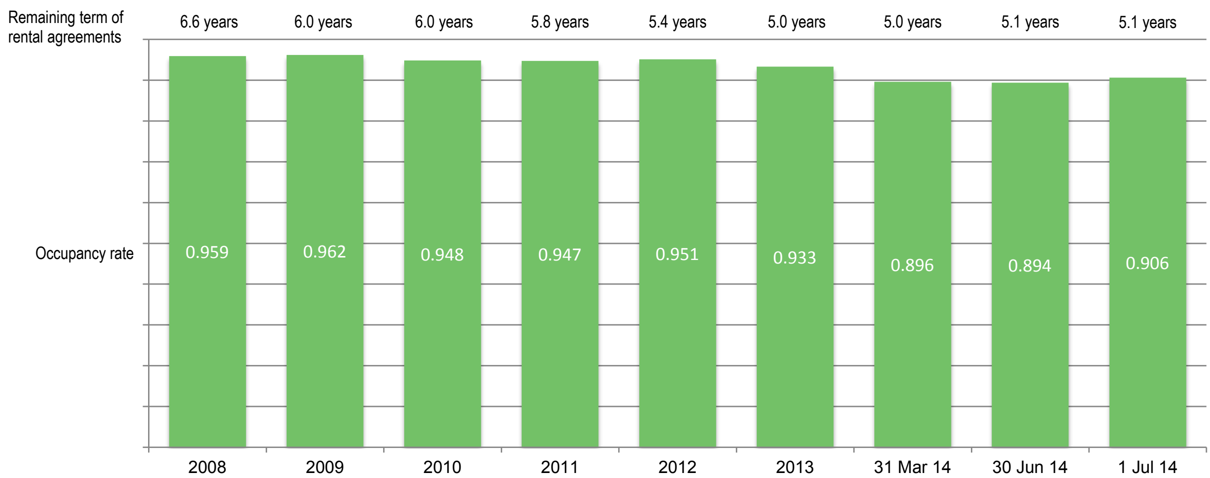
	Total plot size (sqm)	Market value (€000s)*	WAULT (years)**	Contracted rental yield*** (%)	FVI share (%)
Direct investments	40,038	37,102	9.3	7.2	100.0
Subsidiaries	327,682	251,658	4.6	8.2	46.0
Total	**367,720**	**288,760**	**5.1**	**8.1**	**53.0**

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 declined slightly between Q1 and Q2, from 89.6% to 89.4%. The decline from 93.3% at the end of 2013 is 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, will see occupancy increase to 90.6% on a like-for-like basis.

The weighted average unexpired lease term, at 5.1 years, was slightly higher at the end of Q3 than the 5.0 at the end of Q2 and the end of 2013.

Exhibit 3: Trend in occupancy and unexpired lease length



Source: Company data, Edison Investment Research

Financials

2013 saw the first-time adoption of IFRS10, which resulted in the previously equity accounted former associate companies, BBV02, BBV10, BBV14, IC12, IC15, being fully consolidated, reflecting management control over each entity. Both the H114 and restated H113 financials are on this basis, as are our forecasts. The following table summarises the quarterly and half-yearly development, as well as our expectations for H2. For a fuller review of the IFRS10 adoption and portfolio structure simplification, see our update note published on 23 April 2014.

Exhibit 4: Summary of earnings trends

	H113	Q114	Q214	H114	H214e
Gross rental income	14,765	6,185	5,891	12,076	12,086
Income from operating & incidental costs	3,165	1,324	1,335	2,659	2,835
Real estate related operating expenses	-6,471	-2,728	-2,656	-5,384	-5,541
Net rental income	11,459	4,781	4,570	9,351	9,379
General administrative expenses	-1,748	-679	-740	-1,419	-1,350
Net other operating income & expenses	300	40	110	150	20
Net result from sale of investment properties	310	-102	-250	-352	-
Net valuation result	-163	-	-84	-84	-
Operating result	10,158	4,040	3,606	7,646	8,049
Result from equity accounted investments	1,296	-	-	-	-
Net interest expense	-4,425	-1,432	-1,306	-2,738	-2,362
Minority interests	-3,616	-1,434	-1,363	-2,797	-3,055
Tax	-59				
Net attributable income (IFRS)	3,354	1,174	937	2,111	2,633
Net attributable income (EPRA)	2,765	1,292	1,161	2,453	2,633
EPS (EPRA)	0.30	0.14	0.12	0.26	0.28
NAV per share (EPRA)	8.86	8.89	8.74	8.74	9.02

Source: Company data, Edison Investment Research

H114 gross rental income of €12.1m was 18% lower than in H113, reflecting the c 35% reduction in the portfolio value since the beginning of 2013. Net rental income declined by a similar amount. At the gross and net level, Q2 was lower than Q1 as disposals completed earlier in 2014 had a larger impact. H2 will be supported by new lease agreements from 1 July. General administrative expenses were lower in H114 compared with H113. The €300k decline leaves FVI on track to meet management's target of a decline to €2.7m for the year compared with €3.3m in 2013.

As a result of IFRS10 adoption, there is no equity accounted contribution through 2013. Realised and unrealised valuation gains and losses generated a €583k negative swing from H113 to H114, and other operating income and expenses a negative swing of €150k.

In addition to the reduction in operating expenses, the other significant offset to lower rental income is the decline in net interest expense, resulting from both lower borrowing, and reduced interest and swap costs. At €2.7m, there was a 38% decline from €4.4m in H113. Within net interest expense, fair value gains on interest rate swaps of €919k offset the €859k costs incurred for the partial termination of remaining, relatively expensive swaps. H2 net interest expense will benefit from lower average debt compared with H1. Minority interests of €2.8m were c 57% of net income, and c €0.8m lower than in H113 (c 63% on net income excluding equity accounted contribution).

On an IFRS basis, consolidated net income was €2.1m in H114 compared with €3.4m in H113, a decline of €1.2m. On an underlying (EPRA) basis, the decline was a smaller €312k. EPRA strips out the valuation movements (a positive €695k difference) directly in the profit and loss account, as well as similar effects in the historic contribution from the former equity accounted contribution. The latter meant a €770k negative swing in equity accounted contribution on an EPRA basis vs a negative €1.3m on an IFRS basis. Assuming no H2 realised and unrealised valuation movements, a continuation of administrative cost savings and a further decline in net interest income, we forecast €5.1m of full-year consolidated net income on an EPRA basis, in line with FVI's guidance.

Shareholders' equity, together with minority interest, was €145.6m or 45.5% of total consolidated assets at 30 June 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 June 2014 was 50.3% compared with 46.9% at end 2013.

Performance and valuation

Although FVI has historically paid lower dividends than peers, until its recent restructuring and DPS acceleration, 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).

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 Vermoegen	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.

Despite a comparable return performance, Exhibit 6 shows that FVI continues to trade at a much larger discount to NAV than the peer average (c 40% vs c 7%).

Exhibit 6: Peer comparison

		Price	NOS	Mkt cap	P/NAV (EPRA)		Yield	
		(€)	(m)	€m	2012	2013	2012	2013
AOX GR Equity	Alstria Office	10.05	78.93	773.43	0.96	0.95	5.0%	5.0%
HAB GR Equity	Hamborner REIT	7.93	45.50	355.53	0.97	0.96	5.0%	5.0%
VIH GR Equity	VIB Vermoegen	14.20	25.21	308.22	1.09	1.02	2.8%	3.2%
	Average				1.00	0.98	4.3%	4.4%
FVI GR Equity	Fair Value	5.20	9.3	48.5	0.54	0.59	1.9%	4.8%

Source: Company data, Bloomberg. Note: Prices as at 5 August 2014. .

We have previously commented that the larger discount may reflect its corporate structure (which has historically included substantial value in non-consolidated minority holdings), and historically lower dividends as a result of lower distributable earnings under HGB (compared with IFRS). The limited liquidity of FVI may also be a factor. 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	29.7	31.4
Net property expenses		(11.5)	(13.3)	(10.9)	(11.3)
Net rental income		25.3	23.1	18.7	20.0
EBITDA		21.6	19.8	16.1	17.4
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)	(0.4)	0.0
EBIT		11.9	5.0	15.7	17.4
Associates		(0.6)	1.5	0.0	0.0
Net Interest		(10.9)	(12.7)	(5.1)	(4.5)
Profit Before Tax (norm)		10.1	8.6	11.0	12.9
Profit Before Tax (IFRS)		0.4	(6.2)	10.6	12.9
Tax		0.0	0.0	0.0	0.0
Minority interests		(0.6)	0.9	(5.9)	(6.9)
EPRA Net income		5.9	6.4	5.1	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	0.55	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	30.5	30.6
Trade receivables		1.8	33.5	14.0	14.0
Cash		14.2	17.4	14.5	14.6
Other		2.4	2.5	2.0	2.0
Current Liabilities		(61.1)	(70.9)	(33.2)	(32.5)
Trade payables		(1.7)	(2.2)	(1.2)	(1.2)
Short term borrowing		(55.9)	(64.6)	(28.3)	(27.6)
Other		(3.5)	(4.1)	(3.7)	(3.7)
Long Term Liabilities		(170.0)	(128.7)	(137.4)	(131.7)
Long-term debt		(160.8)	(126.6)	(136.3)	(130.6)
Provisions and other		(9.2)	(2.1)	(1.1)	(1.1)
Net Assets		154.0	146.3	149.3	155.8
Minorities		(73.6)	(65.6)	(66.2)	(69.1)
Shareholders' equity		80.4	80.7	83.1	86.7
IFRS NAV per share (€)		8.62	8.65	8.91	9.30
EPRA NAV per share (€)		9.58	8.86	9.12	9.51
CASH FLOW					
Operating Cash Flow		18.0	13.4	12.4	13.4
Net Interest		(10.2)	(12.0)	(5.7)	(4.5)
Tax		0.0	0.0	0.0	0.0
Capex		0.0	(0.0)	0.0	0.0
Acquisitions/disposals		3.3	29.1	22.8	0.0
Financing		(0.1)	(0.8)	(3.5)	(0.0)
Dividends		(0.7)	(0.9)	(2.3)	(2.3)
Net Cash Flow		10.3	28.7	23.7	6.5
Opening net debt/(cash)		212.9	202.6	173.8	150.2
Other		0.0	0.0	(0.0)	0.0
Closing net debt/(cash)		202.6	173.8	150.2	143.6

Source: Company data, Edison Investment Research

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