EDISON

Fair Value REIT

From value to growth

Strategy and results update

Real estate

Fair Value Reit (FVI) is in the latter stages of its portfolio repositioning (disposals continued in Q115 and rental income declined further) and at the beginning of a new planned growth phase. FVI seeks to increase the investment portfolio fourfold over the medium term, locking in attractive property yields and benefiting from scale economies. Based on our 2015 forecast, we estimate that leveraged investment of the recent €34.7m (net) equity increase could lift annualised adjusted earnings by 74%. Additional growth on similar terms would further enhance earnings per share.

Year end	Revenue (€m)	Adj net profit* (€m)	Adj EPS* (€)	DPS (€)	P/NAV (x)	Yield (%)
12/13	36.4	6.4	0.69	0.25	0.89	3.2
12/14	30.1	4.4	0.47	0.25	0.93	3.2
12/15e	28.2	4.7	0.38	0.28	0.93	3.5
12/16e	28.6	5.3	0.38	0.28	0.92	3.5

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.

Positioned for growth

To be positioned for growth, FVI has substantially repositioned its investment portfolio over the past two years, selling off non-core properties representing c 19% of the end-2012 total. Last year saw a major shift in the shareholder base, introducing new shareholders who are willing and able to support the plan, and making possible the recent €34.7m (net) equity increase. 90% of the proceeds are targeted at building directly-owned assets while the balance will largely be directed at further purchases of minority interests in existing subsidiaries. We believe this can be achieved on terms that are accretive to earnings and NAV before any benefit from group simplification and cost efficiencies.

Attractive yields and fragmented market

German commercial property offers attractive yields relative to current funding costs, within a robust economy. The secondary locations that FVI targets (gross yields of c 8%) have historically shown above-average rental growth and less volatility. Over the past 10 years, large quoted residential property players have emerged, offering liquid, efficient and attractively-yielding investment opportunities. The commercial property market is more fragmented, and quoted players are smaller, but has similar potential for scale efficiencies.

Valuation: Growth to take over from value

FVI has performed well in absolute terms (up 51% over 12 months to 9 June 2015) and relative to peers, substantially closing the persistent c 40% P/NAV discount versus peers, while the recently-raised equity is yet to contribute to earnings. As funds are deployed, significantly in directly-owned properties, both earnings and distributable earnings should be boosted. We believe that FVI's rating versus its peers will then be driven by its ability to sustain cash flow-accretive growth off its acquisition platform, supported by access to debt and equity on favourable terms.

11 June 2015

Price	**€7.92**
Market cap	**€111m**
Net debt (€m) at 31 March 2015	140.8
Shares in issue	14.0m
Free float	72%
Code	FVI
Primary exchange	Frankfurt
Secondary exchange	Stuttgart, Berlin, Munich

Share price performance

%	1m	3m	12m
Abs	(1.8)	3.3	49.2
Rel (local)	2.1	8.8	32.8
52-week high/low		€8.6	€4.4

Business description

Fair Value REIT (FVI) is a real estate investment trust managing c 239,000sqm at 41 commercial properties across Germany (as at 31 March 2015). It has a diversified portfolio of office and retail assets, with a focus on regional locations.

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Analyst

Martyn King +44 (0)20 3077 5745

financials@edisongroup.com

Edison profile page

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

Investment summary

Having substantially repositioned its investment portfolio and refreshed its shareholder base over the past two years, FVI has raised a net €34.7m in new equity and is well positioned for its rapid growth strategy, seeking to build its German commercial real estate portfolio to c €1bn over the medium term – 4x the current size. German commercial property offers attractive yields relative to current funding costs, within a robust economy. The secondary locations that FVI targets have historically shown above-average rental growth and less volatility. Currently more fragmented than the residential property market, commercial property has similar potential for scale efficiencies.

Financials: Investment of new equity will lift forecasts

FVI is at the latter stages of its portfolio repositioning (disposals continued in Q115 and rental income declined further) and at the beginning of a new planned growth phase. Given the inherent uncertainty in forecasting the exact terms and timing of new investment, this growth is not yet captured in our current estimates. These allow for the increased number of shares in issue (depressing near-term earnings per share) but not the likely significant impact of new investments. On pages 9 and 10 we illustrate the potential upside from new investments, utilising the capital increase funds and supplemented by debt (an assumed 50% LTV on direct investments) to lock in currently attractive gross yields (c 8%) and benefit from cost efficiencies. Based on our existing 2015 forecasts, we estimate that on an annualised basis, using total shares in issue post the capital increase (rather than average), adjusted earnings (FFO, or funds from operations) and FFO per share could increase by 74%. We also show how additional growth on similar terms (and assuming equity issuance at the current post capital increase IFRS NAV per share of €8.26) would further enhance FFO per share and the FFO yield.

Valuation: Growth to take over from value

From a low valuation, FVI has performed well in absolute terms (up 51% over 12 months to 9 June 2015) and relative to peers. We believe this resulted from earlier moves to simplify the group structure, including the adoption of IFRS10, and measures to increase the proportion of earnings available for distribution. More recently, the reorganisation of the shareholder base, combined with the ability to raise additional equity to support management's growth strategy, has been particularly supportive. The persistent c 40% P/NAV discount versus its peers has substantially closed (FVI c 1.0x vs peers at 1.1x), while the recently raised equity is yet to contribute to earnings. As funds are deployed, significantly in directly-owned properties, both earnings and distributable earnings should be boosted. We believe that FVI's rating versus peers will then be driven by its ability to sustain cash flow-accretive growth off its acquisition platform, supported by access to debt and equity on favourable terms.

Sensitivities

The main drivers of FVI's IFRS earnings are rental rates, occupancy, interest costs and revaluation gains. The overall cost base is relatively high, reflecting a large number of smaller, higher-yielding properties, but flexible as a result of a substantially outsourced model.

- The average remaining lease term was 4.8 years at 31 March 2015.
- FVI has a flexible cost-efficient structure via the outsourcing model.
- Valuations of the directly- and indirectly-owned property portfolio are undertaken annually by CB Richard Ellis. We have assumed no valuation gains or losses in our estimates.
- Assuming a EURIBOR rate of 0.1% for variable-rate debt, the weighted average cost of FVI's €159.9m of total debt at 31 March 2015 was c 2.7%. Fixed-rate debt represented 36% of the total and the average remaining term of the debt was 2.5 years.

Company description: Regional commercial exposure

Fair Value REIT (FVI) is a real estate investment trust stock corporation (REIT), as defined and governed under German law. Its focus is on investment in, and the management of, commercial office and retail properties in secondary locations in Germany (ie outside the top seven cities of Berlin, Hamburg, Munich, Cologne, Frankfurt, Düsseldorf and Stuttgart). It invests both directly in wholly-owned properties and indirectly through fully-consolidated participations in real estate partnerships including closed-ended real estate funds. Secondary locations have historically shown greater rental increases (from lower levels) than the main cities (source: DIW), with less cyclical volatility, and FVI's strategy targets a continuation of this trend. Management believes that the group risk-return profile is further enhanced by the combination of lower-volatility secondary assets with the moderate debt (minimum equity ratio of 45%) imposed by the REIT rules. After a period of strategic alignment of its portfolio, FVI has recently begun a growth phase and seeks to build its portfolio to c €1bn over the medium term, subject to market conditions (Q115: €269.4m) through both new direct and new indirect investment. This strategy targets the attractive spread that continues to exist between secondary property yields and funding costs, aims to further simplify the group structure and increase the share of direct investment, and seeks cost efficiency benefits from greater scale and simplification. The goal is to generate significant growing FFO (proxy cash earnings) and dividend growth.

Brief history

The new strategy for growth largely returns FVI to its strategic ambitions at launch in 2007. The core of FVI's strategy at launch was to be a consolidation vehicle for the unquoted real estate investment fund sector, totalling c €50bn today (source: BSI). It offered investors in these funds the alternative of a tradable investment, greater portfolio diversification and the intention of enhancing returns through active portfolio management. Additional capital was raised for cash from institutional and retail investors to fund investment in directly-owned properties, with a view to further diversifying the overall portfolio. As a result of the financial crisis, which developed soon after FVI's formation, the share price fell to a significant discount to NAV for a time, making it difficult for management to pursue a strategy of further growth through direct investment and further fund consolidation. Meanwhile, management continued to actively manage the portfolio with a view to optimising its composition, gradually gaining greater control and increasing ownership of its investments, and increasing its dividend-paying capacity.

While keeping within the property trading limitations imposed on German REITs, the portfolio refocusing has seen 20, mostly non-core, properties (from an opening 60) sold since the beginning of FY13, with a carrying value of c €66.8m. The number of property-owning associates and subsidiaries has decreased from 11 at the end of 2012 (five fully consolidated subsidiaries and six equity-accounted associates) to eight today (all fully consolidated).

Renewed strategy for growth

Having substantially refocused the investment portfolio and reorganised the shareholder base, the re-rating of the shares has enabled FVI to return its attention to its long-held ambition of growth. In the immediate term, this ambition is supported by an €8.5m convertible bond issue in January 2015 and a recently completed €34.7m (net of costs) equity increase.

Management has indicated that up to 90% of the equity proceeds are likely to be used for additional direct investments – both acquisitions from third-parties as well as from existing subsidiaries. The balance is earmarked for investments in closed-ended real estate partnerships – both new participations and further acquisition of minority interests in existing subsidiaries (management identifies c €60m potential in the short to medium term). Over time, FVI seeks to liquidate its

closed-ended real estate fund investments through direct purchases of their portfolio assets and buying out minority interests. By progressively turning indirect into direct investments, this ongoing simplification process allows closer operating control of the portfolio and generates administrative expense savings when the participation level expenses are eliminated.

A number of direct investment opportunities have been identified, and FVI has already been able to acquire existing minority interests at an attractive, and accretive, discount to NAV.

Clearly stated investment profile and process

From an investment perspective, FVI will continue to focus on investment in retail and office properties in secondary locations identified by management as attractive, through direct and indirect property investments.

The following investment criteria outline FVI's strictly defined investment strategy, although management may amend this at times to better reflect evolving market conditions:

- locations in, or with close ties to, cities in secondary locations and preferably in western German federal states;
- retail properties with a food retailer as the anchor tenant;
- office properties;
- mixed use, office and retail;
- quality tenants with medium-term leases (of four or more years); and
- majority participations in real estate partnerships including closed-ended funds, with good income and value-enhancing opportunities.

The active portfolio management strategy pursued by FVI is provided by a small in-house team reporting to the management board. FVI's targeted investment profile is supported by market research based on FVI's own internally-collected data as well as publicly accessible secondary data. Acquisition leads, preferably off-market, come from industry information and personal networking. Targets that fit the investment profile are subject to extensive due diligence. If there is no fundamental reason why the acquisition should not proceed, a draft contract may be negotiated with the seller and financing structures negotiated with banks. A final investment memorandum is then prepared (including valuation reports and assessment of the opportunity and risks) from which the management board (in discussion with the supervisory board where necessary) may proceed to agree and approve final contract terms.

The non-strategic operating functions and property management are outsourced to specialist third-party providers, rewarded on a partly fixed and partly performance-related variable basis. This outsourcing has limited the fixed cost base of FVI – an advantage during the refocusing phase of the company that has seen the portfolio shrink significantly.

The in-house team has four employees including the CEO. It is expected that as the focus of the team shifts away from managing indirect investments towards acquisitions and a higher share of direct investment, the team will grow to insource some key operational functions such as asset management, acquisitions and accounting, and investor relations. The main outsourcing partner to FVI is IC Immobilien Service GmbH, with contracts covering property management, accounting and fund management services, and human resources services. In the past, the IC Immobilien group has been a significant shareholder in FVI (15.7% at the end of 2013) but no longer holds a position.

To support its strategy the company highlights a number of competitive strengths:

- the ability to source attractive acquisition opportunities – in particular, off-market transactions through its network of industry contacts;

- strong access to, and experience of, the acquisition of participations in closed-ended real estate funds on the secondary market;
- being nimble enough to quickly and efficiently react to acquisition opportunities; and
- strategically focused, with a disciplined investment profile.

German REITs

FVI launched as a REIT in 2007 to take advantage of new German REIT legislation that came into force in June of that year. It was the second German REIT to list on the stock market and the first offering exposure to the German unquoted, closed-ended investment fund sector. German REITs are not subject to corporation or business tax and dividends are taxed at the shareholder level, but with a maximum rate of 25%, plus a solidarity surcharge. The rate can be limited to 15% by some companies and non-resident investors. To receive these benefits German REITs are bound by a number of requirements, including the following:

- They must be listed, so the shares can be easily bought and sold.
- The pay-out ratio is fixed by law at no less than 90% of net income, according to German GAAP.
- They are required to have a ratio of equity (including minority interests) to real estate assets of at least 45% at each balance sheet date.

Commercial real estate seeing strong investment flows

The German economy is expected to grow by 2.1% in 2015 (source: the Joint Economic Forecast Project Group). The unemployment rate, half the European average, continues to fall (6.8% in March) – a positive indicator for retail spending (and retail commercial property) as well as occupier demand for office space. The commercial property market is large and liquid, with a stock of office property of c 400sqm, and the fourth largest per capita retail space in Europe, c 122sqm. However, very different regional dynamics make nationwide commentary difficult.

Retail-letting activity in 2014 increased c 20% on 2013, with demand for larger space (more than 1,000sqm) particularly strong. Top rents are growing at c 2% pa. Office letting showed slower growth than retail in 2014 – at 3% for the year – but was on an accelerating trend towards year end and into Q115. We expect rents in the major cities to show growth of 1-2% with vacancy recently at 7.6% – the lowest since 2002.

2014 investment activity in German commercial real estate was the highest since 2007, with transaction volume increasing by 30% to €39.8bn. The most active buyers were fund managers and special funds, with foreign investment noticeable increasing. The pace remained strong in Q115 (€9.5bn) and FVI management believes that demand for German commercial properties for 2015 may well increase further, primarily as a result of the continuation of historically low interest rates and continued international interest, encouraged by the robustness of the German economy. Prime commercial yields have tightened quite considerably (towards 4-4.5%) and further tightening may be limited. However, this has led to a growing interest in properties in secondary locations.

Portfolio overview

At 31 March 2015 the total portfolio (both directly- and indirectly-held investments) consisted of 41 properties (239,175sqm of rentable space), valued at €269.4m. Exhibit 1 shows a portfolio overview as at 31 March 2015.

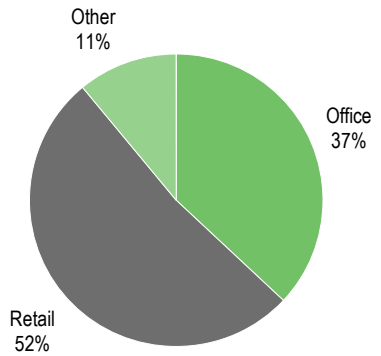
Exhibit 1: Portfolio summary

	Number of properties	Total lettable space (sqm)	Annualised contracted rent (€000s)	Market value (€000s)	Occupancy rate (%)	WALT (in years)	Contracted rental yield, gross (%)	FVI ownership (%)
Direct investments	17	40,580	2,757	36,730	98.2	8.5	7.5	100.0
Indirect investments	24	198,595	19,540	232,678	90.0	4.3	8.4	50.0
Total portfolio	41	239,175	22,297	269,408	91.0	4.8	8.4	53.9

Source: Company data. Note: As at 31 March 2015.

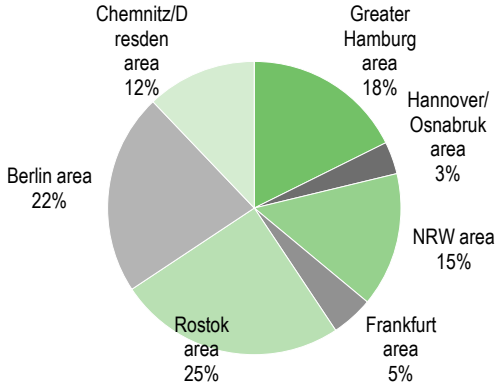
All the indirect investments are held by subsidiaries that are consolidated under IFRS10, but even adjusting for the minority interests, indirect investments currently represent the larger part of the portfolio. The portfolio is diversified by geography and by asset type. Occupancy was 91.0% at 31 March 2015, (2010-14 average 93.9%), with a weighted average unexpired lease term (WALT) of 4.8 years (2010-14 average 5.4 years), and a current gross rental yield of 8.4%.

Exhibit 2: Split of fair value by asset type



Source: FVI. Note: Data at 31 December 2014.

Exhibit 3: Geographical split of fair value



Source: FVI. Note: Data at 31 December 2014.

Using the more detailed data for 31 December 2014, the top 10 tenants represented 52% of the total. The largest share, around 20% of the total portfolio, was made up of large retail chains such as Metro, Lidl/Kaufland, Edeka, and Hammer Fachmarkte. Bank tenants (Sparkasse Südholstein, Commerzbank Group), at 16%, are not far behind.

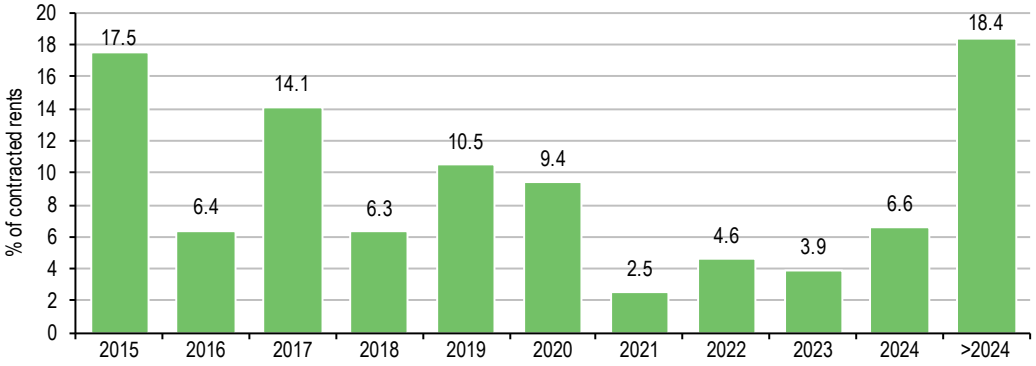
Exhibit 4: Top 10 tenants as at 31 December 2014

Tenant	Property type	Contracted rent (€m)	% of total contracted rent	Rent maturity (in years)
Sparkasse Südholstein	Office	2.14	9.0%	9.8
Commerzbank Group	Office	1.65	7.0%	2.2
Metro Group	Retail	1.61	6.8%	1.0
Kaufland/Lidl Group	Retail	1.45	6.1%	6.6
HPI Germany	Other	1.38	5.8%	6.0
Federal Labour Agency	Office	0.98	4.1%	0.8
Edeka Group	Retail	0.97	4.1%	3.9
RIMC Dresden	Office	0.89	3.8%	14.7
Hammer Fachmarkte	Retail	0.62	2.6%	1.0
WISAG	Other	0.62	2.6%	4.7
Others	N/A	11.36	48.0%	N/A

Source: Company. Note: Data at 31 December 2014.

At 1 January 2015, leases covering 17.5% of the portfolio (by contracted rents) were due for renewal during FY15. By number of leases the percentage is a smaller 15.5% (88 out of 568), indicating that some large leases expire during the year. The largest of these is attributable to a Metro Group subsidiary (6.8% of total contracted rents) that has already indicated it will not renew its lease upon expiry on 31 October 2015. FVI is already in negotiation with several high-profile retail chains for a hypermarket as well as for a discount supermarket.

Exhibit 5: Rental expiry profile



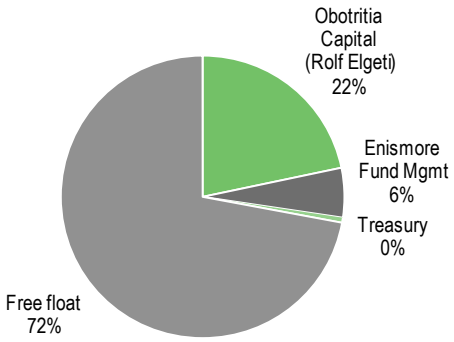
Source: FVI. Note: Data at 31 December 2014.

Management and governance

As described above, FVI has a lean management structure, with the CEO and sole management board member, Frank Schaich, supported by a further team of three. Mr Schaich, with more than 30 years' experience in international real estate markets, has been CEO since September 2007. The management board reports to the supervisory board, consisting of three members and chaired by Mr Rolf Elgeti since February 2015. Mr Elgeti is well known in the capital markets, most recently as chairman of the supervisory board of TAG Immobilien and companies controlled by him (via Obotritia Capital KGaA) became the new core shareholder in late 2014. Their combined stake was recently 21.7%.

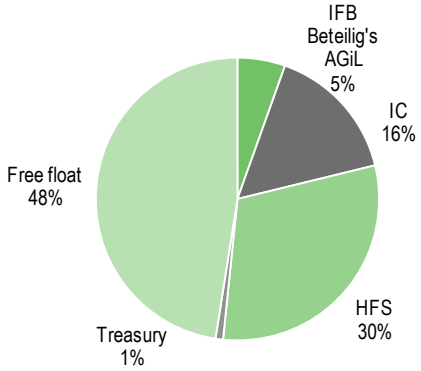
The entry of Obotritia into the FVI share structure represents part of a broader transformation of the shareholder base over the past year, which has seen the introduction of new shareholders who are both willing and able to support the group's growth strategy, and easing any concerns of a potential share overhang. The free float of the shares has also increased, which should continue to support liquidity. The former significant holdings of IC Immobilien Group and Unicredit S.p.a (via HFC) are no longer at a notifiable level (ie not more than 3%). 42% of the recent capital increase was subscribed for by existing shareholders and the remaining 58% was widely placed with new shareholders in Germany and wider Europe.

Exhibit 6: Current shareholder structure



Source: FVI website

Exhibit 7: 31 Dec 2013 shareholder structure



Source: 2013 Annual Report

The 2015 AGM approved a further increase in the authorised share capital of FVI, which may be used to fund management's targeted further growth. Up to 7.1m bearer shares (€14.1m) may be issued between now and May 2020, with the supervisory board's consent. Subscription rights for existing shareholders may be waived for issues of less than 10% of the existing capital, and for larger issues used as payment in kind for corporate acquisitions.

Financials

With the full-year results, management issued its customary earnings guidance for FY15. This looks for EPRA-adjusted earnings or FFO in the range €4.7-5.1m and is based on the portfolio and trends at the end of 2014. In reality, the portfolio and earnings base is likely to differ quite materially from this position, as recently-raised funds are deployed in acquisitions. As we show overleaf, investment of the equity issue proceeds (with additional debt gearing) will have a very significant impact on our existing forecasts. Given the inherent uncertainty in forecasting the exact timing and terms of this new investment, we have not yet included it; we intend to adjust our current forecasts over time as investments are made. We illustrate the potential impact in the section overleaf. Meanwhile, in the near term, until those investments are made, the additional shares in issue will depress FFO per share, and to a much lesser extent NAV per share.

Our existing estimate of €4.7m FFO (as shown in the financial summary on page 15 is struck on a broadly similar basis to management guidance. We have allowed for the disposals (lower rental income) completed in Q1, the January €8.5m convertible bond issue, and we have factored in the impact of the €37.1m (€34.7m net of expenses) capital increase completed in May. However, for illustrative purposes, we also include some further purchases of minority interests from the proceeds of the convertible bond. In Q1 FVI acquired minority interests with a net asset value of c €4.1m for a consideration of c €2.9m (a c 29% discount). For the balance of the year we have assumed that it acquires an additional €3.4m of net assets at a c 25% discount, investing an additional c €2.5m of the convertible bond proceeds.

Otherwise, our forecasts adjust gross rental income for disposals, and we look for a 7% decline in FY15 versus FY14. We have factored in no significant changes in occupancy or rental levels, and we assume no valuation movements or gains/losses on disposal beyond Q1. We have factored in a pick-up in administration costs in anticipation of management's growth plans, even without factoring in asset growth in our actual forecasts. Interest costs decline due to lower debt levels as well as the lower rates that have been recently negotiated. Although the percentage share of minority interests in the consolidated subsidiaries is forecast to decline with FVI's acquisition of minority interests, we look for the IFRS minority P&L charge to increase with no assumption that the 2014 valuation losses within subsidiaries will not repeat.

Meanwhile, in Exhibit 8 we show a comparison of FY14 versus our last published forecasts and the changes in our current FY15 forecast (excluding the anticipated uplift from investment of the equity proceeds). The FY14 difference mainly represents the continued repositioning of the portfolio via sales of non-core properties through H214, as well as some unanticipated administration cost increase in Q4 as the company positioned for its new growth phase. The revision to our FY15 forecast reflects this as well as further property sales in Q115, as management further positioned FVI for the new current phase of growth. In per share terms, the FY15 forecasts also reflect the higher share count. We discuss recent trading in more detail below on page 12.

Exhibit 8: Performance versus forecasts

	Net rental income (€m)			FFO/EPRA EPS (€)			EPRA NAV (€)			DPS (€)		
	Forecast	Actual	Diff. (%)	Forecast	Actual	Diff. (%)	Forecast	Actual	Diff. (%)	Forecast	Actual	Diff. (%)
FY14	18.6	17.6	-5.2%	0.54	0.47	-12.6%	9.12	8.49	-6.9%	0.25	0.25	0.0%
	Old	New	Change	Old	New	Change	Old	New	Change	Old	New	Change
FY15e	20.2	17.0	-15.8%	0.64	0.38	-40.5%	9.52	8.51	-10.6%	0.28	0.28	0.0%

Source: Company data, Edison Investment Research

Investment of new equity should significantly lift forecasts

Exhibit 9: Potential FFO impact of new equity investment

Direct investment (assumes all third-party)	
Share of proceeds (%)	90%
Share of proceeds (€)	31,191
Assumed gearing	50%
Total direct investment	62,383
Assumed return	8.0%
Gross rental income	4,991
Real estate operating expenses as % rental income	20.0%
Real estate operating expenses	(998)
NOI	3,993
Marginal administrative costs	(233)
Cost of borrowing	(624)
FFO/Net income on direct investment	**3,136**
ROE on direct investment	**10.1%**
Indirect investment (assumes all existing minority)	
Share of proceeds (%)	10%
Share of proceeds (€)	3,466
Assumed discount	25%
Total acquired net assets	4,621
Assumed return on net assets	8.2%
FFO/Net income on indirect investment	**378**
ROE on indirect investment	**10.9%**
Total additional FFO/Net Income	**3,514**

Source: Company data, Edison Investment Research

Management has indicated that up to 90% of the equity proceeds are likely to be used for additional direct investments, both acquisitions from third-parties as well as from existing subsidiaries. The balance is earmarked for investments in closed-ended real estate partnerships – both new participations and further acquisition of minority interests in existing subsidiaries. In Exhibit 9 we illustrate the potential contribution to FFO from the investment of the net €34.7m equity issue proceeds (plus debt gearing). We have made the simplifying assumption that all new direct acquisitions are from third parties (rather than from partially-owned subsidiaries) and that all new indirect investment represents the acquisition of existing minority investments. Acquisitions of properties from partially-owned subsidiaries should show a similar result, although the accounting for minority interests and cash transfers between parent and subsidiary make the modelling more complicated. For direct investment we have assumed an 8% gross rental yield on investments and a 50% LTV (debt cost at 2%). Real estate operating expenses are similar to existing and we have assumed a 15% marginal increase in central administration costs. For minority investments we have assumed a 25% discount to NAV, a slightly lower discount than recently achieved, and have applied to this to our existing FY15 subsidiary forecasts.

Exhibit 10: Potential impact of new investment on 2015 forecasts	
Existing FFO forecast	**4,747**
Incremental FFO	
Direct investment	3,136
Indirect investment	378
Pro forma FFO	**8,261**
Increase	**74%**
EPRA EPS (based on outstanding, not average shares as reported)	0.34
Pro forma EPRA EPS	**0.59**
Increase	**74%**
Existing EPRA NAV	119,425
Pro forma NAV	**120,580**
Increase	**1%**
Existing EPRA NAV per share	8.51
Pro forma EPRA NAV per share	**8.60**
Increase	**1%**
Existing FFO earnings yield on NAV	4.0%
Pro forma FFO yield on NAV	6.9%
Existing REIT equity ratio	49.2%
Pro forma REIT equity ratio	50.7%

Source: Company data, Edison Investment Research

In Exhibit 10 we show the impact of a potential additional €3.5m of FFO (as calculated in Exhibit 9). Compared with our existing 2015 forecasts, new investment has the potential to increase FFO earnings and EPRA EPS by 74% (note that we show the calculation using outstanding shares rather than the lower average share count that will actually be used in 2015 reported EPS, rising in 2016). As we have assumed that acquisitions of direct properties are made at fair value compared with the c 25% discount to NAV on the smaller indirect investments, the impact on NAV and NAV per share is limited and the gain on minority interest acquisitions (the difference between minority net assets acquired and the price paid) is excluded from FFO. As the assumed 50% LTV on direct investment is similar to the current position, the REIT equity ratio is also little changed by the significant investment.

Balance sheet and cash flows

Net assets were €304.2m at 31 March 2015, of which investment property assets were €269.4m and cash was €19.1m. Total financial debt was €159.9m, of which €58.0m (36%) was fixed rate debt and the majority balance was floating. Assuming a three-month EURIBOR rate of 0.1%, the weighted average rate on all debt was 2.7%, with an average remaining term of 2.5 years.

The €8.5m convertible bond that FVI issued in January is Included in the fixed-rate debt. The bearer notes of €1,000 each pay 4.5% on the nominal value and can be converted into ordinary shares at a conversion price of €9 up to 19 January 2020. The conversion price is subject to adjustment for certain specified capital developments. The bonds avoided dilution of existing shareholders, with the conversion price above the NAV at issue and currently.

The REIT equity ratio (net assets, or shareholders' equity plus minority interests as a proportion of immovable assets, or investment properties) was 51.3% at 31 March 2015, up from 49.2% at the end of 2014, and compared with a minimum of 45% under the German REIT legislation. The successful equity issue and placing completed in May will substantially boost equity and, cash, and the REIT equity ratio until the funds are deployed.

Highlights of recent trading

- During FY14 and Q115, FVI continued to sell non-core properties (six properties in FY14 with a value of €23m, and three properties in Q115 with a value of €13.2m).

- FY14 adjusted consolidated net income (FFO or funds from operations) came in at €4.4m. This was €2.0m lower than in FY14 and below guidance set earlier in the year of €5.1m, largely because of ongoing non-core property sales.
- FY14 gross rental income was down by 19% (€5.7m), reflecting the ongoing portfolio optimisation and in Q115 was 6% lower than the Q415 level. Net rental income was 24% lower in FY14, although increased slightly in Q115 versus Q414, despite lower gross rental income, as property expenses in the quarter were lower.
- Lower administration expenses helped offset the net rental income decline through the first three quarters of FY14 but increased in Q4 as FVI positioned for its new growth initiatives. For FY14 there was a decline of 12%, although due to the Q4 pick-up, administration expenses exceeded our forecast for the year. We anticipate that the recent higher level of costs will be maintained throughout the year (and will likely increase as we factor in portfolio growth later in the year), with an increase of 10% for the year as a whole.
- Valuation losses of €7.5m (FY13: €14.0m) negatively affected the IFRS results (although these are excluded from FFO/EPRA earnings). On a like-for-like basis (adjusted for divestments) the value of the portfolio declined by 2.6%. 98% of the valuation loss related to five properties in the portfolio – the largest impact (42% of the valuation loss) was in respect of the former Praktiker DIY store in Celle and a hotel in Dresden. Both were re-let on lower minimum rents; although received rents may be higher depending on the level of turnover generated by the tenants, the uncertain nature of this is not captured in the valuation.
- FY14 net interest expense fell sharply by 61% to €5.0m versus €12.7m in FY13. In part this reflected the fall in interest rate swap cancellation fees and valuation movements (€4.0m in FY13) but underlying interest expense also fell significantly, reflecting both lower debt and a lower cost of debt. The decline continued into Q115, and our base forecasts look for a full-year decline. However, as we factor in portfolio growth, and likely further borrowing through the year, this is likely to change.
- Minority interests were a negative €0.9m in FY14 compared with a positive €1.0m in FY13, when consolidated valuation losses within the subsidiaries were larger. Assuming no valuation movements within the subsidiaries in FY15 we expect a larger minority charge, although smaller as a proportion of subsidiary earnings as a result of FVI's increased ownership.

Valuation and performance

Starting from a low valuation, FVI has performed well in absolute terms (up 51% over 12 months to 9 June 2015) and relative to peers. We believe this resulted from earlier moves to simplify the group structure, including the adoption of IFRS10, and measures to increase the proportion of earnings available for distribution. More recently, the reorganisation of the shareholder base, combined with the ability to raise additional funds to support management's growth strategy, have been particularly supportive to the share price.

Exhibit 11: Peer valuation comparison

	Price	Mkt cap	P/E (x)		Yield (%)		P/NAV		
	(€)	(€m)	2015e	2016e	2015e	2016e	2015e	2016e	
Alstra Office	11.6	1,013	16.4	15.6	4.6	4.7	1.0	0.9	Office property across Germany. REIT
Deutsche Office	3.8	702	11.1	10.3	4.7	5.1	0.8	0.8	Mainly office property (83%) across Germany
DIC Asset	8.0	557	20.9	24.6	4.4	4.5	0.7	0.7	Mainly office property (71%) across Germany
Hamborner	9.2	472	30.9	24.0	4.7	4.7	1.4	1.5	Mainly retail (65%) commercial property across Germany. REIT
TLG Immobilien	14.0	859	13.4	11.8	5.9	6.4	0.9	N/A	Office properties in Berlin and surrounding regions
VIB Vermogen	16.4	405	12.7	11.5	3.3	3.6	1.1	1.0	Develops, buys, and holds with retail/logistics focus
Fair Value	7.9	112	20.9	21.3	3.5	3.5	0.9	0.9	Retail and office property across Germany. REIT
Average		589	18.0	17.0	4.4	4.7	1.0	1.0	

Source: Bloomberg data as at 10 June 2015, Edison forecasts for FVI and Bloomberg consensus for others

In its recent prospectus, FVI identified a range of listed property companies active in investment and rental markets for office and retail property with which it actually competes, or may potentially do so. We have included these in a summary of key valuation metrics, shown in Exhibit 11, and believe it forms a reasonable peer comparison group for FVI. It is important to note that the table includes our current forecasts for FVI (which are very similar to Bloomberg consensus), excluding the significant potential uplift from the deployment of the equity issue proceeds. Following its re-rating, these current estimates show FVI to be on a similar P/BV to peers but at a lower yield and higher P/E ratio. However, as we show above, investment of the equity issue proceeds has the potential to significantly lift both EPS, and by implication the earnings yield on NAV.

Taking our potential post-investment annualised EPS for FY15 (investments in FY15 will not fully contribute until FY16, and so reported earnings will lag annualised earnings), the P/E ratio would fall from 20.9x to 13.4x, which is at the lower end of the peer group. The FFO yield on NAV increases from the forecast 4.0% to 6.9% on the same basis, and the forecast dividend of €0.28 is 2.1x covered compared with the c 2.0x that management has been targeting. Dividend-paying capacity is determined by the local statutory HBG accounts (rather than the reported IFRS); as the share of direct investment increases, we believe it is possible that management may review, and possibly increase, the targeted pay-out ratio.

Given the potential c 10-10.5% marginal FFO return on new equity invested, future additional equity increases at around NAV to fund additional growth on similar terms would further enhance FFO per share and the FFO yield on NAV.

Exhibit 12: Illustrative impact of ongoing direct investment, part equity-funded

Additional equity proceeds (€000s)	10,000	Existing number of shares (000s)	14,029
Assumed gearing	50%	Existing IFRS NAV (€000s)	115,883
Total direct investment (€000s)	20,000	Subscription price (€)	8.26
Assumed return	8.00%	New shares issued (000s)	1,211
Gross rental income (€000s)	1,600	New number of shares (000s)	15,240
Real estate operating expenses as % rental income	20.0%	Existing FFO (€000s)	8,261
Real estate operating expenses (€000s)	(320)	**New FFO (€000s)**	**9,266**
NOI (€000s)	1,280	**Increase**	**12%**
Marginal administrative costs (€000s)	(75)	Existing EPRA EPS (€)	0.59
Cost of borrowing (€000s)	(200)	**New EPRA EPS (€)**	**0.61**
FFO/Net income on direct investment (€000s)	1,005	**Increase**	**3%**

Source: Company data, Edison Investment Research. Note illustration of potential impact of equity raising and investment on top of pro forma position illustrated in Exhibit 10.

Using the same assumptions as above, an additional €10m of equity issued at the pro forma (post-investment as per Exhibit 10) NAV per share, by way of payment in kind for directly-owned portfolio assets (in this case no share issuance costs) would lift the pro forma FFO per share by 3% from €0.59 to €0.61 and increase the FFO yield on EPRA NAV per share to 7.1% from 6.9%.

We note that our illustration of the investment of the recently completed equity increase would see the investment portfolio increase to c €330m. Management's medium-term target of c €1bn

therefore implies substantially more, potentially accretive, growth than shown in Exhibit 12, which would see the investment portfolio increase to c €350m.

Sensitivities

The main drivers of FVI's IFRS earnings are rental rates, occupancy, interest costs and revaluation gains. The overall cost base is relatively high, reflecting a large number of smaller, higher-yielding properties, but flexible as a result of a substantially outsourced model.

As detailed above, our current forecasts are based on the current portfolio and trends, and allow for the January convertible bond issue and May equity raise, and some further investment of the convertible bond issue into the minorities of existing subsidiaries. This forecast is likely to change materially as FVI invests the proceeds of the equity raise (with some additional debt gearing) and we will reflect these expected acquisitions as they occur. We provide an illustration of the potential impact on our forecast on pages 9 and 10.

- The average remaining lease term across FVI's portfolio (on a look-through basis, including its share of the associate's investment property) was a relatively healthy 4.8 years at 31 March 2015.
- FVI has a flexible cost-efficient structure via the outsourcing of its property management and accounting functions, enabling management to concentrate on portfolio management. It is likely that more management functions will be in-sourced as the portfolio grows.
- Valuations of the directly- and indirectly-owned property portfolio are undertaken by CB Richard Ellis on an annual basis. We have assumed no valuation gains or losses in our estimates.
- Interest costs. Assuming a EURIBOR rate of 0.1% for variable rate debt, the weighted average cost of FVI's €159.9m of total debt at 31 March 2015 was c 2.7%. Fixed-rate debt (including the recently issued convertible bond) represented 36% of the total and on the balance of floating rate debt there is one interest rate cap amounting to €33.6m at 4.25%. The average remaining term of the debt was 2.5 years.

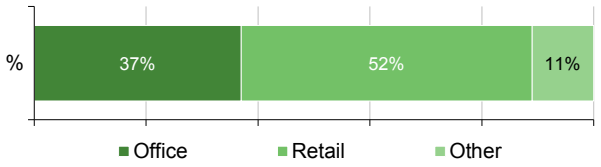
Exhibit 13: Financial summary

Year ending 31 December	€m	2012	2013	2014	2015e	2016e
		IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS		**Restated**				
Revenue		36.8	36.4	30.1	28.2	28.6
Net property expenses		(11.5)	(13.3)	(12.5)	(11.2)	(11.3)
Net rental income		25.3	23.1	17.6	17.0	17.4
Administrative expenses		(3.5)	(3.3)	(2.9)	(3.2)	(3.1)
EBITDA		21.8	19.8	14.7	13.8	14.3
Net other operating income and expense		(0.2)	(0.0)	(0.6)	3.4	0.0
Revaluation of inv. Property		(9.7)	(14.0)	(7.5)	0.6	0.0
Net result from sale of inv. Property		0.1	(0.7)	(0.7)	(0.0)	0.0
Net other income & expenses		(0.2)	(0.0)	(0.6)	3.4	0.0
EBIT		11.9	5.0	5.9	17.8	14.3
Associates		(0.6)	1.5	0.0	0.0	0.0
Net Interest		(10.9)	(12.7)	(5.0)	(4.3)	(4.0)
Profit Before Tax (IFRS)		0.4	(6.2)	0.8	13.5	10.2
Minority interests		(0.6)	0.9	(0.9)	(4.8)	(4.9)
Net income (IFRS)		(0.2)	(5.2)	(0.0)	8.7	5.3
EPRA adjustments:						
Net other operating income and expense		0.0	0.0	0.6	(3.4)	0.0
Revaluation of inv. Property		9.7	14.0	7.5	(0.6)	0.0
Net result from sale of inv. Property		(0.1)	0.7	0.7	0.0	0.0
Associates		2.1	0.1	0.0	0.0	0.0
Net Interest		0.2	3.9	0.0	0.1	0.0
Minority interests		(5.9)	(7.1)	(4.4)	(0.0)	0.0
EPRA net income		5.9	6.4	4.4	4.7	5.3
Average Number of Shares Outstanding (m)		9.3	9.3	9.3	12.5	14.0
IFRS EPS (€)		(0.02)	(0.56)	(0.01)	0.70	0.38
EPRA adjusted EPS (€)		0.64	0.69	0.47	0.38	0.38
Dividend per share (€)		0.10	0.25	0.25	0.28	0.28
BALANCE SHEET						
Non-current assets		366.7	292.5	277.9	279.2	279.2
Investment property		355.9	292.3	267.7	269.4	269.4
Equity accounted investments		10.6	0.0	0.0	0.0	0.0
Other non-current assets		0.2	0.2	10.2	9.8	9.8
Current Assets		18.4	53.4	34.0	56.5	56.1
Trade receivables		2.4	2.5	3.0	2.8	2.8
Cash		14.2	17.4	14.6	50.6	50.2
Assets held as available for sale		0.0	19.6	13.2	0.0	0.0
Other		1.8	13.9	3.2	3.1	3.1
Current Liabilities		(61.1)	(70.9)	(61.0)	(40.2)	(39.8)
Trade payables		(1.7)	(2.2)	(2.3)	(1.8)	(1.8)
Short term borrowing		(55.9)	(64.6)	(54.2)	(34.8)	(34.4)
Other		(3.5)	(4.1)	(4.6)	(3.7)	(3.7)
Long Term Liabilities		(170.0)	(128.7)	(112.5)	(123.0)	(121.6)
Long-term debt		(160.8)	(126.6)	(110.9)	(122.3)	(120.9)
Derivative financial liabilities		(9.1)	(2.1)	(1.0)	(0.1)	(0.1)
Provisions and other		(3.5)	(4.1)	(4.6)	(3.7)	(3.7)
Net Assets		154.0	146.3	138.3	172.5	173.8
Minorities		(73.6)	(65.6)	(60.0)	(53.1)	(53.1)
Shareholders' equity		80.4	80.7	78.3	119.4	120.7
EPRA adjustments:						
Market value of derivative financial instruments (net of minorities)		8.9	1.9	0.9	0.1	0.1
EPRA adjusted NAV		89.3	82.6	79.2	119.4	120.8
Period end number of shares (m)		9.3	9.3	9.3	14.0	14.0
IFRS NAV per share (€)		8.62	8.65	8.39	8.51	8.61
EPRA NAV per share (€)		9.58	8.86	8.49	8.51	8.61
CASH FLOW						
Operating Cash Flow		17.6	14.7	10.8	13.4	9.4
Net Interest		(10.1)	(11.9)	(4.7)	(4.6)	(4.0)
Tax		(0.0)	0.1	0.0	0.0	0.0
Capex		(1.7)	(0.8)	(0.5)	(0.7)	0.0
Acquisitions/disposals		5.0	29.9	22.9	13.2	0.0
Financing		0.0	0.0	0.0	34.7	0.0
Dividends		(0.7)	(0.9)	(2.3)	(2.3)	(3.9)
Other		0.3	(2.3)	(2.8)	(9.6)	0.0
Net Cash Flow		10.3	28.7	23.3	44.1	1.4
Opening net debt/(cash)		212.9	202.6	173.9	150.5	106.5
Closing net debt/(cash)		202.6	173.9	150.5	106.5	105.1

Source: Company data, Edison Investment Research

Contact details	Contracted rents by property type (100% Germany)

Leopoldstrasse 244
80807 Munich
Germany
+49 (0) 89/929 28 15-01
www.fvreit.de



Management team

Management board and CEO: Frank Schaich

Frank Schaich has been CEO of Fair Value since September 2007, and is the sole member of the management board, responsible for all business areas. He has more than 30 years' experience on international real estate markets. He was previously a member of IC Immobilien Holding's management board, responsible for the fund business and executive in various departments at IC GmbH.

Chairman of the supervisory board: Rolf Elgeti

Rolf Elgeti joined the supervisory board, becoming chairman, in February 2015. He was a member of the management board of TAG Immobilien from 2008, and was chairman from 2009-14. During the past five years he has been chairman of the supervisory boards of TAG, Estavis, and a supervisory board member of several other companies.

Vice chairman of the supervisory board: Dr Oscar Kienzle

Dr Oscar Kienzle is the founder of the IC GmbH. He is a lawyer by training but later held various positions in the real estate sector. He founded the IC Real Estate Group in 1988, and was chief executive and chairman of the management board of IC Immobilien Holding until 2011, and later, chairman of the supervisory board. He is a Fellow of the Royal Institute of Chartered Surveyors (FRICS).

Member of the supervisory board: Prof Dr Heinz Rehkugler

Professor Dr Heinz Rehkugler was chairman of the supervisory board of Fair Value until February 2015. He is professor for real estate investments at Steinbeis University, Berlin, scientific director of the Centre for Real Estate Studies at DIA Freiburg and Steinbeis University, and vice chairman of the Supervisory Board of DIA Consulting.

Shareholders	(%)
Obotritia Capital KGaA	21.69
Ennismore Fund Management	5.67
Treasury	0.58
Free float	72.06

Companies named in this report

Alstria Office (AOL), Deutsche Office (PMOX), DIC Asset (DIC), Hamborner REIT (HAB), TLG Immobilien (TLG), VIB Vermoegen (VH)