

# DEMIRE Real Estate

## Strategic programme delivering gains

The first nine months of FY17 showed good operational development as well as significant progress with the strategic programme (DEMIRE 2.0) that targets efficiency gains and portfolio growth. Management has raised FY17 guidance to reflect tax optimisation measures as well as operational performance. FY18 will benefit from significant interest cost savings following recent refinancing. Management targets further efficiencies and simplification of the group structure and is seeking opportunities for portfolio growth with the potential for scale economies. With funds from operations (FFO) earnings rising strongly, we would expect DEMIRE to consider dividend distributions (not in our forecasts), a potential trigger for closing the 17% discount to EPRA NAV.

Year end	Net rental income (€m)	FFO* (€m)	Attributable FFO/share** (€)	EPRA NAV*** per share (€)	P/FFO share** (x)	P/EPRA NAV (x)
12/15	23.7	N/A	N/A	4.25	N/A	0.92
12/16	58.6	8.1	0.04	4.60	95.4	0.85
12/17e	55.8	12.0	0.09	4.75	42.5	0.82
12/18e	56.4	20.3	0.21	5.18	18.6	0.75

Note: \*Funds from operations, excluding gains/losses on disposal, before minority interests but after tax. \*\* Attributable FFO/share is FFO after minority interests per share. \*\*\*EPRA NAV is adjusted for deferred tax, fair value of derivative instruments, and is fully diluted.

## Earnings guidance lifted

Funds from operations grew strongly in 9M17, to €9.2m before minority interests (9M16: €7.0m). Operational progress (like-for-like rents rose 2.6% and occupancy improved 1.7% to 90.1%), together with tax optimisation savings, led management to lift FY17 guidance. It now expects FY17 FFO (before minority) of €11-12m (previously €8-10m) with rental income of €74m (previously €72-73m). With the average cost of debt reduced to 3.0% (end-FY16 4.4%), management expects to save €9m in interest costs in FY18 with a similar reduction in loan amortisation.

## Return to growth

DEMIRE 2.0 targets growth as well as efficiency. The medium-term target is to double the investment portfolio to c €2bn while reducing LTV towards 50% (9M17: 62.0%). Up to €50m of surplus cash is immediately available for investment and several assets (aggregate value c €60m) are undergoing due diligence. A larger pipeline, at a less advanced stage, amounts to c €200m. We do not include acquisitions in our forecasts but in this note we illustrate the potential for growth and scale economies as well as the impact of further simplification of the group structure.

## Valuation: Strong FFO growth suggests re-rating

Our forecasts look for strong FFO growth over the next two years and for DEMIRE's FFO yield to converge on the current peer average. This suggests that the 17% discount to last published EPRA NAV (compared with a peer average 6% premium) is also likely to narrow. Although not in our forecasts, dividend payments are now becoming likely, a potential catalyst for a re-rating. The extent of that re-rating will partly depend on management's ability to balance shareholder distributions with its plans to grow and further de-gear.

Interim results update

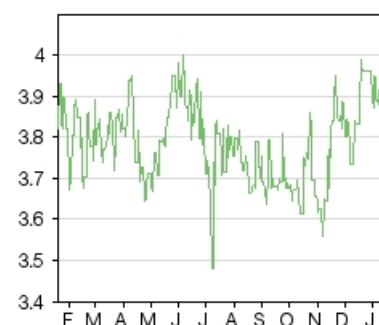
Real estate

17 January 2018

**Price** €3.90  
**Market cap** €212m

Net debt (€m) at 30 September 2017	631.4
Net LTV at 30 September 2017	62.0%
Shares in issue	54.3m
Free float	50.5%
Code	DMRE
Primary exchange	Frankfurt (Xetra)
Secondary exchange	N/A

### Share price performance



%	1m	3m	12m
Abs	0.1	4.0	2.1
Rel (local)	(1.0)	2.1	(10.9)
52-week high/low	€4.0		€3.5

### Business description

DEMIRE Deutsche Mittelstand Real Estate is an investor in German commercial real estate with a focus on properties in secondary locations, targeted at medium-sized company tenants. The portfolio is well diversified geographically and by tenant and is spread across office, retail and logistics assets.

### Next events

Publication of annual report	26 April 2018
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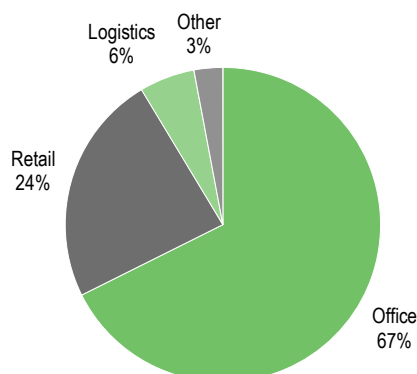
## Company description

DEMIRE Deutsche Mittelstand Real Estate is a holding company for commercial real estate investment in properties located in mid-sized cities and up-and-coming metropolitan areas across Germany, with a gross portfolio value of just over €1bn. Its shares are traded on the Prime Standard segment of the Deutsche Börse. DEMIRE describes its strategic aims as “first in secondary locations” and as indicated by its name, has a focus on properties that it expects to prove attractive to a broad spread of medium-sized corporate tenants.

The current business model was established in mid-2013 after significant changes in the company's ownership structure. It has since grown quickly through both the acquisition of individual property assets and corporate acquisitions suited to its investment objectives, while non-core assets and corporate interests have been sold. In late 2015 it acquired a controlling (77.7%) interest in Fair Value REIT (FVI), a German REIT with a similar investment policy. FVI is fully consolidated and is reported as a separate business segment, alongside what is referred to as the core portfolio and corporate functions. The remaining minority interest in FVI has, for now, increased the complexity of the group and simplifying this is a key target for DEMIRE management.

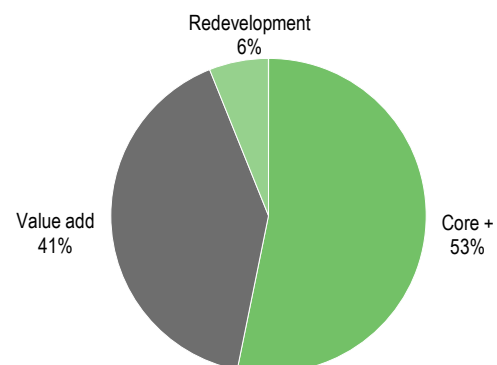
Primarily reflecting strategic and ownership changes, the composition of both the management and supervisory boards have changed considerably in recent years and continues to evolve. Ralf Kind currently represents the management board, as CEO/CFO. Following the departure of Markus Drews, who stepped down as CEO at the end of 2017, the supervisory board is planning to appoint another member, with operating responsibilities. The company indicates that this change will have no material impact on the strategic programme that was announced at last year's AGM, known as DEMIRE 2.0. The main aim of the programme is to increase the profitability of the existing business and to grow the portfolio further, generating scale economies. The medium-term target is to expand the portfolio value to c €2bn while maintaining the focus on secondary locations in Germany, and to reduce the LTV ratio to c 50% (from 62.0% at 9M17).

**Exhibit 1: Portfolio gross asset value by sector**



Source: Company data as at 30 September 2017

**Exhibit 2: Portfolio gross asset value by strategy**



Source: Company data as at 30 September 2017

## 9M17 results show progress with DEMIRE 2.0

**Exhibit 3: Summary of 9M17 results**

€m unless otherwise stated	9M17	9M16	FY17/FY16	FY16
Net rental income	42.0	43.3	(3%)	58.6
General & administrative expenses	(11.0)	(10.6)	3%	(14.5)
Equity accounted investments	0.1	0.0		(0.4)
Other operating income/(expense)	(3.1)	(5.8)		(3.9)
Income before revaluation gains/disposal result	28.1	26.8	5%	39.8
Revaluation of investment property	26.3	14.4		38.4
Profit/(loss) from sale of real estate/real estate companies	(0.6)	(0.0)		4.9
FVI minority	(5.5)	(3.1)		(5.2)
Refinancing costs				
Net financial result (excluding FVI minority)	(36.6)	(32.3)	13%	(38.0)
EBT	11.6	5.8		40.0
Tax	(3.1)	(10.4)		(12.3)
Net profit	8.6	(4.6)		27.6
Minorities	(3.6)	(2.5)		(3.0)
Net attributable	4.9	(7.0)		24.7
FFO (after tax, before minority)	9.2	7.0	32%	8.1
Minority interests	(4.6)	(5.3)		(3.0)
Attributable FFO (after minority)	4.6	1.7	164%	5.1
Diluted attributable FFO1 (after minority) per share (€)	0.07	0.03	149%	0.08
Investment properties (including held for sale)	1,018.5	981.2		1,005.6
Diluted EPRA NAV per share (€)	4.72	4.42	7%	4.60
Net LTV	62.0%	64.8%		62.8%

Source: Company data, Edison Investment Research

The first nine months of FY17 showed operational progress, with increasing occupancy and rents. DEMIRE has also made significant progress in 9M17 and into Q4 in relation to its strategic programme (DEMIRE 2.0), particularly with respect to refinancing and tax simplification. The underlying earnings progress made in 9M17 is obscured by revaluation gains and continuing one-off negative restructuring impacts and can best be seen in management's preferred measure of operating performance, funds from operations (FFO, after tax, before minorities). This measure adjusts for revaluation effects, disposal and other one-off effects, and any income effects relating to prior periods. FFO (after tax, before minorities) increased 32% to €9.2m, or a diluted €0.14 per share. Supported by revaluation gains, EPRA basis NAV per share advanced to €4.72 from €4.60 at end-FY16. The FFO improvement came predominantly from the non-FVI parts of the group such that attributable FFO earnings (after minorities) showed a much stronger advance, to €4.6m (€0.07 per share) versus €1.7m in 9M16. The refinancing and tax progress made in FY17 should have a significant positive impact on performance from FY18, while management is also preparing to return to portfolio growth. Both are discussed in later sections of this report. The highlights of the performance year to date are:

- Net rental income was c 3% lower in 9M17 compared with 9M16, reflecting the impact of non-core property sales on gross rental income and a slight increase in non-recoverable property expenses aimed at increasing future occupancy and income. Like-for-like rental growth was 2.6% during the first nine months and occupancy (EPRA basis) improved by 170bp to 90.1% over the same period.
- Around 51,600 sqm of space was let, of which new lettings represented c 49%, at an average lease term of 5.3 years (overall portfolio 4.8 years). Existing tenants were retained on c 78% of lease maturities.
- Management indicates that these operational improvements accounted for perhaps half of the positive €26.3m revaluation result with strong market fundamentals for secondary assets driving the balance. The gross rental income yield on the portfolio remains at 7.1% (end-FY16:

7.4%) and management is hopeful of future gains as a result of expected further operational improvement.

- Income, before revaluation movements and disposal effects, was c 5% higher in 9M17 compared with 9M16 but still contained some one-off costs which management indicated are in the range of €3-5m. The main items were higher one-off staff costs related to board changes and some continuing legal, consulting and accounting costs related to the restructuring programme.
- The net financial result (excluding that part which represents the minority interests within FVI subsidiaries), included c €13m of one-off items, mainly early repayment penalties, related to the refinancing programme (see below) and so was c 13% higher at €36.6m despite a broadly similar level of debt. The net LTV was 62.0% at 9M17 compared with 62.8% at end-FY16.
- The refinancing programme made significant progress during the first nine months of the year and into Q4. During 9M17, DEMIRE issued €270m nominal value of new rated, unsecured corporate bonds with a five-year maturity and fixed coupon of 2.875%, and an additional €130m nominal value has been issued in Q4. The bonds have been issued at a premium to par value, representing an effective yield of 2.6%. The issue allows for the repayment of existing higher cost debt and continues the reduction in the average cost of debt. This had fallen to 3.8% at end Q3 (4.4% at end-FY16) and 3.0% on a pro-forma basis after the further Q4 corporate bond issuance and debt repayment.
- At the EGM on 15 November 2017 shareholders approved measures that will simplify the group structure and allow for the pooling of profits with subsidiaries for tax purposes. The effect will be back-dated to the beginning of 2017 and management indicates a “7-digit” millions of euro tax saving.

## Financials

With its 9M17 results, DEMIRE increased its FY17 guidance for its operating measure, FFO (after taxes, before minorities), from €8-10m to €11-12m. In addition to the tax benefits made possible by the EGM shareholder approval, the increase reflects operational improvements; guidance for gross rental income was also increased from €72-73m to €74m. The refinancing is proceeding largely as expected and will have a significant impact on FY18 with an expected interest cost saving of c €9m and an additional c €9m benefit to cash flow from reduced debt amortisation.

Our FY17 forecasts benefit from higher net rental income and lower taxes than previously, while the higher than expected administrative and other costs substantially reflects non-recurring items that are excluded from FFO. Our revised FY17e FFO (after tax, before minority) moves to €12.0m, at the top of management's guidance range. For FY18e our forecast FFO (after tax, before minority) also rises materially and may prove conservative as the pre-tax increase only matches the €9m pre-tax gain that management expects from financing costs. We also introduce a first time forecast for FY19 but note that this is based on the current group structure only.

We have revised our method of forecasting minority interests which means that while our FY17 forecast attributable FFO (after tax and minorities) per share increases materially, there is a small reduction in the FY18 forecast growth rate.

Our forecasts include an assumption of vacancy reduction from 9.9% at end Q317 to 7.8% by end-FY18 and 6.0% by end-FY19. We also allow for rent growth at a rate of c 1% pa.

We have included no further revaluation gains for FY17 but do assume €20m pa (€0.4 per share) in both FY18 and FY19 to be consistent with our assumed operational improvements. This may also prove to be conservative as the gross rental income (GRI) yield implied by our revaluation and operating assumptions still rises from 7.1% at end-Q3 to 7.2% by end-FY18 and 7.3% by the end of

FY19. An unchanged GRI yield would imply additional revaluation equivalent to c €0.5 per share (c 9%) by end FY19.

Although management is signalling that property acquisitions are highly likely, we have not included these in our base case forecasts, given the inherent uncertainty in so doing. Rather, we discuss the potential impact on our forecasts in the following sections. We have included the completion of the sale of the €18.5m of investment properties carried as held for sale at end-Q317 within our forecasts. €9.2m of this amount was in respect of an office property in Teltow, Brandenburg owned by the c 78% owned subsidiary of FVI, IC07. The sale was completed by year-end 2017 and as this was the sole property owned by the subsidiary, it will now be liquidated, eliminating a layer of administrative expense and simplifying the group structure. The sale price was €11.5m, c 24% above the Q3 book value. The other assets held for sale have sales agreed at around their carrying value. We have assumed completion of the sales of all other assets held for sale in Q118. Another FVI subsidiary, BBV06 (c 62% owned by FVI), is also targeted for liquidation following the transfer of two of its properties into direct ownership (by FVI) and the sale of its remaining assets. DEMIRE management estimates that the eventual liquidations of IC07 and BBV06 will generate administrative cost savings of c €400k pa.

#### Exhibit 4: Forecast revisions

	Net rental income (€m)			FFO1 (€m)			Attributable FFO per share (€)			EPRA NAV/share (€)		
	Old	New	% change	Old	New	% change	Old	New	% change	Old	New	% change
12/17e	55.3	55.8	1.0	8.2	12.0	45.9	0.07	0.09	27.9	5.22	4.75	(9.1)
12/18e	55.7	56.4	1.2	17.3	20.3	16.9	0.23	0.21	(9.3)	5.53	5.18	(6.4)
12/19e	N/A	58.1	N/A	N/A	21.9	N/A	N/A	0.23	N/A	N/A	5.61	N/A

Source: Edison Investment Research. Note: \*before minorities, \*\*after minorities.

A key driver of the further strong growth in FFO in FY18, expected by management and reflected our forecasts, is lower interest costs arising from the Q4 refinancing operation. Although the average cost of borrowing has been lower in the current year, declining from an average 4.4% at end-FY16 to 3.8% at end-9M17, the reported cost of borrowing has increased from €33.4m in 9M16 to €37.3m. The reported cost includes c €13m of non-recurring costs, mostly linked to the refinancing. These include a c €6.5m early repayment penalties including c €4.0m in respect of the 7.5% coupon 2014/19 corporate bond, c €4.4m in accelerated amortisation of loan arrangement costs and accrued interest, and c €2.1m in derivative fair value movements. Since the end of Q317 the average cost of borrowing has declined to 3.0% (see Exhibit 5) and this is reflected in our forecasts with additional allowance for recurring debt cost amortisation.

#### Exhibit 5: Summary of refinancing and impact of average cost of borrowing

	30-Sep-17	Post Q4 refinancing	Coupon/margin
Senior unsecured notes	262.5	392.5	2.875%
Corporate bond 14/19	98.2	-	7.500%
Bank loans	24.4	24.4	1.500%-5.000%
A/B notes	92.5	-	3.910%-5.250%
Promissory notes	141.8	141.8	4.000%
Fair Value REIT debt	130.0	130.0	2.380%
Convertible bond	10.5	10.5	6.000%
Mandatory 2018 notes	0.3	0.3	2.750%
Other/rounding	1.3	1.3	
<b>Total financial liabilities</b>	<b>761.5</b>	<b>700.8</b>	
Average cost of debt	3.8%	3.0%	

Source: Company data

In the following section we explore the potential for the acquisition of additional investment property assets or minority interests in subsidiaries to materially enhance our forecast earnings. Without making any allowance for this potential we believe that the likely growth in FFO earnings is sufficient for management to consider the commencement of dividend distributions, although this is not reflected in our forecasts.

## Options for growth and simplification

DEMIRE's CEO/CFO has indicated that in the coming year the group will focus on:

- Returning to growth, through acquisitions.
- Further reductions in vacancy and other operational improvements.
- Further simplification of the group structure, with an emphasis on non-controlling interests.

As discussed in the previous section, our existing forecasts include an assumption of continuing vacancy reduction and modest rent increases.

In terms of acquisitions, DEMIRE currently has several assets, with an aggregate value of c €60m, undergoing due diligence. At a less advanced stage, it has a larger pipeline of potential acquisition targets amounting to c €200m across both the office and retail sectors and spanning both the core plus and value add strategies. Towards its target of c 2bn of investment assets over the medium term, management believes that it should be able to invest c €250-350m pa through single asset or portfolio purchases while corporate transactions, less easy to predict, would have the potential to accelerate the process. Management indicates that allowing for Q4 refinancing activity and working capital needs, there is up to c €50m of surplus cash immediately available to fund acquisitions and we illustrate the potential impact of this on our base forecasts below (Exhibit 6). We show the impact on a full year basis (as if the assets were acquired on 1 January 2018), for a range of possible gross yields on the assets acquired and allow for direct property costs at a rate of 25% and show the result on both a fully taxed and untaxed basis. Our 25% direct property cost assumption is similar to the long-term trend at FVI and although the DEMIRE core portfolio has been above this level, with occupancy increasing we assume in our base forecasts that it too will fall to c 25%. Given the new tax pooling arrangements, the effective tax rate that would apply to the additional earnings is likely to be below the standard rate, at least until carried forward group tax losses are exhausted. In the near term we would therefore expect an outcome somewhere between zero and c 30% and our base forecast includes a group-blended current tax rate of c 17%. Because we would not expect any minority interest in the additional earnings, any material loss of income on the cash invested, or any additional administrative cost, the impact on our existing FY18 forecast attributable FFO (after minority) earnings per share is quite significant. We show the outcome on both a fully taxed and untaxed basis, recognising DEMIRE's increased ability to utilise tax losses carried forward but uncertain as to how this may apply in practice. The potential uplift ranges from 11% to 20%, while the impact on forecast net LTV is relatively modest with an uplift from the forecast 58.7% to 60.7%.

**Exhibit 6: Illustration: Investment of surplus cash**

€000s unless otherwise stated				
Assets acquired (notional €50m)	50,000	50,000	50,000	50,000
Gross rental yield on assets	6.0%	6.5%	7.0%	7.5%
Rental income acquired	3,000	3,250	3,500	3,750
Non-allocable property operating costs	25%	25%	25%	25%
Net rental income acquired	2,250	2,438	2,625	2,813
Tax rate (%)	30%	30%	30%	30%
Net rental income acquired after tax	1,575	1,706	1,838	1,969
Pro-forma attributable FFO/share (after minority) - taxed	0.23	0.24	0.24	0.24
Pro-forma attributable FFO/share (after minority) - untaxed	0.24	0.25	0.25	0.25
Increment - taxed	11%	12%	13%	14%
Increment - untaxed	16%	17%	18%	20%

Source: Edison Investment Research

We also illustrate the potential effect of a larger investment of €250m (Exhibit 7), in line with the lower end of management's annual target. We first assume investment of the "surplus" €50m of cash and then assume that the balance of €200m of investment is funded 50:50 with new debt and new equity, in line with management's target to reduce the LTV towards 50% over time. We have



assumed that the new shares are issued at around the current market price and that the cost of the new debt is 2.875%, in line with the coupon on the recently issued long-term fixed rate corporate debt. In current market conditions we would expect DEMIRE to be able to arrange secured bank finance at a lower cost than we have assumed and so our assumption should be seen as conservative. Each 50bp reduction in the assumed cost of debt would increase the accretion by c 2%. We have similarly assumed that the investment is made within DEMIRE ex-FVI, generating no additional minority interest, although we note that within the group FVI has room to further gear its balance sheet (Q317 equity ratio 38.1%, REIT equity ratio 63.0%, and net LTV of 39.9%). The potential uplift to attributable FFO (after minority) per share ranges from 2% to 29%, which includes the significant uplift from the surplus cash investment with the marginal impact of the additional investment slightly tempered by the assumed equity issuance. The net LTV remains at a similar level to the base forecast (59.0%) but lower than in the illustration above.

**Exhibit 7: Illustration: €250m investment, including surplus cash**

€000s unless otherwise stated				
Assets acquired	250,000	250,000	250,000	250,000
Gross rental yield on assets	6.0%	6.5%	7.0%	7.5%
Rental income acquired	15,000	16,250	17,500	18,750
Non-allocable property operating costs	25%	25%	25%	25%
Net rental income acquired	11,250	12,188	13,125	14,063
Less interest cost	(2,875)	(2,875)	(2,875)	(2,875)
Tax rate (%)	30%	30%	30%	30%
Net rental income acquired after tax	5,863	6,519	7,175	7,831
Pro-forma attributable FFO/share (after minority) - taxed (€)	0.21	0.22	0.23	0.24
Pro-forma attributable FFO/share (after minority) - untaxed (€)	0.24	0.25	0.26	0.27
Increment - taxed	2%	5%	9%	12%
Increment - untaxed	15%	20%	24%	29%

Source: Edison Investment Research

Following the acquisition of a 77.7% controlling stake in FVI, minority interests exist at two levels:

- The interest of the 22.3% minority stake in the earnings of FVI, and;
- The interests of minority shareholders in the subsidiaries of FVI.

In recent weeks, Ralph Kind (DEMIRE CEO/CFO) has joined the management board of FVI as CEO, alongside Patrick Kaiser (CFO). The three-strong supervisory board also completely changed in September, including replacements for former DEMIRE CEO, Markus Drews, and Ralph Elgeti. Mr Elgeti's Obotritia Capital has subsequently reduced its holding in DEMIRE (acquired through an exchange of its prior FVI holding) from 11.89% to 9.98%. In late December 2017, FVI announced its intention to change its stock market listing from the Prime Standard to the General Standard, with an easing in listing requirements.

Any increase in DEMIRE's ownership of FVI above 95% would trigger a costly property transfer tax liability. Moreover, for FVI to retain its REIT status, a minimum free float of 90% must be retained. However, should DEMIRE seek to increase its stake up to 95% the required investment at the current FVI market capitalisation is relatively modest (c €20m) and despite the recent narrowing of the FVI discount to NAV to c 5%, we estimate it would be very modestly accretive of DEMIRE's EPRA NAV per share and attributable FFO1 earnings per share, if cash funded.

A more material simplification of the group structure will come from the continued reduction in minority interests in the subsidiaries of FVI, in line with FVI's historical strategy and providing cost savings in addition to a reduced minority interest in earnings. However, the processes of acquiring the minority interests from a wide spread of investors and the liquidation of subsidiaries once they have divested their investment property assets has hitherto been relatively slow moving. In addition to the pending liquidation of IC07 and BBV06, there are two other FVI subsidiaries (BB02 and IC13) that have also disposed of their investment property assets and where liquidation is pending. Five investment property owning subsidiaries remain. Historically, FVI has offered a mixture of shares

and cash to investors in the subsidiary real estate closed end funds and has been able to increase its ownership at a discount to NAV. The outstanding minority interest at end-Q317 was c €64m and we estimate that a substantial portion of this could be acquired with a mix of cash and debt at the level of the FVI subsidiary. The FVI balance sheet could support the acquisition of 60% of the outstanding minority, at NAV, without breaching the REIT equity ratio rules, or 100% of the outstanding minority at a 75% discount to NAV. The FVI net LTV would increase from c 40% to c 53% as a result. It is possible that FVI shares could be offered to minority investors in the subsidiary funds but this would have the effect of reducing DEMIRE's interest in FVI. The exact path to funding a minority buyout is perhaps of less significance than the economic effect on the group. In Exhibit 8 we illustrate the impact of DEMIRE group (either directly or indirectly) acquiring the minorities at a range of P/NAVs.

We have made the assumption that this is funded 50% by the issue of new DEMIRE shares (issued at the current share price) and 50% by debt (at a fixed cost of 2.875%). The range of positive outcomes for pro-forma attributable FFO per share is from 5% accretive to 17%. As above, we have shown the outcome on both a zero tax and full tax basis and in reality would expect the near-term effective rate to fall between the two. It is interesting to note that there would be no positive impact on FFO (after tax, before minorities). We have measured the impact on EPRA NAV per share in relation to our forecast for end-FY18. Because of the assumed issuance of shares at a substantial discount to this, there is slight EPRA NAV per share dilution on most scenarios. Because the acquisition of minority interests has no impact on the consolidated value of investment properties, the additional debt raised does increase LTV. Depending on the size of the acquisition discount to NAV assumed, the impact on our forecast end-FY18 LTV of 58.7% ranges from 2.4% to 3.4%.

#### Exhibit 8: Illustration: Acquisition of minority interests in FVI subsidiaries

€000s unless otherwise stated					
Minorities share of FVI NAV at 30 September 2017	63,787				
Acquisition discount to NAV (%)	0%	10%	15%	20%	25%
Acquisition cost	63,787	57,408	54,219	51,030	47,840
Assumed debt funding (%)	50%				
Additional debt	31,894	28,704	27,109	25,515	23,920
Additional equity	31,894	28,704	27,109	25,515	23,920
Equity issuance price per share (€)	3.86	3.86	3.86	3.86	3.86
Assumed interest cost (%)	2.875%	2.875%	2.875%	2.875%	2.875%
Forecast FY18 minority in FVI subsidiaries	4,623	4,623	4,623	4,623	4,623
Less interest cost	(917)	(825)	(779)	(734)	(688)
Tax rate (%)	30%	30%	30%	30%	30%
Incremental FFO after tax	2,594	2,658	2,690	2,723	2,755
Pro-forma attributable FFO/share (after minority) - taxed (€)	0.22	0.22	0.23	0.23	0.23
Pro-forma attributable FFO/share (after minority) - untaxed(€)	0.24	0.24	0.24	0.24	0.25
Increment – taxed (%)	5%	7%	8%	9%	9%
Increment - untaxed (%)	12%	14%	15%	16%	17%
Pro-forma EPRA NAV per share (€)	5.03	5.09	5.12	5.15	5.17
Increment/(dilution) (%)	-2.8%	-1.7%	-1.2%	-0.6%	0.0%

Source: Edison Investment Research

## Valuation

DEMIRE's P/NAV discount has narrowed slightly since we initiated our coverage in [July 2017](#) (c 17% versus c 19%), while the peer group average (excluding FVI) premium has increased slightly, from c 3% to c 5%. It also continues to trade at a higher FFO multiple than the peer group average but that premium has declined over the same period. This analysis uses the last published NAV data for each of the companies and for each it annualises the reported nine-month FFO. For DEMIRE we use our preferred metric of attributable FFO1 after minorities.



Looking at the FFO multiple differently, the peer group average FFO yield is c 5.85%. As discussed above, our base case forecasts for DEMIRE look for a strong growth in FFO earnings over FY18 and FY19 such that the forward looking forecast FFO yield increases to 5.80% for FY19, very similar to the current peer average. Not included in these base case forecasts is the potential, discussed above, for FFO earnings to be lifted considerably further through cash generative acquisitions, operational gearing, and the elimination of minority interests. With the prospect of significantly improving FFO earnings it seems reasonable to expect that DEMIRE will soon begin to make dividend distributions, although we have not included these in our forecasts pending guidance from management. Management will need to balance shareholder distributions with its desire to grow the portfolio substantially (to c €2bn) over time while reducing the LTV towards 50%. However, a combination of sharply rising FFO and the commencement of distributions is likely to be taken positively by the market, improving DEMIRE's access to the equity capital that will be needed to meet its growth targets.

**Exhibit 9: Peer comparison**

	Price (€)	Market cap. (€m)	P/EPRA NAV (x)	P/FFO (x)	Dividend yield FY17e (%)	LTV (%)	Total return performance (%)		
							3m	6m	12m
DEMIRE	3.91	212	0.83	43.6	0.0	62.0	7.2	7.2	2.1
Fair Value REIT	8.25	116	0.95	16.4	3.0	39.9	3.9	3.9	18.4
Alstria	12.66	1,943	1.10	17.0	4.2	44.5	1.5	1.5	8.3
Deutsche Euroshop	32.10	1,968	0.78	19.3	4.5	35.5	0.0	0.0	-16.7
TLG Immobilien	22.20	2,243	1.11	17.5	3.7	37.9	10.1	10.1	26.8
Hamborner REIT	9.78	788	1.02	17.3	4.5	40.0	6.4	6.4	9.6
VIB Vermogen	21.40	585	1.21	14.5	2.8	53.3	-1.7	-1.7	10.7
<b>Average (ex DEMIRE &amp; FVI)</b>			<b>1.05</b>	<b>17.1</b>	<b>3.9</b>	<b>42.2</b>	<b>3.2</b>	<b>3.2</b>	<b>7.7</b>

Source: Edison Investment Research, Bloomberg. Price data as at 15 January 2018. NAV data as at 30 September. FFO data is first nine months of 2017 annualised.

**Exhibit 10: Financial summary**

Year ending 31 December (€000s)	2015	2016	2017e	2018e	2019e
<b>PROFIT &amp; LOSS (IFRS)</b>	<b>IFRS</b>	<b>IFRS</b>	<b>IFRS</b>	<b>IFRS</b>	<b>IFRS</b>
Net rental income	23,680	58,570	55,810	56,394	58,058
Administrative expenses	(11,332)	(14,505)	(14,800)	(13,800)	(13,800)
EBITDA	12,348	44,065	41,010	42,594	44,258
Gains/(losses) from sales	743	4,924	(623)	2,260	0
Gains/(losses) from equity accounted investments	(500)	(359)	107	40	40
Fair value gains/(losses) on real estate	18,471	38,414	26,262	20,000	20,000
Net other income & expenses	27,678	(3,875)	(3,352)	0	0
Net finance income/(expense)	(25,728)	(37,981)	(43,345)	(19,976)	(19,786)
Interest of minority shareholders in FVI subsidiaries	0	(5,226)	(6,631)	(5,753)	(4,944)
Pre-tax profit/(loss)	33,012	39,962	13,427	39,166	39,568
Tax	(4,139)	(12,313)	(3,165)	(6,340)	(6,591)
Non-controlling interest	(756)	(2,979)	(4,165)	(2,665)	(2,475)
Net income attributable to shareholders (IFRS)	28,117	24,670	6,097	30,161	30,503
Adjustment to FFO*					
PBT		39,962	13,427	39,166	39,568
<b>Adjust for:</b>					
Minority interests	N/A	5,226	6,631	5,753	4,944
Fair value gains/(losses) on real estate	N/A	(38,414)	(26,262)	(20,000)	(20,000)
Gains/(losses) from sales and from equity accounted investments	N/A	(4,565)	516	(2,300)	(40)
Other adjustments	N/A	8,700	18,806	0	0
Tax	N/A	(2,852)	(1,088)	(2,332)	(2,583)
FFO1 (after tax, before minorities)	N/A	8,057	12,030	20,287	21,889
Minority	N/A	(5,400)	(5,802)	(6,022)	(6,494)
Attributable FFO1 (after minorities)	N/A	2,657	6,228	14,265	15,395
Average Number of Shares Outstanding (m)	25.9	51.4	54.3	54.3	54.3
Average Diluted Number of Shares Outstanding (m)	40.6	65.0	67.9	67.9	67.9
EPS basic (€)	1.09	0.48	0.11	0.56	0.56
EPS diluted (€)	0.71	0.39	0.10	0.44	0.45
Attributable FFO per share (€)	N/A	0.04	0.09	0.21	0.23
FFO1 per share	N/A	0.12	0.18	0.30	0.32
Dividend per share (€)	0.0	0.0	0.0	0.0	0.0
<b>BALANCE SHEET</b>					
Non-current assets	948,597	1,001,487	1,020,634	1,040,674	1,060,714
Investment property	915,089	981,274	999,935	1,019,935	1,039,935
Other non-current assets	33,508	20,213	20,699	20,739	20,779
Current Assets	84,348	92,520	123,943	123,079	132,678
Cash & equivalents	28,467	31,289	69,881	87,147	96,083
Assets held as available for sale	13,005	24,291	18,515	0	0
Other current assets	42,876	36,940	35,547	35,932	36,596
Current Liabilities	(71,297)	(66,029)	(65,520)	(65,821)	(66,339)
Financial liabilities	(46,443)	(42,020)	(40,000)	(40,000)	(40,000)
Other current liabilities	(24,854)	(24,009)	(25,520)	(25,821)	(26,339)
Non-current liabilities	(696,746)	(719,340)	(760,740)	(747,580)	(744,515)
Financial liabilities	(608,796)	(620,623)	(659,487)	(646,327)	(643,262)
Other non-current liabilities	(87,950)	(98,717)	(101,253)	(101,253)	(101,253)
Net Assets	264,902	308,638	318,317	350,352	382,538
Non-controlling interests	(34,205)	(36,692)	(40,662)	(42,536)	(45,011)
Shareholders' equity	230,697	271,946	277,655	307,816	337,528
<b>EPRA adjustments:</b>					
Fair value of derivative financial instruments	0	(1,778)	100	100	100
Deferred tax and goodwill impact	25,570	30,292	32,339	32,339	32,339
EPRA adjusted NAV	256,267	300,460	310,094	340,255	369,967
Period end number of shares (m)	49.3	54.2	54.3	54.3	54.3
Diluted period end number of shares	63.9	67.9	67.9	67.9	67.9
IFRS NAV per share (€)	4.68	5.01	5.12	5.67	6.22
Diluted EPRA NAV per share (€)	4.25	4.60	4.75	5.18	5.61
<b>CASH FLOW</b>					
Pre-tax operating Cash Flow	11,001	36,670	29,038	36,957	39,369
Tax paid	(186)	(1,318)	(348)	(6,340)	(6,591)
Net cash flow from investing activity	(29,165)	5,726	12,696	20,775	0
Interest paid	(21,255)	(33,487)	(36,321)	(20,176)	(19,986)
Borrowings drawn/(repaid)	54,031	(20,590)	33,526	(13,160)	(3,065)
Equity issuance (net of costs)	9,644	15,906	0	0	0
Other financing	0	(84)	0	(791)	(791)
Cash flow from financing activity	42,420	(38,255)	(2,795)	(34,127)	(23,842)
Change in cash	24,070	2,823	38,591	17,266	8,936
Opening cash	4,397	28,467	31,290	69,880	87,146
Closing cash	28,467	31,290	69,880	87,146	96,082
Financial liabilities	(655,239)	(662,643)	(699,487)	(686,327)	(683,262)
Net debt	(626,772)	(631,353)	(629,607)	(599,181)	(587,180)
Net LTV	67.5%	62.8%	61.8%	58.7%	56.5%

Source: Company data, Edison Investment Research. Note: \*Due to changes in company reporting, FFO unavailable for 2015.

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