Noratis

Real estate

4 July 2018

On a growth path

Recent significant fund-raising and portfolio expansion by Noratis confirm the company's ambition to benefit from favourable macro factors and the clear opportunity to develop real estate in non-core German cities. This follows a "very successful" 2017, with sales up by over 50% and adjusted PBT more than doubled, driven by the disposals of newly-enhanced (optimised) property blocks. Reinvestment was no less effective; the continued ability to buy at attractive yields led to a 25% increase in the asset base (c €100m). Positive 2018 guidance increases the prospect of a rise in an already generous dividend (7.3% yield 2018e).

Scaling up in 2017

By any measure 2017 was a success for Noratis. June's Scale listing apart (the IPO raised €17m), the sale of two blocks at Dormagen (530 units), its largest project to date, endorsed a key element of its business model, the disposal of value-enhanced properties. This was exceeded by a step-up in additions, hence a net buyer in the year (+186 units and stock book value of €99m vs €80m at December 2016). This was reflected in a sharp increase in PBT (€13.7m, adjusted for €1.5m IPO costs, up from €6.0m) thanks both to top-line buoyancy and good control of costs eg asset sales gross profit margin was 29% vs 24% and net interest was down by a quarter. In line with its policy of a c 50% payout, a dividend of €1.50 was declared.

Growth fuelled by latest capital increase

Management has newly reiterated 2018 guidance of a clear improvement in EBIT, buoyed by positive economic signs and unchanged strong demand for residential real estate. Increased proceeds from block sales are expected in the second half. Longer term, given the typical two-year lead time for investment projects, recent fund-raising (€15m from a three-for\ -10 rights issue at €22.50) should help Noratis deliver on its goal of net acquisitions in 2018. This target may already have been achieved by two recent deals that added >40% to the number of units at end 2017.

Valuation: Unduly cautious

Sitting between asset holder and developer makes for difficult comparison with listed peers but Noratis is at a notable discount to RCM Beteiligungs, which has a similar model (trailing P/E ratio of 20x). At under 8x prospective earnings, Noratis offers an attractive yield, backed by a positive outlook and dividend commitment.

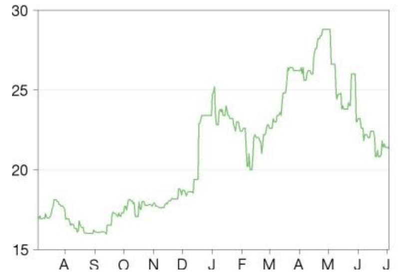
Consensus estimates

Year end	Revenue (€m)	EBIT (€m)	EPS** (€)	DPS (€)	P/E (x)	Yield (%)
12/16	44.6	9.9	N/A	N/A	N/A	N/A
12/17	68.0	15.2*	3.0	1.5	7.3	6.9
12/18e	75.0	16.4	2.8	1.6	7.8	7.3
12/19e	82.0	17.4	3.0	1.7	7.3	7.8

Source: Noratis accounts, consensus estimates. Note: *After €1.5m IPO costs. **Based on 2.9m shares in 2017, 3.3m shares in 2018 and 3.6m shares in 2019.

Price	€21.80
Market cap	€78m

Share price graph



Share details

Code	NUVA
Listing	Deutsche Börse Scale
Shares in issue	3.6m
Net debt at March 2018	€68m*

*Before €15m (gross) from May 2018 rights issue

Business description

Noratis is a specialised asset developer, acquiring residential rental income producing assets in secondary locations with optimisation potential. Investing in the asset base and improving the tenant mix creates value, which Noratis exploits during well-structured asset sales, either through individual or block sales.

Bull

- Strong experience operating in Germany's non-core areas.
- Focused investment and asset management approach to boost yields and asset values.
- Established business concept and strong partner network across Germany.

Bear

- Smaller company in a very competitive market.
- Low interest rate environment may end.
- Dependence on attractive portfolio opportunities

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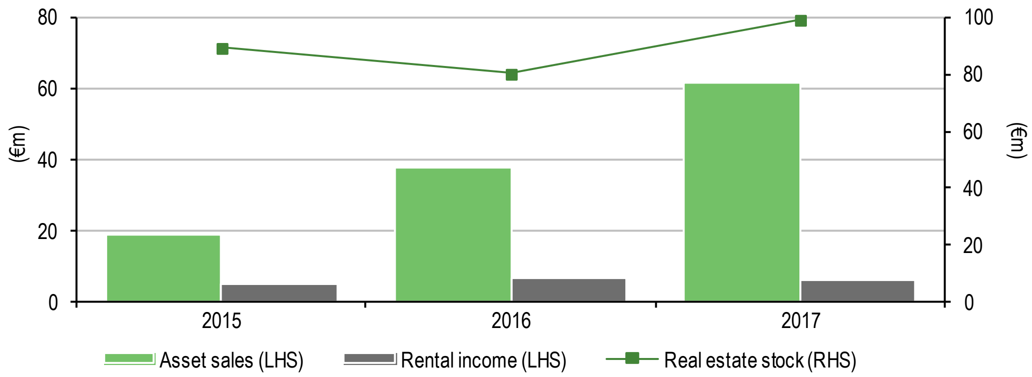
Review of 2017 results

The Noratis model of upgrading and selling assets allows financial periods to be regarded as either acquisition or disposal years. Exhibit 1 shows that 2017, unlike its predecessor, was clearly an acquisition year despite a step-change in sales proceeds. Year-end stock was up by c 20%, both in terms of units (1,194 vs 1,008 in 2017) and book value (€99m against €80m), which lays a strong base. A highlight was the purchase of 355 units at Ratzeburg/Mölln in H2. In turn, the two blocks at Dormagen, acquired in late 2015 and sold separately in 2017, accounted for the bulk of disposals (530 of 587 units sold). Rental income was broadly stable and in line with the company's focus on acquiring largely occupied residential assets, which yield immediate income.

Exhibit 1: Revenue and year-end real estate stock



Source: Noratis accounts

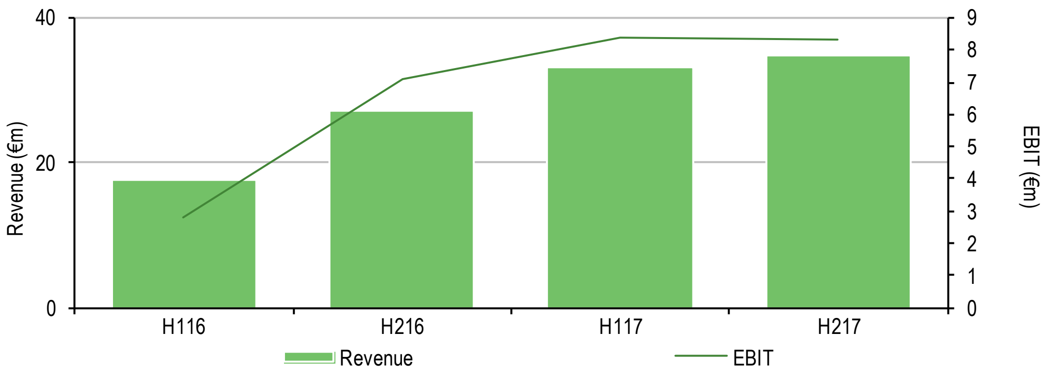
Noratis's financial performance in 2017 (see Exhibit 2) was similarly positive. The scale of the Dormagen disposal was of course the key driver (price not disclosed but c 90% of units sold by the company in the period). Importantly, it also contributed to an impressively higher gross margin for asset sales (29% vs 24%). The decline in rental income was due simply to lower stock at the start of the period after a 'disposal' year, while its gross profit held up.

Exhibit 2: Financial performance

Year end December (€m), HGB	H116	H216	FY16	H117	H217	FY17
Revenue						
Asset sales	14.1	23.7	37.8	30.4	31.5	61.9
Change			99%	116%	33%	64%
Rental	3.4	3.3	6.7	2.7	3.4	6.1
Change			40%	(21%)	3%	(9%)
Total	**17.5**	**27.1**	**44.6**	**33.1**	**34.9**	**68.0**
Change (%)			**87%**	**89%**	**29%**	**52%**
Gross Profit						
Asset sales	2.4	6.8	9.2	8.5	9.2	17.7
Margin	17%	29%	24%	28%	29%	29%
Rental	1.9	2.0	3.9	1.5	2.3	3.8
Total	**4.3**	**8.8**	**13.1**	**10.1**	**11.5**	**21.5**
EBIT	**2.8**	**7.1**	**9.9**	**8.4**	**8.3**	**16.7**
Net interest	(1.8)	(2.1)	(3.9)	(1.5)	(1.5)	(3.0)
Pre-tax profit – adjusted	**1.0**	**5.0**	**6.0**	**6.9**	**6.8**	**13.7**
Exceptional item (IPO costs)	-	-	-	(1.5)	-	(1.5)
Pre-tax profit – reported	1.0	5.0	6.0	5.4	6.8	12.2
Net profit	**0.7**	**3.5**	**4.2**	**3.3**	**5.4**	**8.7**

Source: Noratis accounts

Exhibit 3: Revenue and EBIT



Source: Noratis accounts

Progress at the gross profit level was matched at EBIT (see Exhibit 3) despite higher labour costs owing to expansion and bonuses and a doubling of other operating costs. This is after adjusting EBIT for €1.5m one-off IPO expenses. The improvement in profit was even more evident at the PBT line, thanks to lower net debt following the IPO; management guidance was slightly exceeded.

Noratis's accounts are prepared under HGB standards, so assets are held at book value, unlike IFRS where it is common for assets to be shown at realisable market value. We point therefore to hidden reserves at Noratis, which management identifies as c €21m at end 2017, based on the valuation by an international RICS appraiser, ie fair value of €120m vs book value of €99m.

Stepping up in 2018

Recent active trading should underpin the company's solid growth prospects. In addition to the sale of 99 units in Schwarzenbek (Hamburg), purchased in 2015, Noratis has soon delivered on the expansion it promised at its May fund-raising. Three portfolios, mainly in Celle (252 of 365 units), meet the company's usual acquisition requirements ie older buildings (mainly from 1960s) with significant value potential on modernisation and reduction of 10% vacancy rate. This follows the purchase of 161 units in Frankfurt and Ratingen (Düsseldorf) – slightly newer properties but with particular scope for higher rent on expiry of social housing agreements. These deals represent in total a c 50% rise in post-Schwarzenbek stock, hence a substantial base for medium-term disposal at c 25% gross margin (2017 29%). Further expansion is on the cards, given recent management comment and market opportunity (c70% of apartments in Germany date from the 1920s to mid-80s).

For 2018, management's guidance is for a clear improvement in EBIT. However, this is against an outturn, depressed by €1.5m IPO costs. On an adjusted basis, consensus forecasts of €16.4m compare with €16.7m for 2017. Given the expectation of higher asset sales, even on a demanding comparative, the EBIT forecast therefore appears cautious. However, it may be that the 2017 driver, Dormagen, was especially high margin (not disclosed).

Valuation

Sitting between asset holder and developer makes for a difficult comparison with listed peers but Noratis's P/E ratio is at a notable discount to RCM Beteiligungs, which has a similar model (trailing 20x). However, its P/BV (2017) ratio is markedly higher at 2.7x, vs 1.4x for RCM Beteiligungs.

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