EDISON Scale research report - Update

RCM Beteiligungs

Real estate

16 July 2018

Playing smart

Ahead of H1 results on 15 August, Q1 showed the success of RCM Beteiligungs' strategic focus on certain well-defined projects. Quarterly PBT of €2.3m, which alone exceeded full-year 2017 thanks to a c €11m development sale, all but guarantees guidance of more than €3m PBT in 2018. Driven by favourable macro factors and scope for efficiencies, asset development and appreciation, RCM's positive outlook is reflected in confirmation of a 50% dividend hike for last year. Solid finances (almost 5x 2017 interest cover and an above industry-average equity ratio of 40%+ at March 2018) provide ample scope for reinvestment after Q1 disposals.

Acceleration in H217

RCM built on a good start to the year (H117 PBT up 11%) with a strong second half (PBT up 16% to €1.4m against €1.2m in H216). The period saw sustained buoyancy, boosted by the initial consolidation of a project company, which made a notable c 4,000m² disposal. Further to its goal of growing recurrent revenues, despite asset sales rental income was almost maintained thanks to enhanced rent per square metre (4% for the year). This was complemented by another significant reduction in rental admin costs (down 20% like-for-like in 2017). Reluctance to pay up in the face of sharp property price rises (no additions in 2017) explains the reduction in the year-end portfolio from c 50,000m² to c 38,000m².

RCM continues to please

A flying start to 2018 may offer room for surprise as much of management's full-year PBT guidance has already been secured in Q1 (€2.3m of €3m+). This bumper outturn largely reflected completion of a c €11m development project sale (12 properties or 7,700m²), which was reported late last year but recognised substantially (80%+) in the period as well as a transaction which concluded earlier than expected. There should also be increasing benefits from restructuring both its portfolio, eg fewer locations, a focus on its Dresden core and higher average unit size, and its corporate set-up, namely new profit transfer agreements.

Valuation: Fair

FY17 P/E is 31x, ie at a premium, but given the strong Q1 performance and positive management guidance we are likely to see a visible reduction in the valuation in 2018. A P/BV (2017) ratio of 1.4x is undemanding as it compares with the book value of assets (RCM reports under HGB standards).

Historical financials

Year end	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/14	12.2	1.0	0.02	0.03	108.0	1.4
12/15	14.7	1.3	0.05	0.04	43.2	1.9
12/16	11.4	1.8	0.09	0.04	24.0	1.9
12/17	19.4	2.1	0.07	0.06	30.9	2.8

Source: RCM Beteiligungs

Price	€2.16
Market cap	€32m

Share price graph

Share details

Code	RCMN
Listing	Deutsche Börse Scale
Shares in issue	14.7m
Net bank debt at December 2017	€27.6 m

Business description

RCM Beteiligungs is a property developer, acquiring rental income-producing assets in and around Dresden and investing in refurbishment with the aim of improving the tenant mix to enhance value. RCM also invests in financial assets. It is a large shareholder in KST Beteiligungs, a financial investor.

Bull

- Low unemployment levels in Dresden.
- Focus on a defined region leads to greater understanding of opportunities.
- Established business concept and strong partner network in the region.

Bear

- Small company, largely dependent on the development of the Dresden region.
- Low interest rate environment may end.
- Dependence on positive macro environment in the region and attractive sourcing potential.

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Edison profile page

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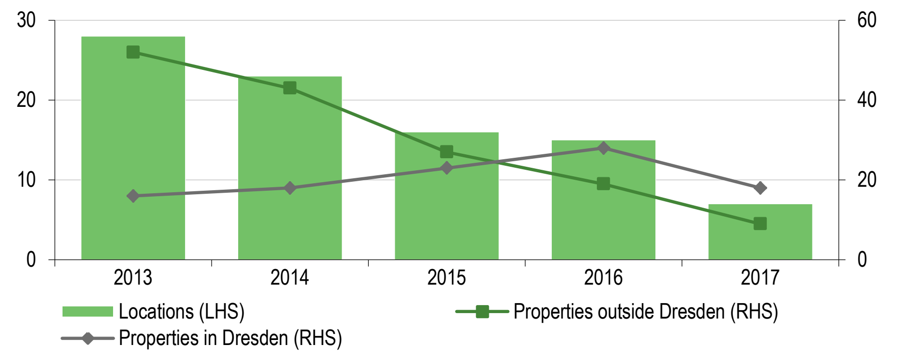
Review of 2017 results

2017 saw an acceleration in implementation of RCM's strategic focus on investment in its Dresden core. As evident in Exhibit 1, outside Dresden the number of its properties was halved (from 19 to nine) with an even sharper reduction in locations (just four against 12 at the end of 2016). Indeed over the last four years the company has withdrawn from 75% of its investment locations, resulting in just four sites outside Dresden and three within (over 50% of the portfolio).

Exhibit 1: Streamlining of investment locations and properties



Source: RCM accounts

Such active streamlining with associated efficiencies continued to drive the company's improved financial performance in 2017, although importantly the bulk of the aforementioned disposals, notably the €11m development package in Q3, was not recognised in the accounts of the period, ie not until Q118. This is confirmed in Exhibit 2 as the full-year step-change in revenue was due largely to inclusion from H2 of project company SFG Liegenschaften, which made a material disposal (c 4,000m²) in Dresden itself in the third quarter. While its contribution is not disclosed, transaction volumes in the existing ECM estate look to have picked up well in H2 after a planned reduction (41%) in the first half as the portfolio was being developed.

Rental income is of course affected by transaction business. However, management is at pains to minimise the impact of rationalisation through efficiencies and enhanced unit returns. In 2017 a 6% decline in rental revenue was almost halved at the profit level thanks to 20% lower admin costs from geographical focus and targeted enhancement of rent per square metre (up 4%).

Exhibit 2: Financial performance

Year end December (€m)	H116	H216	FY16	H117	H217	FY17
Asset sales	3.6	3.8	7.4	2.2	13.0*	15.2
Rental	1.6	1.5	3.1	1.5	1.5	2.9
Other	0.5	0.3	0.8	0.6	0.7	1.3
Revenue	5.8	5.6	11.4	4.2	15.2	19.4
Asset sales			1.3			4.0*
Rental			2.7			2.6
Other			0.7			0.6
Profit			4.7			7.2
Other costs			(2.0)			(1.7)
Goodwill write-off			-			(2.8)*
EBIT			2.7			2.6
Net interest			(0.9)			(0.6)
Pre-tax profit	0.6	1.2	1.8	0.7	1.4	2.1

Source: RCM accounts Note: *Including newly-consolidated project company and associated impairment.

Further encouragement comes from much higher like-for-like asset sale margin (almost 40%), continued diversification of income streams (other, mainly financial, up by a half) and stable labour costs despite so much activity.

2018 confidence

As Q118 bumper returns (revenue: €12.1m vs €2.2m in Q117; PBT: €2.3m vs €0.4m in Q117) were driven by recognition of a disposal package announced in the preceding quarter, it is understandable that guidance for 2018, introduced last November, should simply have been confirmed post-Q1. The relative vagueness of its PBT forecast (to exceed €3m) leaves scope for surprise, given the proportion of first-quarter profit delivery.

Management remains positive about the real estate market thanks to persistently low interest rates and the growing appeal of second-tier locations such as Dresden, which still offer attractive rental yield despite rising prices.

Strong finances allow a resumption in property expansion after a pause in 2017, notwithstanding a continued commitment to investment in existing holdings to enhance value.

Valuation

RCM's business model sits between that of an asset holder and that of a developer, making direct comparisons to listed companies somewhat difficult. Its P/E ratio is at a premium to Noratis, which has a similar model (trailing 7x). However, its P/BV (2017) ratio is markedly lower at 1.4x, vs 2.7x for Noratis.

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