EDISON Scale research report - Update

Noratis

Real estate

11 October 2018

Building well

The shortfall in H1 results (revenue and adjusted EBIT down by a third) should not detract from Noratis's ambition to benefit from favourable macro factors and clear opportunity in real estate with development potential in non-core German cities. The outturn was, as expected, a matter of timing (likely high-margin asset sales will be H2 oriented), so guidance of a rise in full-year profit is maintained, albeit on lower revenue. For the longer term, the asset base (stock book value up 15% in H1 at €114m) continues to be actively grown with c 900 units acquired since May (under 1,200 units in total at the start of 2018). Solid finances should allow a further generous dividend (6.7% yield 2018e).

Investment to the fore in H118

With lower financial returns in the period regarded by management as an accident of timing and to be remedied in H2, Noratis's focus remained firmly on growth. Consequently, even excluding a major 161-unit purchase in May but not completed until H2, the company was again clearly a net buyer in the first half, laying a strong base with +210 units and a stock book value of €114m vs €99m at December 2017. Rental income was duly up by a quarter following similarly aggressive expansion last year. However, sales of value-enhanced properties, Noratis's main profit centre, were, as budgeted, well down (notably only one block disposal), hence a sharp fall in overall profit (see page 2).

Full-year on track

With the majority of planned 2018 disposals in H2 and sustained strong demand for residential real estate, management has affirmed guidance of higher profit. However, given its revised expectation of lower revenue, it does assume much higher asset sales margin, as in H1 which saw gross profit 34% vs 28%. Assuming a two- to three-year lead time for investment projects, recent step-up in expansion, topped by a mid-double-digit €m block purchase in Frankfurt promises longer-term growth.

Valuation: Attractive

Sitting between asset holder and developer makes for a 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 c 30x). At 8x prospective P/E and P/BV (June 2018) of 1.9x, the company offers an attractive yield, backed by a positive outlook and dividend commitment (c 50% payout of annual net income).

Consensus estimates

Year end	Revenue (€m)	PBT (€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*	3.5	1.5	6.4	6.7
12/18e	65.0	16.0**	2.8	1.5	8.0	6.7
12/19e	85.0	19.4	3.0	1.6	7.5	7.1

Source: Noratis accounts, consensus estimates. Note: *After €1.5m IPO costs. **After €0.8m capital increase costs. ***Based on 2.5m shares in 2017 and 3.3m shares in 2018.

Price	€22.50
Market cap	€81m

Share price graph

Share details

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

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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Edison profile page

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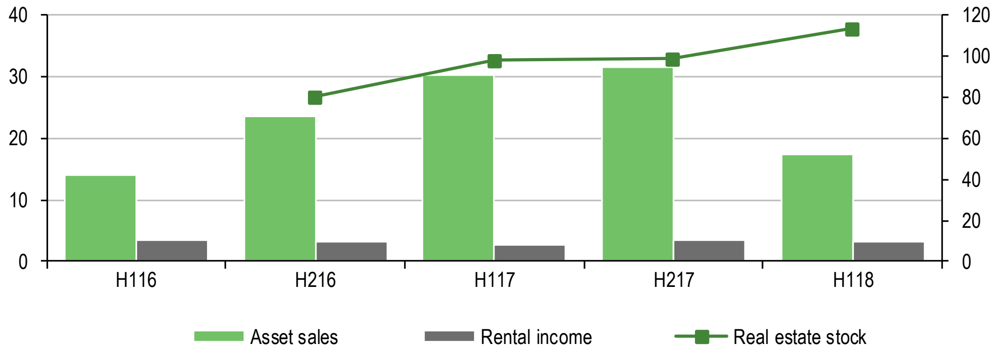
Review of H118 results

The Noratis model of upgrading and selling allows financial periods to be seen as either acquisition or disposal-led. Exhibit 1 shows H118, like its y-o-y comparative, to have been markedly acquisition led, even if this was achieved in H117 despite a step-change in sales proceeds. Stock at June 2018 was up by c 15% on December 2017, both in terms of units (1404 against 1194) and book value (€114m against €99m). A highlight was the purchase of two portfolios, mainly in Celle (252 of 345 units), which meet usual acquisition requirements, ie older buildings (typically from 1960s) with significant value potential on modernisation and reduction of c 10% vacancy rate. In turn, a block at Schwarzenbek in the Hamburg area, acquired in 2015, accounted for the 99 units sold in the period. Rental income was up by a quarter 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 (€m)



Source: Noratis accounts

Noratis's financial performance in H118 (see Exhibit 2) was dictated by the reduction in asset sales. However, the impact was mitigated by impressively higher gross margin on disposals (34% against 28%). The increase in rental income reflected higher stock at the start of the period after an 'acquisition' year, while its gross profit saw a slightly lower margin.

Exhibit 2: Financial performance

Year-end December (€m), HGB	2016	H117	H217	FY17	H118
Revenue					
Asset sales	37.8	30.4	31.5	61.9	17.5
Change	+99%	+116%	+33%	+64%	-42%
Rental	6.7	2.6	3.4	6.1	3.3
Change	+40%	-21%	+3%	-9%	+27%
Total	**44.6**	**33.1**	**34.9**	**68.0**	**20.8**
Change	**+87%**	**+89%**	**+29%**	**+52%**	**-37%**
Gross profit					
Asset sales	9.2	8.5	9.2	17.7	6.0
Margin	24%	28%	29%	29%	34%
Rental	3.9	1.5	2.3	3.8	1.7
Total	**13.1**	**10.1**	**11.5**	**21.5**	**7.7**
EBIT	**9.9**	**8.4**	**8.3**	**16.7**	**5.5**
Net interest	(3.9)	(1.5)	(1.5)	(3.0)	(1.2)
Pre-tax profit – adjusted	**6.0**	**6.9**	**6.8**	**13.7**	**4.3**
Exceptional items*	-	(1.5)	-	(1.5)	(0.8)
Pre-tax profit – reported	6.0	5.4	6.8	12.2	3.5
Net profit	**4.2**	**3.3**	**5.4**	**8.7**	**2.6**

Source: Noratis accounts. Note: *Stock market costs (H117 IPO and H118 capital increase).

The shortfall at gross profit level (24%) was exacerbated at EBIT (35%), reflecting much higher labour costs (up by over a half) owing to expansion and bonuses and a near-doubling of other operating costs. This is after adjusting EBIT for exceptional capital market expenses, €1.5m and €0.8m for H117 and H118 respectively.

Noratis's accounts are prepared under HGB standards. Unlike IFRS, HGB does not use mark-to-market valuations or annual impairments. This implies that all Noratis's asset sales revenues are booked at the time of the disposal and are therefore cash earnings. On the balance sheet, this implies that hidden reserves are building due to optimisation and rent multiple expansions. In IFRS accounts, these value increases would be seen as profits and typically are then seen in equity. Based on the valuation by an international RICS appraiser, Noratis's hidden reserves were c €21m at end 2017, ie asset value of €120m against book value of €99m. We may assume current hidden reserves to be materially higher, given subsequent accelerated portfolio growth.

Bright outlook

After management assurance of a clear H218 pickup in profit, thanks to planed high-margin asset sales, the immediate outlook appears positive with an improvement in full-year profit on the cards. However, this is against an outturn, depressed by €1.5m IPO costs. On an adjusted basis, consensus forecasts of c €16.8m (after adding back €0.8m costs of the H1 capital increase) compare with €16.7m for 2017.

Thereafter, recent active trading should underpin solid long-term growth prospects, assuming a typical two-year lead time for value enhancement. The company has delivered quickly and significantly on expansion promised at its May fund-raising. The purchase of three portfolios, mainly in Celle (252 of 365 units), followed that of 161 units in Frankfurt and Ratingen (Düsseldorf) – slightly newer properties but with particular scope for higher rent on expiry of social housing agreements. This was topped by a mid-double-digit €m acquisition of 365 residential units and seven commercial units in the Frankfurt area. Built in 1987, these properties have an area of 24,000m² and a c 5% vacancy rate. In total, these deals (almost 900 units since May) represent c 90% rise in post-Schwarzenbek stock, hence a substantial base for medium-term high-margin disposal. Further expansion is to be expected, given management comment and market opportunity (c 70% of apartments in Germany date from the 1920s to mid-80s).

Valuation

Sitting between asset holder and developer makes for difficult comparison with listed peers but Noratis P/E ratio is at a notable discount to RCM Beteiligungs, which has a similar model (trailing 30x). However, its P/BV (2017) ratio is higher at 1.9x, against 1.4x.

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