Aroundtown SA

Germany / Real Estate
Frankfurt Stock Exchange
Bloomberg: AT1 GR
ISIN: LU1673108939

TLG merger update

RATING	**BUY**
PRICE TARGET	**€ 9.80**
Return Potential	26.4%
Risk Rating	Medium

BINDING BUSINESS COMBINATION AGREEMENT IN PLACE

Aroundtown (AT) and TLG Immobilien AG (TLG) have agreed on 'binding terms' for a potential merger. AT will make an offer through a voluntary public takeover to all TLG shareholders, who will receive 3.6 AT shares for each TLG share based on the 30 June 2019 NAVPS of the two companies. Both landlords estimate an FFO increase of the combined company in the range of €110m to €139m p.a. (pre-tax) within five years post merger. Including the identified synergy potential, the transaction will be accretive from year 1. The transaction is fully supported by TLG's major shareholder and boards. The latter will recommend that their shareholders accept the offer. Our rating is Buy with a €9.8 price target.

Merger will be FFOPS and NAVPS accretive from year 1 Based on the mutual due diligence, FFO of the emergent company is expected to rise by €110m to €139m p.a. within five years post merger. Upside is traced to operational synergies from the joined operations and mutual savings on financing costs that would result from an accelerated path to an A- credit rating from S&P. This would allow the company to optimise the respective debt and perpetual notes (table 1 overleaf). Operational profitability will be spurred by economies of scale, overlapping portfolios, lower corporate costs from centralisation and IT effects. This should result in EBITDA uplift of 2.5% to 3.5% for the emergent company.

Bolting on a new growth engine To compliment a €24bn income generating portfolio, the emergent company will have a stronger platform to exploit a full development pipeline and accelerate a 'develop-to-core' strategy. The good overlap will provide a solid operational backbone for project development including planning, negotiation and execution processes plus enhanced pre-letting ability to counterbalance construction risk with a forward sales component. The pipeline covers Germany's top metropolises including a 63% Berlin component. Plus, with a larger asset base, the ratio of development assets would retreat to 15% of the combined portfolio and significantly improve the risk profile. (p.t.o.)

FINANCIAL HISTORY & PROJECTIONS

	2016	2017	2018	2019E	2020E	2021E
Net rent (€m)	233.38	448.98	633.00	783.38	869.48	925.20
Adj. EBITDA (€m)	268.23	429.30	606.04	741.08	817.14	869.80
Net income (€m)	901.09	1,539.00	1,827.80	1,375.97	1,190.86	1,107.63
EPS (diluted) (€)	0.88	1.35	1.49	1.01	0.82	0.86
EPRA NAV[1] (€m)	4,349.05	7,656.28	10,290.10	13,054.52	14,009.13	14,833.85
NAVPS[1] (€m)	5.40	7.63	9.11	10.67	11.45	12.12
DPS (€)	0.16	0.23	0.20	0.27	0.29	0.32
FFO 1 (€m)	165.63	293.00	405.74	490.08	554.44	595.38
FFOPS 1 (€)	0.25	0.36	0.39	0.42	0.45	0.49
Liquid assets (€ m)	833.44	841.60	1,599.50	2,716.97	2,057.98	1,887.34

[1] includes perpetual notes

RISKS

Risks include, but are not limited to, unfavourable interest rate developments, unfavourable macroeconomic developments, and the departure of key personnel.

COMPANY PROFILE

Aroundtown SA is a specialist real estate company focused on investing in and managing value-add properties primarily located in the German/ Netherlands real estate markets.

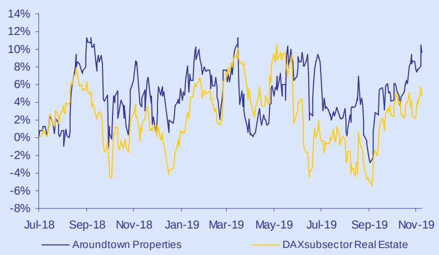
MARKET DATA

As of 20 Nov 2019

Closing Price	€ 7.76
Shares outstanding	1224.00m
Market Capitalisation	€ 9493.34m
52-week Range	€ 6.88 / 7.87
Avg. Volume (12 Months)	3,277,963

Multiples	2018	2019E	2020E
P/FFO 1	20.1	18.6	17.1
P/EPRA NAV	0.9	0.7	0.7
FFO 1 Yield	5.0%	5.4%	5.8%
Div. Yield	2.6%	3.5%	3.8%

STOCK OVERVIEW



COMPANY DATA

As of 30 Jun 2019

Liquid Assets	€ 2,416.00m
Current Assets	€ 2,979.00m
EPRA NAV[1]	€ 11,382.00m
Total Assets	€ 22,667.00m
Current Liabilities	€ 1,007.00m
Total Equity	€ 11,453.00m

[1] including perpetual notes

SHAREHOLDERS

TLG Immobilien	15.0%
Avisco Group	12.0%
Blackrock	5.1%
Free Float	67.9%

Analyst: Ellis Acklin, Tel. +49 (0)30 - 80 93 96 83

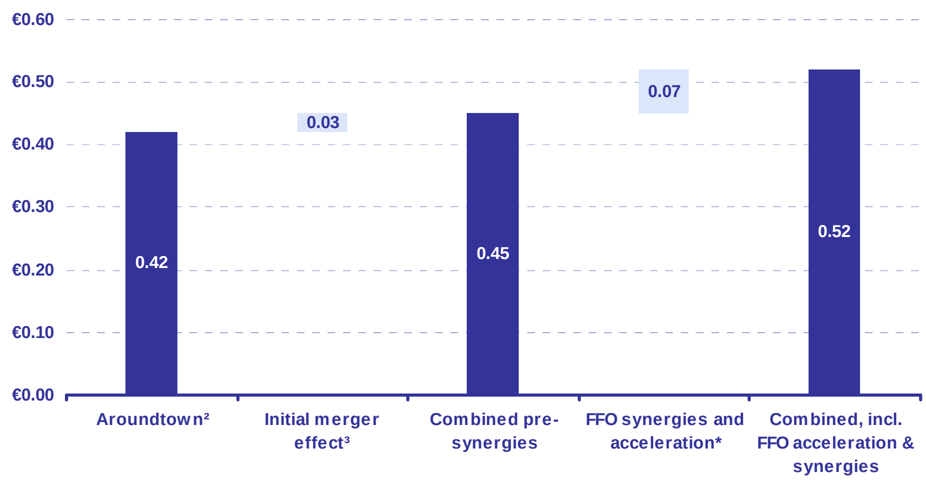
Table 1: Five year FFO upside of combined company

	Unit	FFO p.a.	
Operational synergies	€m	24 - 34	Efficiency gains through joint operations, joint HQ, strong portfolio overlap, cost optimization on corporate cost level, ancillary cost reduction, scale benefits
Acceleration of financial savings: reaching A rating (on AT in-place debt and perpetual notes)	€m	64 - 80	Acceleration of reaching long term target of A credit rating
Synergies of financial savings: reaching A- rating (on TLG in-place debt and perpetual notes)	€m	22 - 25	A credit rating unlikely to be achieved on current TLG stand alone
Total pre-tax	**€m**	**110 - 139**	
(-) current tax (16%)	€m	18 - 22	
FFO potential after 5 years	**€m**	**90 - 114**	

Source: First Berlin Equity Research; Aroundtown

FFOPS accretion supportive of merger Based on the recent due diligence, Aroundtown analysts reckon the deal would be highly FFO accretive (+25%) for all shareholders of both companies in year one. Gains would steadily rise over the five years post merger as synergies are captured unlocking >€110m in FFO. The calculations do not include long-term synergies from accelerated development activites, value-add upside, internal or external growth, or potential DAX inclusion. Plus, shareholders can expect to be rewarded with a higher dividend payout. The company hinted at a payout ratio of 65% to 70% of FFO for the emergent company.

Figure 1: FFOPS accretion bridge[1]

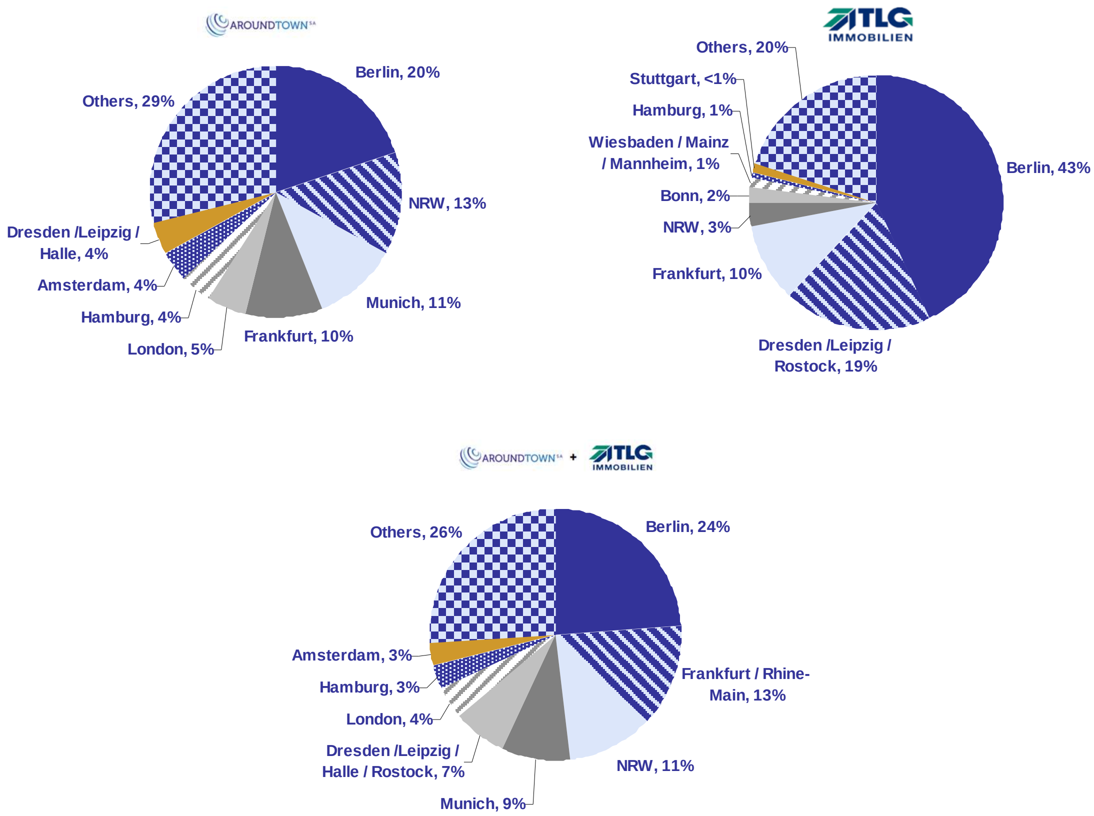


*[1]Based on 100% acceptance rate and 3.6x exchange rate; [2]Based on AT FFOPS 2019E guidance (mid-point of range); [3]Based on TLG FFOPS 2019E guidance excl. AT stake held by TLG; * Mid-point synergies captured 5 years post merger*

Source: First Berlin Equity Research; Aroundtown

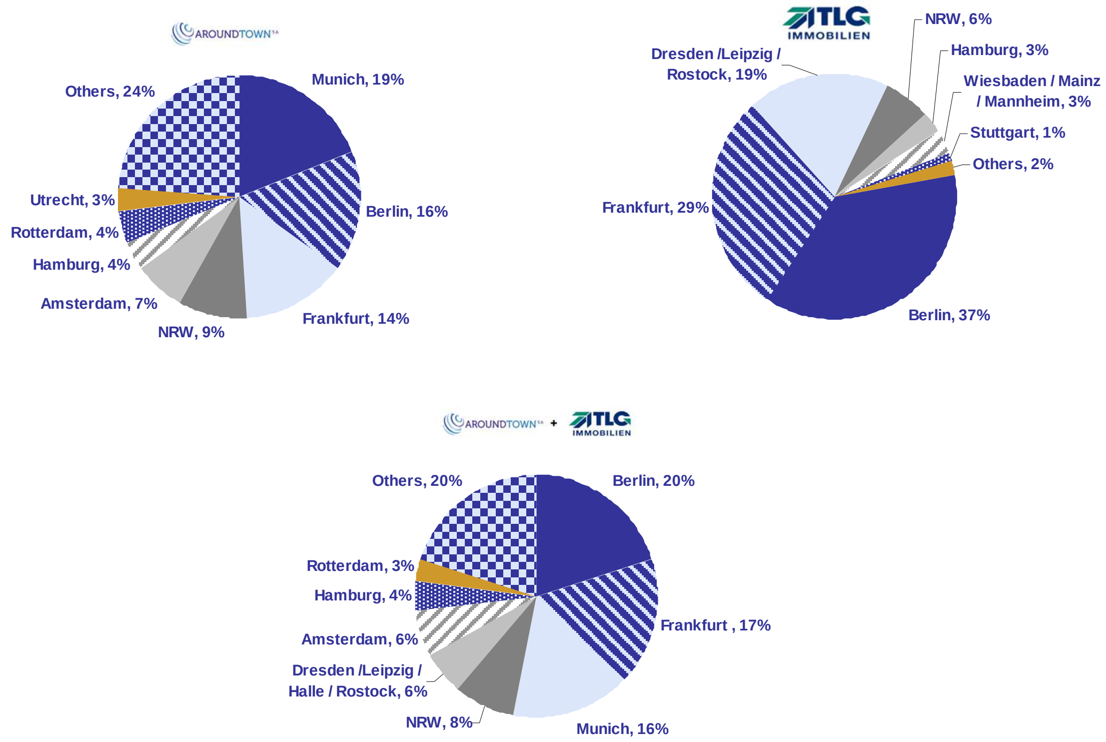
Boosted exposure to top tier German and European hubs The strong geographic and asset type overlap should provide good synergies to drive the LFL rental growth and projected FFO accretion. Over half of the combined office portfolio is in Berlin, Munich and Frankfurt, while ~ 50% of the combined hotel portfolio is in Berlin, London, Munich and Frankfurt.

Figure 2: Combined portfolio strengthens geographic footprint (GAV)



Source: First Berlin Equity Research; Aroundtown

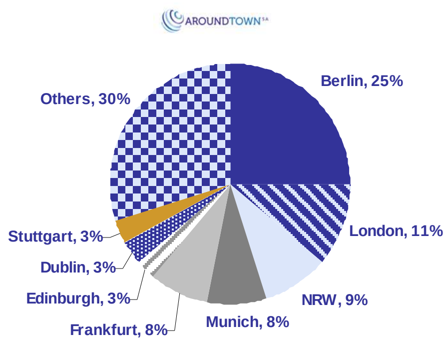
Figure 3: Combination by office assets (GAV)

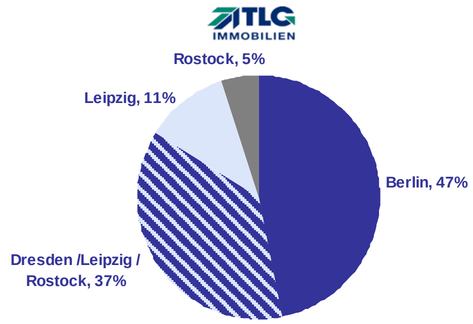


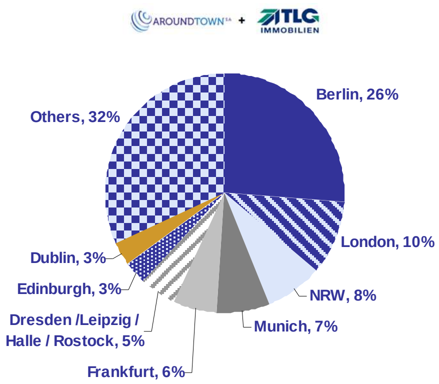
Source: First Berlin Equity Research; Aroundtown

Improved tenant diversity The merger will have a particularly strong effect on tenant diversification with the top ten equating to <20% of the rent. The combined portfolio would boast over 160 hotels (GAV €4.8bn) making it the largest hotel portfolio among listed European commercial landlords.

Figure 4: Portfolio combination by hotel assets (GAV)



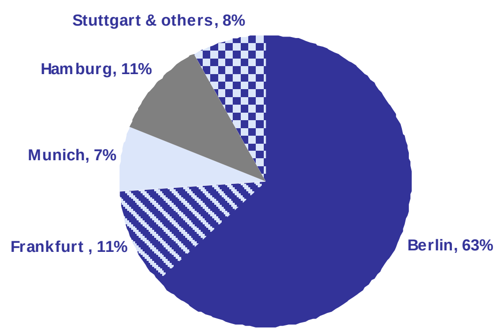




Source: First Berlin Equity Research; Aroundtown

Development to take the growth reins The combined development pipelines including TLG's project on Berlin's Alexanderplatz would approach €1.9bn (AT: €1.1bn, TLG €0.8bn) and predominantly cover prime locations across Germany's top metropolises to spur future organic growth and value-add creation. The rub for TLG has been that development presently accounts for around half of TLG's assets. This amplifies perceived risk and gates the company's rating. Thanks to the larger asset base, this ratio would retreat to 15% of the combined portfolio and significantly improve the risk profile.

Figure 5: Combined geographic development potential



** Excludes €750m of TLG's currently assessed value creation potential*

Source: First Berlin Equity Research; Aroundtown

Governance structure to include key AT execs A new governance structure for the combined company will be introduced at >50% acceptance rate (holding threshold) and entail the following elements:

- **Board of Directors**: 7-8 members; chairman with casting vote nominated by TLG (at 40% acceptance rate); 3-4 independent members
- **Management Body**: Five members (CEO, CFO, CIO, COO, CDO). Aroundtown nominates a CEO. TLG nominates a CFO, and at >66% acceptance rate an additional management board member, one of them will be Co-CEO
- **Advisory Board** with Dr Cromme (chairman) and Mr Gabay (vice chairman) will remain intact with one member to be nominated by TLG
- **Operational headquarters** in Berlin will be combined and the emergent company will rebrand in due time

Next steps in the process A Section 10 announcement (decision to make an offer) has now been published; AT anticipates the launch of a tender offer by year end. The offer period is expected to run four weeks with a two week extension. We thus expect closing by end of Q1/20. Management hinted that the emergent company would be rebranded but will keep its headquarters in Luxemburg.

Bold corporate activity would supercharge operations Aroundtown has an impressive resume in combining organic with external growth having rapidly built a stable of commercial assets that now tops €16bn, thanks to >€13bn in acquistions since YE14. We believe operations could have continued their current strong trajectory, but a successful TLG takeover could supercharge operations and box out rivals from potential market consolidation. The business combination will result in a portfolio of ~€24bn and create a pan-European commercial real estate powerhouse with only Unibail and Vonovia ranking higher in terms of GAV (gross asset value).

The merger news took investors initially off guard causing the stock to dip on the surprise announcement, but the market has reacted positively to the plans in recent weeks. We also think the merger harbours plenty of aspects to be positive about and maintain our Buy rating with a €9.8 price target.

VALUATION

in €m	2019E	2020E	2021E	2022E	TV
EBITDA	625	694	740	787	795
(+) Revaluations	985	745	611	532	242
(+) Investment income (GCP)	116	123	130	137	138
(-) Tax expense	56	61	65	69	70
NOPAT	**1,670**	**1,501**	**1,415**	**1,386**	**1,105**
Total assets	**23,712**	**25,100**	**26,422**	**27,426**	**27,426**
(-) Current liabilities	724	791	837	866	866
(+) Current financial debt	27	27	27	27	27
(-) Cash	2,346	1,687	1,516	1,508	1,508
(+) Deferred taxes	1,033	1,232	1,416	1,596	1,596
Capital employed (CE)	**21,703**	**23,881**	**25,513**	**26,674**	**26,674**
Average CE	19,864	22,792	24,697	26,094	26,674
ROCE	8.4%	6.6%	5.7%	5.3%	4.1%
WACC	4.0%	4.0%	4.0%	4.0%	4.0%
ROCE-WACC	4.4%	2.6%	1.8%	1.3%	0.2%
Economic Profit	881	595	434	349	45
NPV	**877**	**570**	**400**	**309**	**1,341**
Fair value calculation					
Total return	**3,497**				
(+) NAV¹ (2018)	8,742				
(-) Dividend to be paid	210				
Equity value	**12,030**				
Diluted SO (m)	1,224				
Fair value per share (€)	**9.80**				
Target price (€)	**9.80**				
Share price (€)	7.76				
Return potential	26.4%				
Dividend yield	3.5%				
Total return potential	**29.8%**				

INCOME STATEMENT

All figures in EURm	2016	2017	2018	2019E	2020E	2021E
Net rent	**233**	**449**	**633**	**783**	**869**	**925**
Operating and other income	40	78	114	142	157	167
Rental and operating income (RI)	**274**	**527**	**747**	**925**	**1,027**	**1,092**
Capital gains, property revaluations & other	720	1,327	1,536	985	745	611
Result from equity-accounted investees	197	228	252	199	162	164
Property OpEx	-75	-147	-219	-270	-300	-319
Administration & other OpEx	-8	-15	-23	-28	-31	-32
Operating income (EBIT)	**1,107**	**1,920**	**2,294**	**1,811**	**1,603**	**1,517**
Net financial result	-47	-70	-115	-147	-147	-153
Other financial expenses	-36	-15	-94	0	0	0
Pre-tax income (EBT)	**1,024**	**1,836**	**2,085**	**1,665**	**1,456**	**1,364**
Tax expense	-20	-34	-44	-56	-62	-66
Deferred tax	-103	-263	-213	-233	-204	-191
Tax result	**-123**	**-297**	**-257**	**-289**	**-266**	**-257**
Comprehensive net income	**901**	**1,539**	**1,828**	**1,376**	**1,191**	**1,108**
Minority interests	169	228	161	138	119	111
Perpetual notes	4	29	46	51	73	73
Net income to owners	**728**	**1,283**	**1,620**	**1,188**	**999**	**924**
Basic EPS (€)	1.11	1.56	1.54	1.01	0.82	0.76
Diluted EPS (€)	0.87	1.35	1.49	1.01	0.82	0.76
Adjusted EBITDA commercial	**195**	**339**	**497**	**625**	**694**	**740**
Ratios						
Adj EBITDA commercial margin	83.4%	81.7%	80.9%	79.8%	79.8%	80.0%
Tax rate	7.4%	7.8%	7.3%	7.5%	7.5%	7.5%
Expenses as % of revenues						
Property OpEx	27.5%	27.9%	29.3%	29.2%	29.2%	29.2%
Administration & other OpEx	2.9%	2.8%	3.0%	3.0%	3.0%	2.9%
Y/Y Growth						
Revenues	118.7%	92.6%	41.7%	23.8%	11.0%	6.4%
Operating income	6.3%	73.5%	19.4%	-21.0%	-11.5%	-5.4%
Adjusted EBITDA	109.8%	74.3%	46.5%	25.8%	11.1%	6.6%
Net income/ loss	6.0%	76.1%	26.3%	-26.7%	-15.9%	-7.5%
Funds from Operations (FFO)						
Adjusted EBITDA commercial portfolio	**195**	**339**	**497**	**625**	**694**	**740**
Finance expense	-47	-70	-115	-147	-147	-153
Tax expense	-20	-34	-44	-56	-62	-66
Minority adjustment	-7	-9	-7	-8	-9	-10
Other adjustments	0	10	8	7	4	4
FFO 1 commercial (long-term recurring)	**120**	**237**	**339**	**421**	**480**	**516**
Adjustment for GCP contribution	46	56	67	69	74	79
FFO 1	**166**	**293**	**406**	**490**	**554**	**595**

BALANCE SHEET

All figures in EURm	2016	2017	2018	2019E	2020E	2021E
Assets						
Current assets, total	**1,100**	**1,523**	**2,102**	**3,270**	**2,649**	**2,502**
Cash and cash equivalents	641	736	1,243	2,346	1,687	1,516
Short-term investments	181	99	366	366	366	366
Receivables	111	163	277	342	380	404
Other current assets	11	18	5	5	5	5
Assets held for sale	155	508	211	211	211	211
Non-current assets, total	**6,989**	**12,247**	**16,939**	**20,442**	**22,451**	**23,920**
Property, plant & equipment	23	26	33	34	34	35
Investment properties	5,016	9,804	14,174	17,496	19,379	20,724
Equity accounted investees	1,557	1,906	2,215	2,361	2,465	2,568
Other LT assets	393	512	517	552	573	593
Total assets	**8,089**	**13,770**	**19,041**	**23,712**	**25,100**	**26,422**
Shareholders' equity & debt						
Current liabilities, total	**349**	**566**	**606**	**724**	**791**	**837**
Short-term debt	160	17	27	27	27	27
Accounts payable	108	267	451	564	626	666
Provisions & other current liabilities	81	282	128	133	138	144
Long-term liabilities, total	**3,799**	**5,955**	**8,491**	**10,327**	**10,775**	**11,305**
Long-term debt	3,385	5,078	7,444	9,042	9,281	9,615
Deferred tax liabilities	366	752	882	1,115	1,319	1,510
Other LT liabilities	48	125	164	169	175	180
Minority interests	373	674	567	705	824	935
Shareholders' equity	**3,568**	**6,576**	**9,377**	**11,957**	**12,710**	**13,346**
Total consolidated equity and debt	**8,089**	**13,770**	**19,041**	**23,712**	**25,100**	**26,422**
Ratios						
ICR (x)	5.7	5.4	4.7	4.9	5.4	5.5
Equity ratio	48.7%	52.6%	52.2%	53.4%	53.9%	54.0%
EPRA NAV[1]	3,871	6,483	8,742	10,557	11,511	12,336
EPRA NAVPS[1] (€)	4.9	6.5	7.7	8.6	9.4	10.1
Net debt	2,737	4,400	5,871	6,352	7,251	7,754
Return on equity (ROE)	25.3%	23.4%	19.5%	11.5%	9.4%	8.3%
Loan-to-value (LTV)	39.3%	35.9%	35.3%	31.5%	32.8%	32.9%

[1] excludes perpetual notes

CASH FLOW STATEMENT

All figures in EURm	2016	2017	2018	2019E	2020E	2021E
Net income	**901**	**1,539**	**1,828**	**1,376**	**1,191**	**1,108**
Depreciation & amortisation	2	2	2	2	2	2
Capital gains, property revaluations & other	-720	-1,327	-1,536	-985	-745	-611
Profit share from equity accounted investees	-197	-228	-252	-199	-162	-164
Shared based payment in a subsidiary	2	2	3	0	0	0
Net finance expenses	83	85	208	147	147	153
Tax result	123	297	257	289	266	257
Operating cash flow	**195**	**369**	**510**	**629**	**698**	**744**
Changes in working capital	-17	-13	-39	26	17	10
Provisions for other liabilities	-1	-2	-3	2	2	2
Dividend received	18	41	51	54	57	61
Tax paid	-16	-33	-46	-56	-62	-66
Net operating cash flow	**179**	**362**	**473**	**655**	**712**	**751**
CapEx/ intangibles	-7	-9	-5	-3	-3	-3
Disposal/ investment in investment properties, net	-1,051	-615	-915	-2,337	-1,137	-735
Acquisition/disposals of subsidiaries	-994	-1,946	-1,829	0	0	0
Proceeds from investments in financial assets	151	-184	-175	-5	-5	-5
Cash flow from investing	**-1,900**	**-2,754**	**-2,924**	**-2,344**	**-1,145**	**-742**
Debt financing, net	1,786	1,165	2,588	1,598	239	333
Equity financing, net	741	1,561	953	1,551	0	0
Dividends paid	-34	-155	-226	-210	-319	-360
Other financing activities	-204	-13	-265	0	0	0
Net paid financing expenses	-45	-66	-97	-147	-147	-153
Cash flow from financing	**2,244**	**2,492**	**2,953**	**2,792**	**-227**	**-180**
Net cash flows	**523**	**100**	**501**	**1,103**	**-659**	**-171**
Assets held for sale - cash	-2	-5	6	0	0	0
Cash, start of the year	121	641	736	1,243	2,346	1,687
Cash, end of the year	**641**	**736**	**1,243**	**2,346**	**1,687**	**1,516**
Adjusted EBITDA commercial/share (€)	0.30	0.41	0.47	0.53	0.57	0.60
FFO 1	166	293	406	490	554	595
FFOPS 1 (€)	0.25	0.36	0.39	0.42	0.45	0.49
Y/Y Growth						
EBITDA/share	75.7%	38.6%	14.4%	12.6%	6.8%	6.6%
FFO 1	76.1%	76.9%	38.5%	20.8%	13.1%	7.4%
FFOPS 1 (€)	47.5%	40.7%	8.1%	8.1%	8.7%	7.4%

FIRST BERLIN RECOMMENDATION & PRICE TARGET HISTORY

Report No.:	Date of publication	Previous day closing price	Recommendation	Price target
Initial Report	29 September 2015	€3.40	Buy	€5.70
2...27	↓	↓	↓	↓
28	29 August 2019	€7.40	Buy	€9.80
29	5 September 2019	€7.33	Buy	€9.80
30	28 October 2019	€7.41	Buy	€9.80
31	Today	€7.76	Buy	€9.80

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Category		1	2
Current market capitalisation (in €)		0 - 2 billion	> 2 billion
Strong Buy[1]	An expected favourable price trend of:	> 50%	> 30%
Buy	An expected favourable price trend of:	> 25%	> 15%
Add	An expected favourable price trend of:	0% to 25%	0% to 15%
Reduce	An expected negative price trend of:	0% to -15%	0% to -10%
Sell	An expected negative price trend of:	< -15%	< -10%

[1] The expected price trend is in combination with sizable confidence in the quality and forecast security of management.

Our recommendation system places each company into one of two market capitalisation categories. Category 1 companies have a market capitalisation of €0 – €2 billion, and Category 2 companies have a market capitalisation of > €2 billion. The expected return thresholds underlying our recommendation system are lower for Category 2 companies than for Category 1 companies. This reflects the generally lower level of risk associated with higher market capitalisation companies.

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- **key sources of information in the preparation of this research report**
- **valuation methods and principles**
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