Deutsche Grundstücksauktionen

Real estate

20 May 2020

Berlin rent cap coupled with coronavirus

Lower trade volumes resulted in Deutsche Grundstücksauktionen (DGA) reporting an almost 70% y-o-y decrease in net profit for FY19 (€0.5m). The decline is almost fully attributable to the parent company, which in H219 started to suffer from declining demand in anticipation of the Berlin rent cap, effective from February 2020. This was in part offset by the improved performance of the fully owned subsidiaries, which collectively doubled their income in FY19 due to real estate market development in up-and-coming cities. As a result of the coronavirus outbreak management decided to recommend a dividend pay-out ratio below 50%, resulting in dividend per share of €0.15 against €1.0 paid from FY18 income.

Commission income shaped by lower trade volume

The group reported that in FY19 the number of properties auctioned fell to 1,568 versus 1,665 in FY18. Contrary to previous years, however, improved pricing was unable to fully offset the decline, resulting in c 19% y-o-y drop in overall trade volume. We note this is also partially attributed to the high comparative basis. Although DGA saw a slight improvement in its annual net commission rate to 10.1% (9.7% in FY18), it was insufficient to compensate for the lower trade volumes, resulting in net commission income of €10m versus €12m in FY18.

Berlin rents frozen for five years

The Berlin rate cap is effective for five years and applies to c 90% of rental properties in the city, with rents effectively frozen at 18 June 2019 levels. For contracts signed after this, rent cannot exceed that for the previous contract for the same residential unit or the lowest regulatory rental cap. The regulation also limits the rent increase following a property's modernisation up to a maximum of €1.00 per sqm. No rent hikes can be introduced until 2021 and from 2022, only rental growth up to 1.3% per year will be possible.

Valuation: Significant drop in dividend payment

In previous years DGA's dividend policy assumed a pay-out of all profit earned in the period, providing shareholders with a relatively attractive dividend yield – 7% in 2019, calculated on the end-2019 share price. However, due to the coronavirus outbreak and related market uncertainties, management has opted for a pay-out of €0.15/share, which constitutes a pay-out ratio of c 49% and dividend yield of 1.4%.

Historical results

Year end	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/16	10.6	1.17	0.73	0.72	14.8	6.7
12/17	11.2	1.22	0.76	0.77	14.2	7.1
12/18	12.0	1.59	1.00	1.00	10.8	9.3
12/19	10.1	0.77	0.31	0.15	34.8	1.4

Source: DGA accounts

Price	€10.8
Market cap	€17m

Share price graph

Share details

Code	DGR
Listing	Deutsche Börse Scale
Shares in issue	1.6m
Last reported net cash at 31 December 2019	€3.3m

Business description

Deutsche Grundstücksauktionen is a market leader in the auctioning of all types of properties in Germany. It expanded actively after its 1999 listing with a network of four regional auction houses, operating in Saxony, West and Northern Germany. It also has as online auction company.

Bull

- Sustained long-term demand for property, assisted by a favourable interest rate outlook.
- Clear market leader with experienced management and wide client base.
- Real estate market may be considered a safe haven by investors.

Bear

- Macroeconomic uncertainties related to coronavirus outbreak and economic downturn.
- Intensely competitive.
- Impact from Berlin rental cap.

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Financials: Revenues below management guidance

2019 has been another robust year in the German real estate market, with residential building approvals up 4% to 360.6k, according to the Federal Statistical Office (Destatis) and a c 20% y-o-y increase in the volume of commercial properties investment, reaching €71.6bn (according to JLL). However, DGA reported a c 19% y-o-y decrease in auction sales turnover of €100.1m, which fell short of both management guidance for the year and the six-year average, which were €109m and €107.7m, respectively. The company sold 1,568 properties in FY19, which was another year of decline after falling to 1,665 in 2018 from 2,043 in 2015. In the previous two years, the impact of the decrease in the number of properties sold has been fully offset by the increase in the price per property. However, in FY19, DGA's average transaction price stood at c €64k per property versus c €74k in FY18. We note the FY18 figure is inflated by a significant one-off €15.2m sale of commercial property in Berlin-Marzahn, completed in Q118, but the decline in revenue was also driven by the scarcity of attractive land in top locations as well as by uncertainties related to the introduction of rent cap in Berlin (see below). Even though DGA managed to improve the annual net commission rate by 37bp to 10.1%, it hardly compensated for the more limited sales volumes, resulting in a c 16% y-o-y decline in net commission earned, sitting at €10.1m.

As the parent company of a group, DGA's results are shaped by the earnings of its five fully owned subsidiaries. However, according to German accounting standards (HGB), which apply to DGA, the company is not obliged to present consolidated accounts and management reports. Therefore, detailed top-down analysis of the financial statement is impossible. We note, however, that the parent company's income in FY19 declined by over 43% y-o-y; despite some minor declines in costs levels against FY18, this resulted in a standalone pre-tax loss for the year of €0.7m against a €1.7m profit in the previous period. On the back of the aggregate net profit of subsidiaries, which more than doubled year on year in FY19 to €1.4m, the group reported positive EBT and net income although these were materially lower than in FY18, at €0.8m and €0.5m, respectively.

Exhibit 1: Financial highlights

€000s	FY19	FY18	change y-o-y
Turnover from auction sales*	***100,114***	***123,919***	***-19.2%***
Net commission*	***10,067***	***12,003***	***-16.1%***
Net commission rate*	***10.1%***	***9.7%***	***37 bps***
Revenue + other operating income	3,553	6,266	-43.3%
Material costs	(132)	(173)	-23.8%
Labour costs	(1,834)	(2,014))	-9.0%
Other operating costs	(2,060)	(2,222)	-7.3%
Depreciation / interest etc.	(197)	(177)	11.6%
Parent company profit	(670)	1,681	N/M
Profit /losses from subsidiaries, of which:	1,435	674	112.7%
Sächsische Grundstücksauktionen	641	20	N/M
Norddeutsche Grundstücksauktionen	328	247	33.2%
Plettner & Brecht Immobilien	51	49	3.9%
Deutsche Internet Immobilien Auktionen	93	153	-39.1%
Westdeutsche Grundstücksauktionen	322	206	56.2%
Pre-tax profit	**765**	**2,355**	**-67.5%**
Income and other taxes	(270)	(761)	-64.5%
Net profit	**495**	**1,594**	**-69.0%**

Source: DGA accounts, Note: *Group level figures.

In FY19 DGA acquired new admissions (new properties for auction) of €41m on a standalone basis and €98m as a group, improving the previous year's figures by c 10%. Along with a renewed agreement (covering 2020 and beyond) with Institute for Federal Real Estate and Bodenverwertungs-und Verwaltungs (one of the company's key state-owned clients), DGA could have expected a rebound in sales and earnings in 2020. The results of Q120 auctions confirmed this, as the group reported a €32.3m trade volume against €23.5m in Q119. However, due to the

coronavirus pandemic outbreak the current outlook is uncertain and management has refrained from providing any guidance for the year.

Increased contributions from subsidiaries

Although the parent company reported a slight decline in the number of properties sold in FY19 against the previous year (301 vs 320), their value plummeted from €62.3m to just €28.9m. This difference can be partially be explained by the high comparative basis related to the aforementioned sale in Berlin-Marzahn. In H219 DGA started to experience the impact of the Berlin rent cap announcement, which resulted in the inability to find a buyer for 12 properties valued at c €10.6m.

The largest FY19 group profit contribution, amounting to €0.6m, is attributable to **Sächsiche Grundstücksautionen**, which rebounded from an unprecedentedly weak FY18, when €20k net profit was reported due to the lowest property trade volume since 2009. In FY19, the subsidiary returned to a development path, benefiting from the characteristics of Dresden and Leipzig as up-and-coming German cities. However, the key driver of the rebound was the pricing of the properties sold, rather than their number. In eight auctions held over the year, total of 371 properties were sold for €22.4m against 375 objects and only €15.7m in FY18.

Similarly, **Westdeutsche Grundstücksauktionen** and **Norddeutsche Grundstücksauktionen** improved their earnings in FY19 by 56% and 33% respectively, with the former improving the net commission rate from 8.1% in FY18 to c 10%, while the latter expanded the trade volume and therefore improved commission earnings. The only subsidiary to report a decline in pre-tax profit in FY19 was **Deutsche Internet Immobilien Auktionen**, which recorded a decrease in commission earnings despite increasing trade volume, on the back of unfavourable price dynamics and declining commission scale (the overall sales volume was shaped by fewer high value trades, which are characterised by disproportionately high commission earnings).

Berlin rent cap discourages potential buyers

Although the Berlin rent cap was approved by local authorities on 30 January 2020 and came into effect on 23 February 2020, it already started to impact the local real estate market in mid-2019 due to its significant extent, as it covers c 90% of rental properties in the city. Based on the five-year regulation the rents are effectively frozen at the levels of 18 June 2019, which implies an upper rent limit between €3.92 and €9.80 per sqm (depending on the construction year and fittings) for buildings with three or more residential units. For contracts signed after this, the rent level cannot exceed that for the previous contract for the same residential unit (or the lowest regulatory rental cap). The regulation also limits the rent increase as a result of property modernisation to a maximum of €1.00 per sqm (irrespective of the number of modernisations completed while the law is in force). No rent hikes can be introduced until 2021 and from 2022 only rental growth up to 1.3% per year will be possible. It is worth noting, however, that the prohibition of rents, which are more than 20% ahead of those allowed for the given location, is effective for existing contracts after nine months, so from 23 November 2020. Moreover, it is the role of the tenant (not the district authorities) to follow through with the restriction. Finally, the regulation is now subject to Federal Constitutional Court after a Berlin district court found it unconstitutional and referred it for a definitive ruling (Deutsche Bank mentioned in its February 2020 report that a verdict is expected in autumn 2020).

Digitalisation of the auctioning process

While European property markets have demonstrated solid fundamentals in recent years, the coronavirus outbreak has increased uncertainty, which could negatively affect investment volumes in the sector. In contrast, the increase in global risk awareness may attract capital to lower-risk investments such as German residential and office properties. We note there are multiple government support measures that have already been introduced or are being discussed to overcome the economic slowdown, but these come after government was forced to impose severe restrictions to limit the spread of the pandemic. These included social distancing and cancellation of all events that would have large audience. Consequently, some of company's the auctions could not take place as planned. However, the company has benefitted from the experience of the Deutsche Internet Immobilien Auktionen subsidiary and consequently, DGA was able to smoothly organise the events online. The additional accessibility resulted in higher buyer attendance than for the live events and consequently selling prices exceeded management expectations. The successful transition to online auctioning is one of the key factors behind c 37% y-o-y improvement in trade volume recorded in Q120.

Valuation

With no direct peers listed on the Frankfurt Stock Exchange, we look at the iShares MSCI Germany Small-Cap ETF, which seeks to track the performance of an index composed of small-cap German equities. As there are no consensus data available for either of these entities, we base our comparison on FY19 reported earnings. DGA's P/E multiple is 34.8x against 12.5x for iShares MSCI Germany Small-Cap ETF.

Historically, DGA has paid shareholders all the profit earned in the period, providing them with a relatively attractive dividend yield that would have equated to 7% in 2019. Due to the coronavirus outbreak and related market uncertainties, management opted for a pay-out of €0.15 per share from FY19 profit, which constitutes pay-out ratio of c 49% and dividend yield of 1.4%. At end-April 2020, the 12-month trailing yield for iShares MSCI Germany Small-Cap ETF was 2.18%.

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