Diok RealEstate AG

6.0 % Senior note (2018/2023)

2 | August | 2022

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Der Spezialist für Finanzaktien

DIOK RealEstate

SRC Research Risk-Return Rating

★★★★☆

Rate (in %)	**95.13%**
Interest rate p.a.	6.00%

Key Data

Issuer	Diok RealEstate AG
Sector	Real Estate
Company's Headquarter	Cologne, Germany
Value Date	1 October 2018
Stock Exchange	Frankfurt Stock Exchange
Stock Market Segment	Open Market
WKN	A2NBY2
ISIN	DE000A2NBY22
Term start	01.10.2018
Term end	30.09.2023
Remaining Term (Years)	1.25
Type of Coupon	Fix-Coupon
Coupon	6.00%
First Coupon	01.10.2019
Interest Payment	Annually
Interest Payment Date	01.10.
Issue Volume	up to Euro 250m
Currently placed	Euro 42m
Accrued Interest Begin	01.10.2019
Principal Amount / Note	1,000 €
Issue Price	100%
Documentation	Securities Prospectus (German Law)
Rating	B / stable outlook
Rating Agency	S&P Global Ratings
Type of Bond	senior unsecured
Internet	www.diok-realestate.de

Financial indicators (Euro '000)

	2021	2022e	2023e	2024e
Rental income	11,792	14,544	21,455	32,536
Net operating income (NOI)	**6,666**	**9,178**	**15,501**	**24,983**
Operating profit (EBITDA)	**4,795**	**7,022**	**12,811**	**22,035**
Net revaluation result	-625	2,556	4,886	6,843
Operating profit (EBIT)	**4,052**	**9,449**	**17,553**	**28,719**
Net financial result	-8,062	-8,863	-12,188	-17,893
Pre-tax profit (EBT)	-4,011	586	5,365	10,827
Net profit after minorities	**-4,590**	**302**	**4,372**	**9,021**
FFO I	**-3,268**	**-1,841**	**623**	**4,143**
Portfolio size (GAV)	**205,790**	**265,332**	**436,449**	**728,536**
Equity	**38,438**	**62,143**	**112,548**	**241,750**
Interest bearing liabilities	**167,705**	**204,763**	**326,071**	**503,560**
ICR (Interest cover ratio)	**0.70**	**0.82**	**1.05**	**1.23**
DSCR (Debt service coverage ratio)	**0.63**	**0.73**	**0.83**	**0.89**

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Consortium led by London-based Alvarium Investments takes 49.9% of the Diok shares – reduction of leverage and accelerated growth planned – first pipeline deal already reported – 4 of 5 stars affirmed

On 14 June, the company published a corporate news, that 49.9% of the share capital of Diok was acquired by an international consortium led by London-based Alvarium Investments, a wealth and asset manager providing tailored solutions to families, foundations and institutions in the Americas, Europe and Asia Pacific regions. Alvarium has AuM of Euro 22bn and has more than 220 employees at 14 locations in 10 countries worldwide.

Diok has an appealing portfolio of commercial properties of about Euro 228m with a focus on South and Western Germany and selected technology driven tenants like SAP, Nokia, Philips, Siemens and ABB and a focus of secondary cities with a higher yield on average. The strategic focus has now moved to science parks and Alvarium is geared to specialize even stronger in this very stable and yielding asset class. To accelerate the future growth, Alvarium will repay in the course of transaction a significant part of the subordinated debt. That should also allow to improve future corporate ratings and to bring significantly down future financing costs of Diok RealEstate.

The company furthermore reported that Dr. Ralf Nöcker, principal at 64 Investments, was appointed to the Board of Directors. He will strengthen the existing management board with his extensive track record of over 30 transactions with an investment volume of more than Euro 5.5bn. He will join Daniel Grosch and Markus Drews, who will stay for further three years and together lead the company and the implementation of the growth targets for the post-Covid era. With Alvarium as major shareholder, Diok should be able to clearly accelerate the portfolio size to the mid-term target of Euro 1bn, possibly until year-end 2025 in our view. After the management was careful in 2020 and 2021 to expand the portfolio in turbulent and uncertain times, we see the current year 2022 as a transition year, including the acquisition in Griesheim and believe that the effects of the accelerated growth and the improved financing costs will become only visible in the years 2023 and after. Thus, we expect the firm to clearly return to the profit zone and to turn positive in terms of FFO from 2023 onwards, while 2022 might already show a slight net profit.

With Alvarium as new partner and strong shareholder we clearly confirm our 4 of 5 stars SRC rating for the Diok note, which currently trades slightly below Par, but has a significantly reduced risk level following the backing of Alvarium. The Diok senior note offers a rewarding risk/ return profile, now more than ever, and we see no risk regarding a repayment of the outstanding amount of the note at the due date in September 2023.

Strengths

- Diok is a lean managed company with a portfolio of more than Euro 227m at present including the recent transaction in Griesheim, which is and will be further diversified across different industries, tenants and locations throughout Germany. Therefore, its business model provides better protection against macro- and microeconomic risks in that regard.
- With an average WALT of 5 years across the entire portfolio of Diok, its tenant base and long-term lease agreements provide them with good long-term visibility with rental income and cash flow from operating activities.
- The new strategic focus on science parks should provide Diok an even more stable tenant base with attractive yields and long-term contracts. The asset class has already a longer successful track record in markets such as the United States, and has more recently also seen European players establishing an investment portfolio or investment fund with that focus.
- The board members are highly senior, experienced and very well-known in the German real estate sector.
- The tenant's creditworthiness and the quality of the buildings are excellent and represent a cross-section of the German Mittelstand.
- The company has a high level of transparency due to the published information about the portfolio and financials
- With the new major shareholder Alvarium, DIOK is now backed by a well-known investor and thus on the one hand significantly reduces the risk for bond investors and also clearly increases the firm's network and financial flexibility.

Weaknesses

- The portfolio is spread over 16 locations in 15 cities and only 5 federal states, which could lead to increased clump risks. However, the diversification is already improving and will further improve with new transactions in the future.

Opportunities

- Diok follows the strategy to establish a commercial real estate portfolio in German secondary cities of over Euro 1bn within the next two to three years. The company aims to reduce its financing costs and the vacancy in the existing portfolio (EPRA vacancy rate at more than 25%). The entry of the new major shareholder should clearly help to grow the business faster and to reduce the financing costs. The focus will now also be shifted more toward science parks. We believe this asset class is in high demand and Diok should be able to gain a good market position as there are still not too many real estate companies with the focus on that asset class in the German market. Furthermore, a possible European expansion should open further attractive investment opportunities.
- The focus on tier-two cities and university cities still offers lucrative yields compared to the Top 7 locations, in which is too much demand from institutional side and wealthy family offices. The good buying opportunities and lucrative deals with upside potential are much more often to be found in the higher yielding tier-two cities.

Threats

- The business strategy is dependent on the successful financial firepower that allows for growth of the portfolio. With the entry of Alvarium this should not be too much of an issue anymore.
- The company follows a "manage-to-core" strategy in its value-add portfolio. Problems regarding the improvements of the assets could lead to higher than expected costs.
- The current geopolitical and economic uncertainties, as well as the rising interest environment and the high level of inflation could lead to a recession and harder times in the real estate sector than compared to the last decade. However, keep in mind that Diok's rental income is fully CPI linked.

Diok RealEstate AG at a glance

Industry:	Commercial Real Estate	**Management Board of Diok:**
Sub-segment:	Office Properties	Daniel L. Grosch
Region:	Germany	Markus Drews
Headquarters:	Cologne	Dr. Ralf Nöcker
Foundation	2013	
Employees:	7	**Supervisory Board of Diok:**
		Arndt Krienen (Chairman)
IR Contact:		Florian Funken
info@diok-realestate.de		Jonathan Elkington

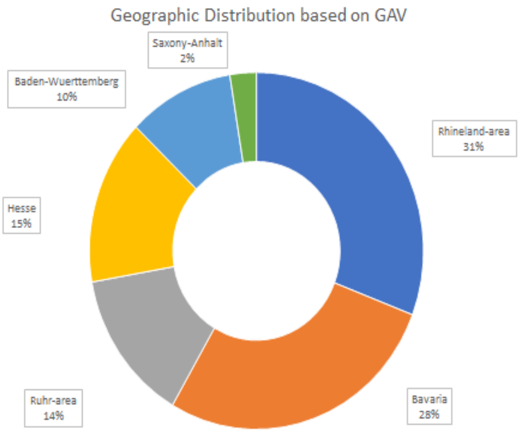
Diok RealEstate AG acquires and manages commercial real estate properties in tier-two locations across Germany with an existing portfolio focused on office properties and a new focus on science parks. As of 1H 2022, Diok holds a portfolio with 16 properties with a total lettable area of about 126k sqm and an aggregate portfolio value of almost Euro 228m.

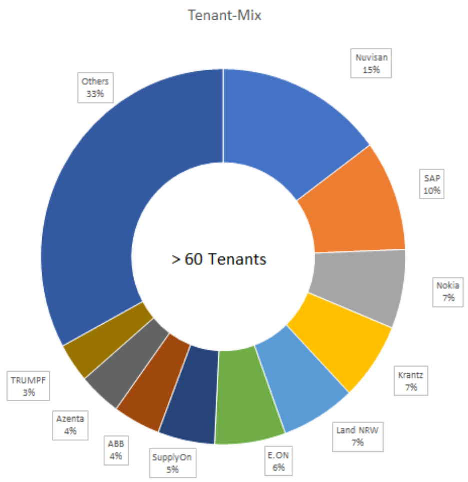
NRI yield*: > 6%	Net rental income*: c. €14m	Portfolio size: 126k sqm
Number of units: 16	Vacancy rate*: c. 10%	GAV: €227.8m

*stabilized numbers

The total net rental income based on stabilized numbers amounts to about Euro 14m, giving a rental yield of more than 6%. The stabilized vacancy rate is at about 10%. Diok has a strong base of more than 60 tenants, of which are science companies. The tenants include the Dax companies SAP and Siemens, Nokia, Philips, Azenta, Nuvisan, the public Jobcenter, the state of NRW etc. The long-term lease agreements with a WALT of more than 5 years allow Diok a high visibility on rental income and cash flow generation. Their goal is to create a diversified portfolio of cash flow producing and high yielding properties in Germany with a steady growth of value and income to a gross asset value of more than Euro 1bn. Therefore Diok is outsourcing the property and facility management, as well as the accounting.

The regional distribution of the portfolio and the tenant mix as of 1H 2022 are as follows:





Source: Company Data, SRC Research

First transaction after the entry of Alvarium already reported – more transactions expected soon

Just about two weeks after the announcement of the entry of the new investor Alvarium and the statement of the accelerated growth expectations, the company reported on the first acquisition. In an off-market transaction, the firm acquired 89.9% of a vehicle that owns a multi-tenant research property in Griesheim, close to Darmstadt. The Campteq Innovation Campus property has a lettable space of about 13.6k sqm and is occupied to about 60%. The anchor tenant is Azenta Life Sciences. While the vacancy is currently high, we assume that the firm can find an appropriate tenant within the coming quarters and thus can significantly lift the value of the property.
While this is already a good first acquisition following the entry of Alvarium, we believe that more transactions will be reported within the second half of 2022 that will further lift the firm's portfolio and drive the numbers of Diok.

FY 2021 still impacted by Corona – Significant growth expected after the transition year 2022

On 30 June, the company published the financial report for 2021. Rental income for the year amounted to Euro 11.8m, while net operating income stood at Euro 6.7m. Personnel expenses came in at Euro 950k, while the other operating result amounted to Euro -920k. The revaluation result was at Euro -625k. While the portfolio recorded valuation uplifts of Euro 4.8m on the one hand, it also saw negative valuations impacts due to current vacancies or looming vacancies. We expect these values to revert however, when the assets are leased up again. The firm's EBIT all in all amounted to more than Euro 4m. The financial result for the period came in at about Euro -8.1m, including some negative one-offs from the repayment of debt, leading to a pre-tax loss of Euro -4m and a bottom line after minorities of -4.6m.

While the company remained clearly below our expectations in 2019, 2020 and 2021, as the for 2019 planed tap of the bond was postponed due to delays on the transaction side and 2020 and 2021 were heavily impacted by the Corona pandemic, we believe that the current 2022 year will be a transition year followed by an accelerated growth in the coming years. This is also underlined by the entry of Alvarium, which opens up much more possibilities for the firm in terms of growth and financing. Another factor that reflects the transition year 2022 and that should support the firm's growth in the coming years is the strategic move toward science parks, an asset class that while not new to the market (e.g. US based Alexandria Real Estate, Kadans Science Partner, BEOS, Garbe) still offers a very high level of demand in our opinion and should also provide Diok a stable tenant base with attractive yields and long-term contracts. The tenant base should mainly consist of tenants with sustainable and future-proof technologies and we see the barriers for them to easily change locations as higher than for the regular commercial tenants, as the requirements are different and more complex. We could also imagine that the company will in the future expand its regional focus to European markets outside of Germany. As the science parks are mainly located in university cities, the options for attractive locations are definitely high within Europe. Overall, the Life-Science industry is currently rapidly growing and we expect that to continue for quite some time, which will clearly support the new strategic move of Diok.

Following the first acquisition in Griesheim, as described above, we expect further acquisitions to be reported during 2022 and believe that the portfolio will stand at about Euro 265m at year-end. For the coming years, we believe that the portfolio will grow more significantly to about Euro 440m at FY 2023, Euro 730m at FY 2024 and to cross the Euro 1bn mark by FY 2025. The portfolio currently has a good lease maturity profile with more than 50% of long-term contracts and a manageable amount of contracts expiring in the coming 12 months, allowing for a high visibility on rental income.

Significantly improved balance sheet expected in the coming years

Following the entry of Alvarium, we expect the financial position of the firm to significantly improve in the coming quarters. On the one hand, this is due to the fact that debt has already been repaid following the entry of Alvarium and that future acquisitions will be acquired at a much lower LTV levels, below 60%. Diok will benefit from subordinated shareholder loans in the future that will strengthen the equity base of the company and in turn significantly reduce the LTV level. Thus, we expect the equity ratio now to improve from 17.5% at FY 2021 to even above 30% by FY 2024. For the leverage our new estimates see the LTV declining from about 80% at FY 2021 to below 60% by FY 2024. This will also clearly benefit the firm’s gearing ratio and coverage ratios.

Profit & Loss Account

Diok RealEstate AG IFRS 31/12 (Euro '000)	2019	2020	2021	2022e	2023e	2024e	CAGR '21 - '24e
Rental income	7,085	13,156	11,792	14,544	21,455	32,536	40.3%
expenses directly attributable to properties	-1,725	-3,583	-5,126	-5,366	-5,954	-7,553	
Net operating income (NOI)	5,360	9,573	6,666	9,178	15,501	24,983	55.3%
Other operating income	104	267	606	139	170	201	
Personnel Expenses	-964	-1,066	-954	-1,158	-1,472	-1,566	
Other operating expenses	-1,896	-2,619	-1,524	-1,137	-1,388	-1,583	
EBITDA (cash driven operating profit)	2,605	6,155	4,795	7,022	12,811	22,035	66.3%
Depreciation	-91	-110	-118	-129	-144	-159	
Net revaluation result	38,178	741	-625	2,556	4,886	6,843	
Operating profit (EBIT)	40,692	6,786	4,052	9,449	17,553	28,719	92.1%
Net financial result	-5,586	-8,277	-8,062	-8,863	-12,188	-17,893	
Pre-tax profit (EBT)	35,106	-1,491	-4,011	586	5,365	10,827	
Taxation	-5,194	-430	-542	-88	-805	-1,624	
Minorities	-874	-102	-36	-196	-189	-182	
Net profit after minorities	29,038	-2,024	-4,590	302	4,372	9,021	
FFO I before taxes	-1,881	-1,922	-3,268	-1,841	623	4,143	
Portfolio size (GAV)	205,573	206,260	205,790	265,332	436,449	728,536	
Total Assets	214,924	226,149	219,977	286,559	458,271	764,963	51.5%
Equity	39,725	37,803	38,438	62,143	112,548	241,750	
Equity ratio	18.5%	16.7%	17.5%	21.7%	24.6%	31.6%	
Interest bearing liabilities	162,057	176,173	167,705	204,763	326,071	503,560	44.3%
Interest bearing liabilities without senior note	117,057	136,684	125,509	184,509	326,071	503,560	58.9%
LTV (without senior note)	56.9%	66.3%	61.0%	69.5%	74.7%	69.1%	
Cash	3480	9126	3672	17634	44586	86341	
Net-LTV	77.1%	81.0%	79.7%	70.5%	64.5%	57.3%	
Gearing (Debt-to-Equity-Ratio)	441.0%	498.2%	472.3%	361.1%	307.2%	216.4%	
Interest cover ratio (EBITDA / net financial expenses)*	0.47	0.74	0.70	0.82	1.05	1.23	
Debt service coverage ratio*	0.31	0.56	0.63	0.73	0.83	0.89	

** skewed as not on an annualized basis, thus lower than actual number*

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Rating Chronicle

Company	Date	Rating
Diok RealEstate AG	17.03.2020	4 Stars
Diok RealEstate AG	11.11.2019	4 Stars
Diok RealEstate AG	24.09.2018	4 Stars

Please note:

- Diok RealEstate AG mandated SRC Research for covering the issue of the Senior note.
- The price mentioned in this report is based on the nominal value of 100%.