DiokRealEstate AG

6.0 % Senior note (2018/2023)

17 | March | 2020

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DIOK RealEstate

SRC Research Risk-Return Rating

★★★★☆

- **Rate (in %)** **92,61%**
  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)	3.5
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 45m, tap ongoing
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)**

	2019	2020e	2021e	2022e
Rental income	7,085	19,476	29,873	39,417
Net operating income (NOI)	**5,360**	**15,386**	**24,496**	**33,110**
Operating profit (EBITDA)	**2,605**	**13,546**	**22,457**	**30,954**
Net revaluation result	38,178	43,214	32,514	30,581
Operating profit (EBIT)	**40,692**	**56,652**	**54,856**	**61,406**
Net financial result	-5,586	-12,230	-15,955	-19,498
Pre-tax profit (EBT)	35,106	44,422	38,901	41,909
Net profit after minorities	**29,038**	**37,573**	**32,874**	**35,426**
FFO I	**-1,881**	**1,516**	**6,802**	**11,807**
Portfolio size	**205,573**	**420,146**	**590,103**	**751,430**
Equity	**39,725**	**90,654**	**127,314**	**162,936**
Interest bearing liabilities	**162,057**	**349,561**	**463,467**	**580,480**
ICR (Interest cover ratio)	**0.47**	**1.11**	**1.41**	**1.59**
DSCR (Debt service coverage ratio)	**0.31**	**0.86**	**1.03**	**1.14**

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Good progress in terms of numbers and portfolio growth in 2019 – portfolio expected to more than double in 2020 to Euro 420m – tap of note ongoing – 4 of 5 stars affirmed

Yesterday, the company published the numbers for the recently closed 2019 fiscal year and for most parts even came out on top of our estimates. Rental income amounted to almost Euro 7.1m, leading to a net operating income of Euro 5.4m. The revaluation result came in at Euro 38m, significantly on top of our estimates, reflecting that the company has done a good job regarding the operational work within the portfolio, making use of the value-add potential of the objects. The firm's operating profit on EBIT basis was at almost Euro 41m. With a net financial result of Euro -5.6m, the firm's bottom line after minorities came in at Euro 29m. The equity ratio improved from 14.2% at 1H 2019 to 18.5% at year-end and our calculated net-LTV came down from 80.4% to 77.1% over the same time period, thus clearly below the threshold of 85% of the note's covenants. In terms of the coverage ratios, an improvement compared to 1H became apparent as well. The interest cover rage hiked from 0.39 to 0.47 and the debt service coverage ratio climbed from 0.19 to 0.31. These numbers are still relatively low, however, an improvement is already visible and we expect a further clear improvement in 2020.

Four of the in November announced objects from the so called "Eagle" portfolio were already signed and two objects, namely in Hallbergmoos in Bavaria and in Offenbach in Hesse, were already closed before year-end, lifting the company's portfolio to a value of more than Euro 205m. For the other two signed objects we expect a closing in 2Q 2020. Including these two objects, the portfolio value amounts to more than Euro 250m, thus clearly fulfilling the firm's growth plans for 2019. The annualized net cold rental income of the portfolio amounts to more than Euro 14m, with a yield of more than 5.6%, a vacancy rate of about 7% and a long WALT of 5,2 years.

The fiscal year 2019 was successful in our opinion. The portfolio has grown significantly and more than tripled from Euro 64m to Euro 205m. In terms of the numbers, a strong hike was realized and another significant increase can be expected for 2020, as the newly acquired objects will contribute and further acquisitions during the year should also add to rental income for a good portion of the year. Two weeks ago, the company announced the intention to tap the note with the third tranche and the management will thus conduct a road show. This will give the firm more firepower for further additions. As the first call option of the note becomes available on 1 October, the current yield to first call is lucrative at more than 17%. We confirm our 4-Star risk-return rating for the 2018/2023 corporate bond.

Der Spezialist für Finanzaktien

SWOT Analysis

Strengths

- The board members Daniel Grosch and Markus Drews are highly senior, experienced and very well-known in the German real estate sector.
- Diok is a lean managed company with a portfolio of more than Euro 250m at present, which is and will be further diversified across different industries, tenants and locations throughout Germany. Therefore, their business model provides better protection against macro- and microeconomic risks in that regard.
- With an average WALT of 5.2 years across the entire portfolio of Diok, their tenant base and long-term lease agreements provide them with good long-term visibility with rental income and cash flow from operating activities.
- The outsourcing of the facility and property management simplifies the calculation of costs and the improvement of cash flows. This allows the focus on reducing vacancy and monitoring local market dynamics on a constant basis. The partner company for PM, FM has a very long track record and already worked for Mr. Grosch and Mr. Drews. All processes and interfaces were already set up and ready for transactions from Day 1. The partner is also involved in the Due Diligence process before buying new properties for the portfolio.
- The tenant's creditworthiness and the quality of the buildings are excellent and represent a cross-section of the German middle class.
- The company has a very high level of transparency due to the published information about the portfolio and financials

Weaknesses

- As the firm started its real estate operations only in spring 2018, Diok does not have a meaningful operating and financial track record yet, which would allow for a higher trust from an investor's view.
- The portfolio is currently spread over 17 locations in 12 cities and only 5 federal states, which could lead to increased clump risks. However, the diversification is already improving and will further improve significantly after the planned acquisition of the "Eagle" portfolio.

Opportunities

- Diok follows the strategy to establish an office real estate portfolio in German secondary cities of over Euro 1bn within the next two to three years. The company aims to reduce their financing costs and the vacancy in the existing portfolio (EPRA vacancy rate at present about 7%). The strategic plan sounds promising and, if accomplished, will lead to lucrative earnings in the mid-term.
- Diok focuses on well-maintained, suitable office assets in secondary locations, which provide high yields with low cyclicality, at least lower than in the primary locations. Due to the pronounced management knowledge in the regional markets, this should lead Diok to a favourable position in this segment.
- The focus on tier-two 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.

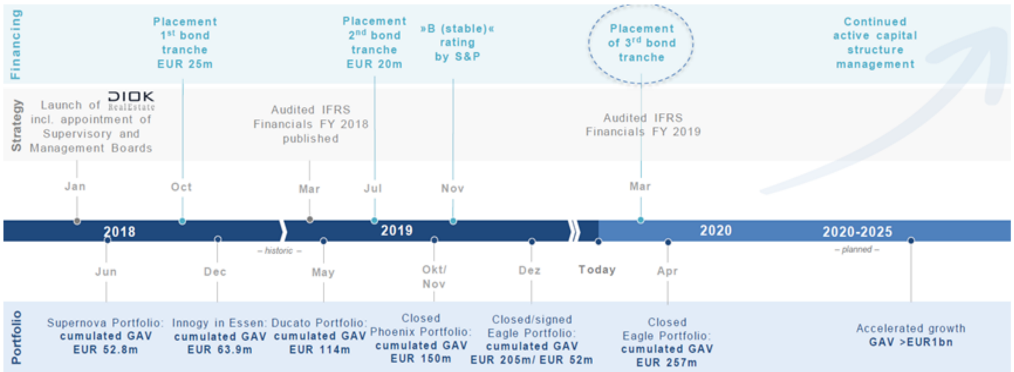
Threats

- The business strategy is dependent on the successful continuous tapping of the bond and the proceeds raised.
- The company follows a "manage-to-core" strategy in their value-add portfolio. Problems regarding the improvements of the objects could lead to higher than expected costs.
- The institutional demand to buy in German tier-two locations is rising as yields became very low in tier-one cities and the offer side shrunk. Thus we expect more competition to follow for good tier-two locations, which is a threat for a quick portfolio expansion.

Diok RealEstate AG at a glance

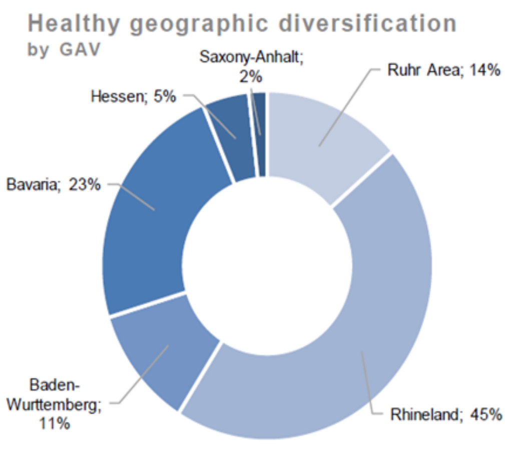
Industry:	Commercial Real Estate	**Management Board of Diok:**
Sub-segment:	Office Properties	Daniel L. Grosch
Region:	Germany	Markus Drews
Headquarters:	Cologne	
Foundation	2013	
Employees:	5	**Supervisory Board of Diok:**
		Arndt Krienen (Chairman)
IR Contact:		Florian Funken
info@diok-realestate.de		Stefan Lutz

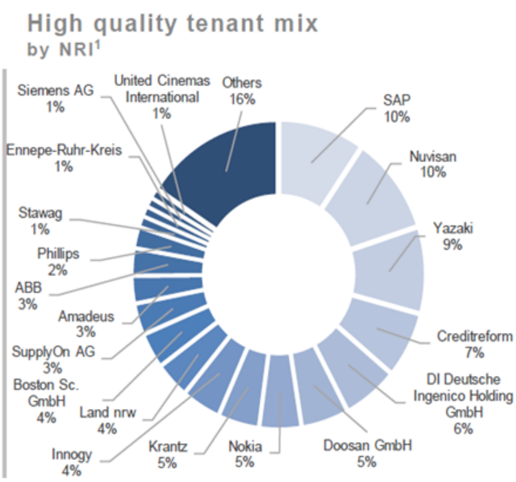
Diok RealEstate AG acquires and manages commercial real estate properties in tier-two locations across Germany, mainly office.



Diok currently already holds a portfolio with 17 properties with a total lettable area of 139k sqm and an aggregate portfolio value of more than Euro 250m. The total net cold rental income amounts tomore than Euro 14m, giving a rental yield of 5.64%. The vacancy rate is at about 7%. As of FY 2019, Diok has a strong base of more than 40 tenants, of which about 58% are blue chip companies. The tenants include the Dax companies SAP and Siemens, Nokia, Philips, Creditreform, the public Jobcenter, the state of NRW etc. The long-term lease agreements 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 office properties portfolio in Germany with a steady growth of value and income to a gross asset value of more than Euro 1bn with the intention to position the company with this portfolio as an attractive takeover target or IPO candidate and to sell a streamlined portfolio as a whole, externally managed and reduced to its assets with a very limited number of employees, in a timeframe of up to four years. So 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 FY 2019 are as follows:





Source: Company Data, SRC Research

More objects were added to the portfolio since our most recent update - Further growth expected soon

As described in our last update from 11 November, the company intended to acquire the so called Eagle portfolio. So far, DIOK has managed to sign four objects, two have already been closed, while the other two objects are to be closed soon, expectedly by the end of April.

On 19 November, just shortly after our last update, the company announced the acquisition of the first object, an office building in the city of Offenbach in the Rhine-Main region. The object has a lettable area of 9,200 sqm and the net annual rental income amounts to almost Euro 700k. As the closing was already in 2019, the object will fully contribute to the 2020 numbers.

Just a few days after, DIOK released news about the purchase of two office buildings, both of which were off-market transactions. The one object is located in the Detmold area in the state of North Rhine-Westphalia. The almost 4,800 sqm are fully let to a high-net-worth tenant and currently delivers about Euro 410k of annual net rental income after the closing which we also expect for the end of April . The other object is located in Hallbergmoos, next to the Munich Airport, and has a lettable area of more than 15,000 sqm, which is let to several tenants, including SAP as the anchor tenant. The transaction has already been closed and the annual net rental income amounts to about Euro 1.8m.

On 11 December the next acquisition was announced, an office building in the greater Düsseldorf area. The about 27,000 sqm object currently has a vacancy rate of about 22%, thus offering substantial appreciation potential, which we believe the company can realize within the year. The current annual net basic rent amounts to more than Euro 2.3m while the targeted rental income amounts to Euro 3m. The closing of the objects is still outstanding and we expect it at the end of April.

Together the four objects account for almost Euro 100m of market value with an annual basic rent of about Euro 5.2m. The WALT of the four properties is at 5.5 years. We expect further acquisitions within 2020. The management plans to at least double the portfolio size in the current year. Our estimate is at Euro 420m.

Profit & Loss Account

Diok RealEstate AG IFRS 31/12 (Euro '000)	2019	2020e	2021e	2022e	2023e	CAGR '19 - '23e
Rental income	7,085	19,476	29,873	39,417	48,716	90.2%
expenses directly attributable to properties	-1,725	-4,090	-5,377	-6,307	-6,333	
Net operating income (NOI)	5,360	15,386	24,496	33,110	42,383	99.2%
Other operating income	104	105	117	139	170	
Personal Expenses	-964	-1,021	-1,103	-1,158	-1,212	
Other operating expenses	-1,896	-924	-1,053	-1,137	-1,258	
EBITDA (cash driven operating profit)	2,605	13,546	22,457	30,954	40,083	148.7%
Depreciation	-91	-108	-115	-129	-144	
Net revaluation result	38,178	43,214	32,514	30,581	38,470	
Operating profit (EBIT)	40,692	56,652	54,856	61,406	78,409	
Net financial result	-5,586	-12,230	-15,955	-19,498	-22,869	
Pre-tax profit (EBT)	35,106	44,422	38,901	41,909	55,540	16.5%
Taxation	-5,194	-6,663	-5,835	-6,286	-8,331	
Minorities	-874	-186	-192	-196	-189	
Net profit after minorities	29,038	37,573	32,874	35,426	47,020	17.4%
FFO I before taxes (2019 estimate)	-1,881	1,516	6,802	11,807	17,604	
Portfolio size	205,573	420,146	590,103	751,430	951,208	
Balance Sheet Sum	214,924	436,952	601,905	773,973	970,232	65.3%
Equity	39,725	90,654	127,314	162,936	210,145	
Equity ratio	18.5%	20.7%	21.2%	21.1%	21.7%	
Net-LTV	77.1%	76.4%	75.1%	74.9%	74.8%	
Gearing (Debt-to-Equity-Ratio)	441.0%	382.0%	372.8%	375.0%	361.7%	
Interest cover ratio (EBITDA / net financial expenses)	0.47	1.11	1.41	1.59	1.75	
Debt service coverage ratio*	0.31	0.86	1.03	1.14	1.20	

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

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Rating Chronical:

Company	Date	Rating
Diok RealEstate AG	11/11/2019	4 Stars
Diok RealEstate AG	24/09/2018	4 Stars

Pleasenote:

- DiokRealEstate AGmandatedSRC Research for covering the issue of the Senior note.
- The price mentioned in this report is based on the nominal value of 100%.

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