Real estate stocks awake investor’s appetite, CEE still seen as a poison pill

Back

07.10.2009

- Real estate has caught up with the easing of credit conditions, plummeting interest rates and outward yield shifts coming to a halt
- Investors still fear CEE real estate stocks and trade them with discounts of around 40% to NAV, which offers upside potential when the concerns subside further
- Immoeast, S Immo and ECO valued as top picks due to their very attractive discounts to P/BV and expected strong cash flow improvement

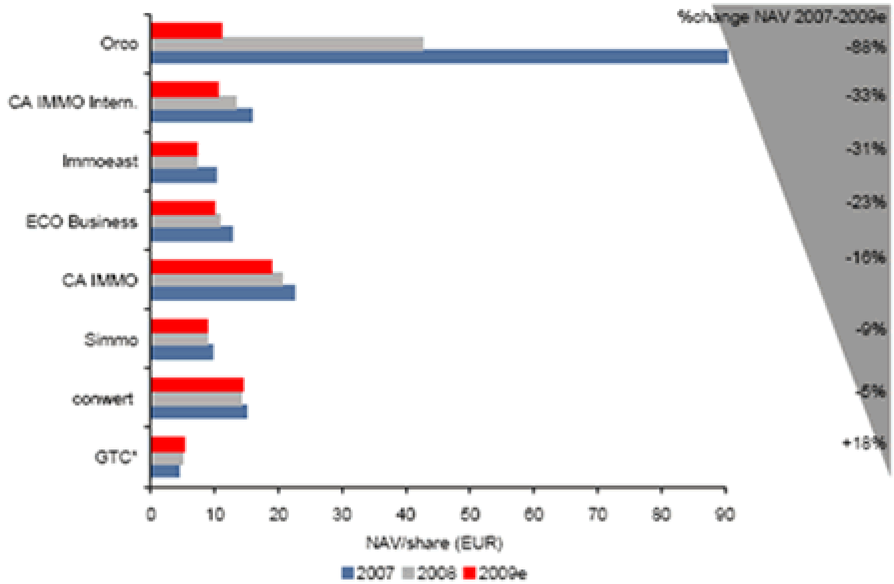
European and global real estate stocks fell by around 50% between the end of August 2008 (shortly before the Lehman collapse) and trough March 2009. The Austrian real estate index IATX crash-landed even harder, with an 80% value erosion. “Since March, we have seen two upswing phases in real estate stocks, one ranging from the beginning of March until mid-April and the second from mid-July to around mid-September as more and more market participants have expected an economic recovery, based on improving sentiment and other macro indicators”, states Günther Artner, Co-Head CEE Equity analyst. All in all, European and global real estate stocks bounced back by around 70% from their March lows, whereas the IATX shot up by around 250%.

Performance of real estate stocks by country Austria was hit the hardest, due to the CEE exposure of some stocks as well as company specific issues of the largest stock, Immoeast. Austria was among these countries one of the first to come under attack in the financial crisis.

Investors still afraid of CEE

A look at the performance of Erste Group's real estate coverage universe compared to other industries shows that, in the 12M and 24M time horizon, real estate was the worst performer, along with banks (shaken by the financial crisis) and basic resources, with the bursting of the commodity bubble and the economic downturn. The development of P/BV ratios mirrors the performance of the real estate stocks. Austrian real estate stocks fell from a peak P/BV of 1.05x to 0.17x in 2H08 and are now back at around 0.6x."This still represents a substantial discount to Western European peers, which are back at close to P/BV parity or even higher. We can thus say that investors still demand high risk premiums for CEE markets", explains Gernot Jany, CEE Real estate analyst at Erste Group. However, YTD, real estate has caught up with the easing of credit conditions, plummeting interest rates and outward yield shifts coming to a halt. London and Paris were among the first to move back onto investors' radar screens regarding investments. While investment volumes on European real estate markets were still down 37% y/y in 2Q09, turnover increased in a quarterly comparison. Markets that fell the most, like London, Madrid, Barcelona and Paris, now attracted the most buyer interest. CEE investment markets, however, still seem paralyzed by investor risk aversion.

NAV growth 2007 to 2009e

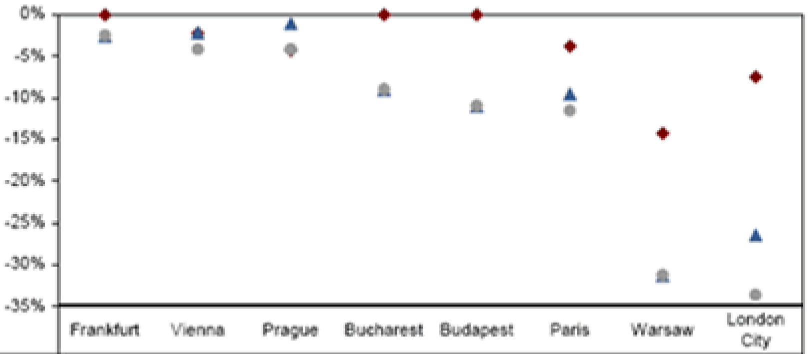


** GTC: BVPS, as company does not provide NAV*
Source: Company data, Factset, Erste Group estimates

Companies with CEE exposure hit the most

The worst-hit companies in terms of NAV decline were Orco, CA Immo International and Immoeast, all of them having a high CEE share, high development pipelines and high gearing ratios (in the case of Orco). conwert and S Immo, with high residential stakes in their portfolios, could hold up their NAVs pretty well. "However, we expect development margins to come in lower in 2009 and 2010",describes Martina Valenta, analyst at Erste Group.The highest upside to the average P/NAV of 0.6x – when excluding Orco, which is in a restructuring phase – is currently at ECO Business Immobilien and CA Immo. However, none of the stocks has yet come close to the 2007 P/NAV multiples. Western European stocks already trade at multiples of close to 1 or above 1. "Looking at our projections, we do not assume negative NAV growth rates between 2009 and 2011. Thus, the current discounts of around 40% seem to offer upside potential when investor concerns on CEE and Austrian real estate stocks subside further", foresees Valenta.

Development of office rents in key European markets



	Frankfurt	Vienna	Prague	Bucharest	Budapest	Paris	Warsaw	London City
Last 3 months	0.0%	-2.2%	-4.3%	0.0%	0.0%	-3.8%	-14.3%	-7.5%
Last 12 months	-2.6%	-2.2%	-1.1%	-9.1%	-11.1%	-9.6%	-31.4%	-26.5%
from peak	-2.6%	-4.3%	-4.3%	-9.1%	-11.1%	-11.7%	-31.4%	-33.8%

Source: CBRE

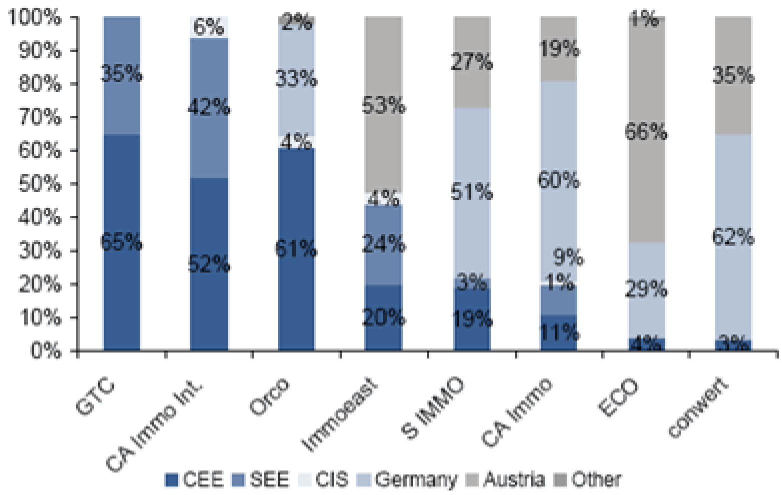
9/30/2009 Company	Rep. Curr.	Mcap (EURmn)	Price Current (LC)	Target	Recommendation	Upside potential	Performance (EUR terms) 1M	3M	6M	12M
Sparkassen Immobilien	EUR	356	5.22	7.1	Buy	36%	4%	22%	122%	9%
ECO Business-Immo	EUR	161	4.73	6.4	Buy	35%	15%	88%	231%	33%
Immoeast	EUR	3,519	4.22	5.2	Buy	23%	18%	136%	294%	138%
CA IMMO International	EUR	256	5.90	6.9	Accumulate	17%	16%	63%	158%	43%
conwert Immobilien Invest AG	EUR	761	9.39	10.7	Accumulate	14%	10%	63%	98%	42%
GTC	EUR	1,248	24.10	26.7	Accumulate	11%	-5%	9%	63%	10%
CA IMMO	EUR	771	8.84	10.2	Hold	15%	2%	50%	144%	28%
Orco	EUR	84	7.80	7.2	Reduce	-8%	-11%	32%	93%	-54%

Source: Factset, Erste Group

Signs of relief in hard hit Western European markets, CEE investment volume aging behind

CEE investment volume in 1Q09 was about two times higher than in 2Q09. The only market with growing activity was - 'thanks' to really depressed valuations – Russia. Overall, investors are still interested only in prime office and retail buildings in core CEE markets such as Prague and Warsaw, where price expectations of buyers and sellers seem to be getting closer. Market sources talk about up to 20-30 pending deals in Prague. Thus, there is a possibility investment volumes will increase in 2H09, but at higher yield levels.

Portfolio breakdown by region (in sqm)



Source: Company data

Local rental yields of CEE properties are sufficiently (but not 'excessively') above those in WE. Rents are still declining - especially in CIS markets, which had seen excessive rent increases earlier, like Russia and Ukraine. According to our yield model, the decline in 10-year government bond yields, interest rates and risk premiums should provide some cushion in current rental yields for a further deterioration in occupier markets and rents. Thus, 2009 should likely conclude the cycle of hefty revaluation losses in the P&Ls of real estate companies.

All of our three **top picks** - **Immoeast, S Immo and ECO** - have very attractive discounts to P/BV. ECO is still the cheapest among the Austrian real estate stocks in our coverage universe. While S Immo trades above the median in 2009, it shows strong discounts in 2011, after finalization of its development projects. These development projects also provide for attractive growth in earnings and cash flows in later years. Due to free cash flows from asset sales not used for deleveraging, ECO offers the upside of paying a dividend or conducting a share buyback program, which should benefit current investors. Due to its large size, Immoeast is the Austrian real estate stock most widely followed by international investors and still offers interesting upside potential as a restructuring case.

We confirmed our **Hold** recommendation for **CA Immo** which cannot realize its full income potential from its extensive land bank in Germany at the moment due to lack of demand for commercial real estate projects. We also stick to our **Reduce** recommendation for the Czech developer **Orco** which is still in a restructuring phase with lots of open issues.

We upgrade our recommendation for Polish developer **GTC** from Hold to **Accumulate** with a new target price of PLN 26.7. We confirm our**Accumulate** recommendation for **CA Immo International** with a new target price of EUR 6.9. We downgrade our recommendation for the **conwert** share from Buy to **Accumulate**, but step up the target price to EUR 10.7.

Back