Diok RealEstate AG

6.0 % Senior note (2018 / 2023)

11 | November | 2019

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SRC Der Spezialist für Finanzaktien

DIOK RealEstate

SRC Research Risk-Return Rating

★★★★☆

Rate (in %)	**100%**
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)	3.9
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 of Euro 75m 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)

	1H 2019	2019e	2020e	2021e
Rental income	2,891	6,843	22,897	29,873
Net operating income (NOI)	**1,926**	**5,817**	**19,462**	**25,691**
Operating profit (EBITDA)	**819**	**3,747**	**17,958**	**23,820**
Net revaluation result	11,866	19,836	28,665	27,631
Operating profit (EBIT)	**12,679**	**23,571**	**46,605**	**51,426**
Net financial result	-2,120	-4,956	-9,084	-10,960
Pre-tax profit (EBT)	10,558	18,615	37,522	40,465
Net profit after minorities	**8,539**	**15,696**	**31,708**	**34,204**
FFO I	**-1,301**	**-109**	**9,075**	**13,159**
Portfolio size	**114,200**	**386,043**	**493,214**	**590,103**
Equity	**17,642**	**61,013**	**92,907**	**127,302**
Interest bearing liabilities	**97,264**	**342,845**	**429,333**	**511,619**
ICR (Interest cover ratio)	**0.39**	**0.76**	**1.98**	**2.17**
DSCR (Debt service coverage ratio)	**0.19**	**0.38**	**1.12**	**1.19**

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Very pleasing progress on the acquisition side and within the portfolio – tap of up to Euro 75m planned – B Rating assigned by S&P Global Ratings – 4 of 5 stars affirmed

Since our initial report on 24 September 2018 and the initial placement of the firm's senior note a few days later, Diok's operations have progressed significantly. Diok has initially placed Euro 25m in a first tranche, thereby allowing the company to grow their operations while preventing an excessive hike in financing costs for at first unused funds, while having the option to tap the note at later periods. While some of the funds were as planned used to repay more expensive loans, the lion's share was used to acquire new properties and to grow the portfolio. With these funds, the portfolio has more than doubled, from Euro 53m to Euro 114m at 1H 2019. In July, a second tranche was placed with a volume of Euro 20m and the portfolio value was further lifted to a volume of more than Euro 150m with the acquisition of three office objects, which were just recently closed. The annualised rental income thus now amounts to about Euro 8.9m.

Last week Monday, on 4 November, the company further announced the intention to once again tap the bond with a volume of up to Euro 75m via a private placement. The proceeds are for further planned acquisitions such as the so called "Eagle Portfolio" with a gross asset value of more than Euro 224m, which the company expects to sign and close within the year or in 1Q 2020.

Furthermore, the company reported the numbers of the first half of 2019 about two weeks ago, on 21 October. Rental income was at Euro 2.9m up 33% compared to the second half of 2018. For the second half a further hike in that number can be expected, as some of the mentioned acquisitions will add to the numbers of the second half of the year. The firm's NAV almost doubled in the first six months and climbed from Euro 9.5m to Euro 19.0m.

We are very pleased with the progress of the company since the placement of the bond. The management proved that it can lucratively invest the proceeds from the placement and the taps, as well as that it can make use of the value-add potential of some of the acquired objects via e.g. lease extensions and vacancy reductions. The planned tap of the bond and the to be signed acquisitions will again significantly drive the company's growth and the P&L numbers. We expect the firm's portfolio to stand at about Euro 386m, thus up more than seven-fold compared to our initial report a little over a year ago. We thus see the firm fully on track regarding the set targets and the outlook for the coming quarters. The recently assigned B rating with stable outlook by S&P Global Ratings further underlines the positive developments. We thus clearly confirm our 4-Star risk-return rating for the 2018/2023 corporate bond.

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 about Euro 150m 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 6.0 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 level of transparency and trust from an investor's view.
- The portfolio is currently spread over 13 locations in 12 cities and only 4 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 three to four years. The company aims to reduce their financing costs and the vacancy in the existing portfolio (EPRA vacancy rate at present about 9%). The strategic plan sounds very 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 secondary 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 much higher yielding B 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 B locations is rising as yields became very low in A cities and the offer side shrunk. Thus we expect more competition to follow for good B locations, which is a threat for a quick portfolio expansion.

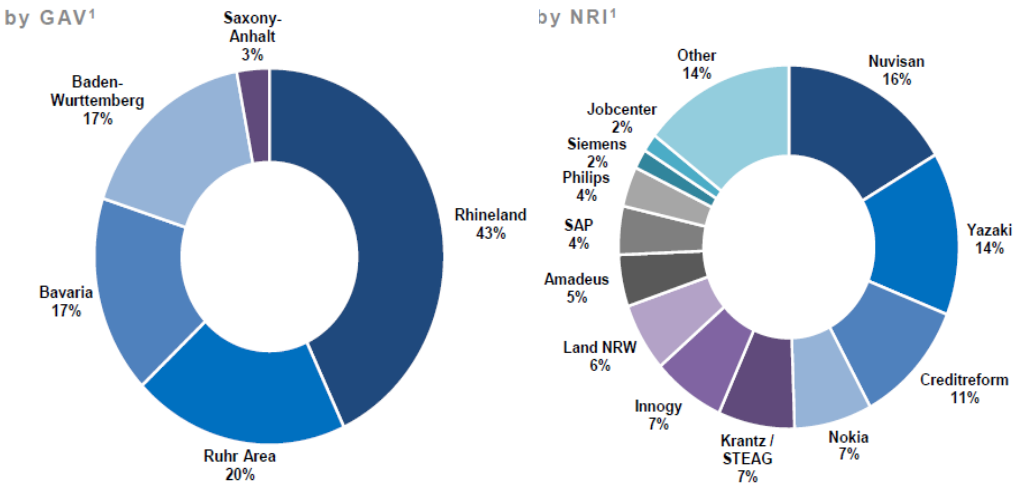
Diok RealEstate AG at a glance

Industry:	Commercial Real Estate	**Management Board of Diok:**
Sub-segment:	Office Properties	Daniel L. Grosch
Region:	Germany	Markus Drews
Headquarters:	Cologne	
Foundation	2013	
Employees:	4	**Supervisory Board of Diok:**
		Florian Funken (Chairman of the Supervisory Board)
IR Contact:		Arndt Krienen
info@diok-realestate.de		Stefan Lutz

Diok RealEstate AG acquires and manages commercial real estate properties in secondary locations across Germany, mainly office. The firm was originally incorporated in 2013 under the name "JobHub AG" as stock corporations and was engaged in human resources consulting. On 23 May 2017, the annual general meeting changed the company's name to "Diok RealEstate AG". At the same time, the annual general meeting passed the transfer of the Company's registered office to Cologne, North Rhine-Westphalia, as well as the amendment of the company's articles of association, including the business purpose, allowing Diok to acquire office real estate with a focus on buying, operating, repositioning and trading office property assets, portfolios or companies.

Diok currently already holds a portfolio with 13 properties with a total lettable area of 89k sqm and an aggregate portfolio value of more than Euro 150m. The total gross rental income amounts Euro 8.9m, giving a gross rental yield of 5.9%. The average vacancy rate is at about 9%. 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.

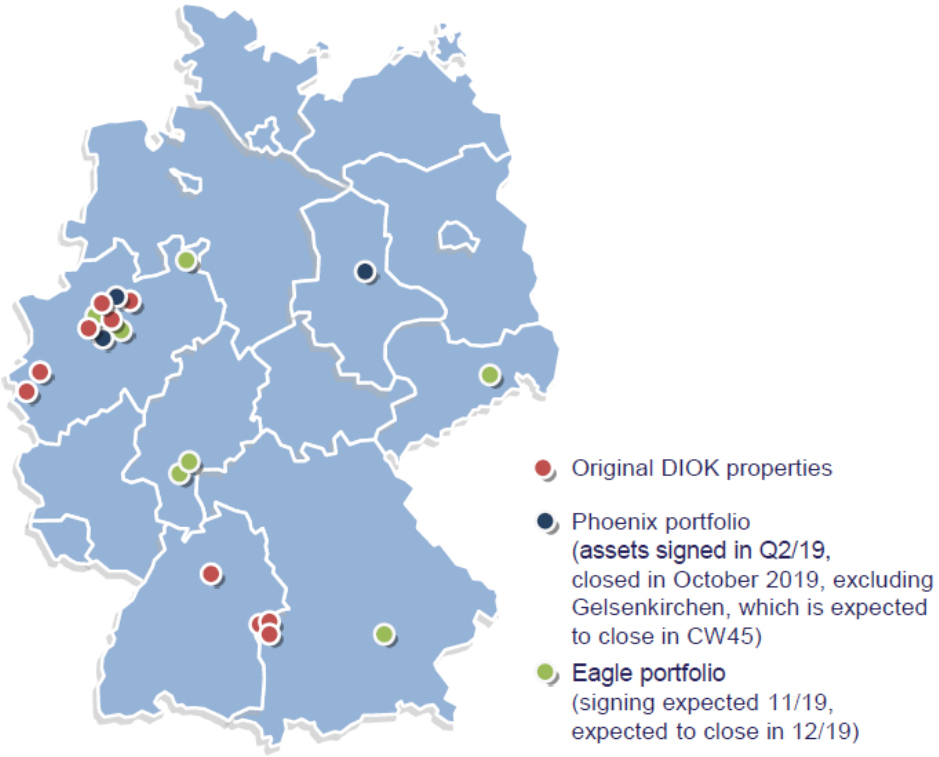
The regional distribution of the current portfolio and the tenant mix are as follows:



Source: Company Data, SRC Research

Significant growth in the portfolio since the placement of the first tranche of the bond – More growth is already in sight

The portfolio has significantly increased since our initial report in September 2018. Compared to the relatively small portfolio with six assets and a GAV of about Euro 53m about a year ago, the portfolio now comprises 13 assets with a GAV of more than Euro 150m. In December 2018, the company acquired an object in Essen. In May 2019 the so called "Ducato" portfolio was closed with objects in Aachen, Würselen and Neu-Ulm. Earlier this week, the in June signed Phoenix portfolio was closed and the properties in Magdeburg, Köln and Gelsenkirchen were added to the portfolio.



Source: Company presentation

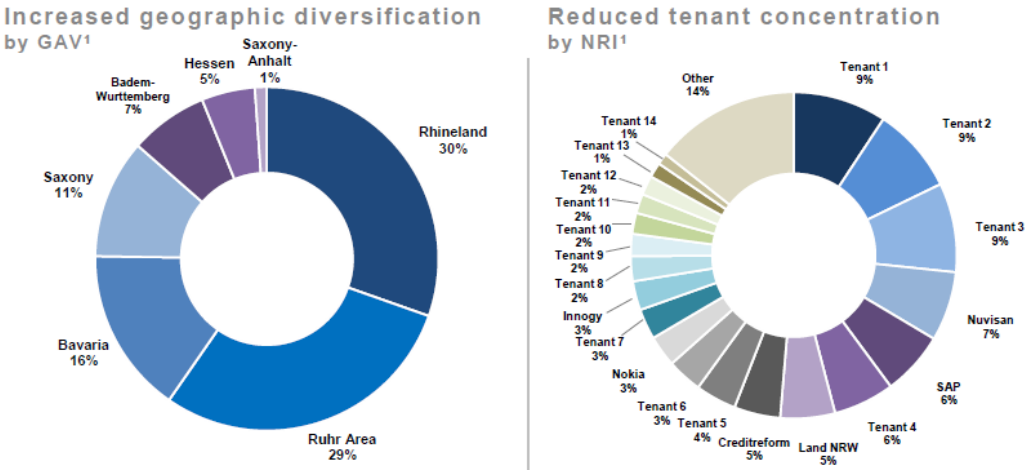
Further objects are to be signed and closed within the year or in 1Q 2020. The so called "Eagle portfolio" (green dots), consisting of 12 assets with a GAV of almost Euro 225m will thus significantly lift the overall value of the firm's portfolio to Euro 375m. The annualized rental income including the Eagle portfolio will in turn be lifted to almost Euro 20m, while the annualized overhead expenses will only slightly increase from Euro 1.8m to Euro 2.2m including one-off costs after the closing. The run rate is at only about Euro 1.1m.

			Illustrative combined perspective		
(€m)	H1 2019A		Including Phoenix[1]		Including Eagle[2]
GAV	114.2	+36.5	150.4	+224.6	375.0
Number of assets	10	+3	13	+12	25
Annualised rent	6.8	+2.1	8.9	+10.9	19.8
Net financial debt	91.8	+32.8	124.6	+185.0	309.6
Equity	17.6	+7.7	23.6	+37.4	61.0

Source: Company presentation

In terms of gross rental income, the current portfolio consists of 69% of Core+ assets and 31% of Value-add assets with a manage-to-core approach. Thus, the portfolio is within the parameters of the targeted long-term split of 75% Core+ and 25% value-add. The overall portfolio currently has a vacancy rate of 9% with a WALT of 6.0 years. Included here is the object in Hattingen, which has a vacancy rate of 73% as it is currently being refurbished.

The tenant mix and the geographical diversification look already good and will improve further with the upcoming acquisitions. Currently more than 40 high-quality tenants are in the portfolio. About 58% are blue chip companies, 40% are Mittelstand companies and 2% are small businesses. The current objects are located across four states. The lions share with 43% is located in the Rhineland area. Following the planned "Eagle" portfolio acquisition, the tenant mix will include more than 50 high-quality tenants of which 66% are blue chip companies. The geographical split will then include two new states, Saxony and Hesse, while the largest share in Rhineland will be reduced to 30%.



Source: Company presentation

Profit & Loss Account

Diok RealEstate AG IFRS 31/12 (Euro '000)	1H 2019	2019e	2020e	2021e	2022e	2023e	CAGR '18 - '23e
Rental income	2,891	6,843	22,897	29,873	39,417	48,716	156.4%
expenses directly attributable to properties	-965	-1,026	-3,435	-4,182	-5,124	-6,333	
Net operating income (NOI)	1,926	5,817	19,462	25,691	34,293	42,383	180.2%
Other operating income	44	76	105	117	139	170	
Personal Expenses	-294	-603	-685	-935	-1,047	-1,162	
Other operating expenses	-857	-1,543	-924	-1,053	-1,137	-1,258	
EBITDA (cash driven operating profit)	819	3,747	17,958	23,820	32,248	40,133	265.9%
Depreciation	-7	-12	-18	-25	-32	-39	
Net revaluation result	11,866	19,836	28,665	27,631	25,837	22,882	
Operating profit (EBIT)	12,679	23,571	46,605	51,426	58,053	62,976	
Net financial result	-2,120	-4,956	-9,084	-10,960	-15,107	-18,426	
Pre-tax profit (EBT)	10,558	18,615	37,522	40,465	42,946	44,550	61.6%
Taxation	-1,791	-2,792	-5,628	-6,070	-6,442	-6,682	
Minorities	-228	-126	-186	-192	-196	-189	
Net profit after minorities	8,539	15,696	31,708	34,204	36,308	37,678	64.0%
FFO I before taxes (2018 estimate)	-1,301	-109	9,075	13,159	17,491	22,097	
Portfolio size	114,200	386,043	493,214	590,103	768,957	951,208	
Balance Sheet Sum	124,312	413,066	512,943	601,905	792,026	970,232	98.4%
Equity	17,642	61,013	92,907	127,302	163,806	201,673	
Equity ratio	14.2%	14.8%	18.1%	21.1%	20.7%	20.8%	
Interest bearing liabilities	97,264	342,845	429,333	511,619	643,125	805,293	102.3%
Net-LTV	80.4%	81.8%	81.2%	81.7%	81.1%	80.9%	
Gearing (Debt-to-Equity-Ratio)	604.6%	577.0%	452.1%	372.8%	383.5%	381.1%	
Interest cover ratio (EBITDA / net financial expenses)	0.39	0.76	1.98	2.17	2.13	2.18	
Debt service coverage ratio	0.19	0.38	1.12	1.19	1.18	1.15	

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Rating Chronical:

Company	Date	Rating
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%.