**Real Estate**  
Germany

# Colonia Real Estate

KBUG.DE; KBU GY

**Buy**

(Unchanged)

**Still building****Current price €34.83, Target price €45**

Colonia Real Estate is due to report Q1 2007 results on 29 May. It continued to build up its residential portfolio in Q1, with the acquisition of 51% of two portfolios, amounting to 9,850 (10,100 units indicated initially), and its second business pillar, non-residential co-investments, by teaming up with Merrill Lynch to acquire a 10% stake in a 12-unit portfolio. Both transactions should boost the company's third pillar, asset management, as both portfolios are managed by its Resolution GmbH asset management unit.

## Portfolio build up was the focus of activities in Q1 2007

Colonia Real Estate bought 9,850 residential units for c. €360m in Q1. These assets generate rental income of c. €30m, but it currently owns just 51%, hence only 51% of total rental income will be accounted for, starting in Q2 2007. We believe that the price paid (€576/sq m) is in line with group's overall average price per sq m. The purchase almost doubled Colonia Real Estate's purely residential units to 18,830 at the end of Q1 2007. As the Merrill Lynch portfolio also includes some residential units, the total number of residential units under management is likely to be higher.

## Rental income not likely to have benefited in Q1, but should do so in Q2 2007

The company held 8,973 residential units contributing to its rental income stream as at April 2007. We expect it to have had total rental income of €6.62m in Q1 2007, compared with €2.83m in Q1 2006. We believe the vast majority of rental income is likely to come from the residential portfolio built up during 2006.

### Estimated Q1 rental income (excluding new portfolios)

Portfolio (€m)	Acquired in:	Initial annual rent	Initial vacancy rate	Current vacancy rate	Rent as % of initial rent	Current annual rent	Estimated Q1 2007 rent	Q1 2006 (A)
Grasmus	June 05	3.80	5.6%	6.8%	82%	3.13	0.78	
Bremen	Aug 06	1.10	8.1%	7.5%	108%	1.19	0.30	
Berlin Capital	Sep 06	6.10	20.0%	18.5%	108%	6.59	1.65	
Aachen	Nov 06	2.00	11.0%	17.4%	63%	1.26	0.32	
Hamburg	Dec 06	4.80	23.7%	25.4%	93%	4.48	1.12	
Berlin Pike	Dec 06	6.60	9.5%	9.7%	98%	6.46	1.62	
<b>Total</b>		<b>24.40</b>				<b>23.12</b>	<b>5.78</b>	<b>2.01</b>
Hotel	2005						0.33	0.32
Commercial	2005						0.52	0.50
<b>Total rental income</b>							<b>6.62</b>	<b>2.83</b>

Source: Colonia Real Estate, Commerzbank Corporates & Markets

## Management revenues likely to have surged in Q1, but should rise further in Q2

Asset management has firmly established itself as one of the company's core activities. We estimate that Fund Management booked a gain of €1.75m from the placement of the 'CareInvest 1' fund, while Asset Management should have received some €875,000 for advising on the 'Maximilian' transaction and about €2.4m in ongoing fee income.

## Capital increase proceeds did not affect Q1 results

Colonia Real Estate increased its capital in April through a 2:5 capital increase at €28.50, which boosted the group's equity by about €179m (before costs). While the cash inflow should not have affected the Q1 2007 results, it might well do so in Q2 2007, as the interest income on the amount is likely to be more than €1.0m in the current quarter, while the deal to purchase the 'Maximilian' portfolio was only closed in late April.

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[www.cbksec.com/rsh/real\\_estate.html](http://www.cbksec.com/rsh/real_estate.html)

For important disclosure information please see pages 3 and 4
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## IFRS40 valuation gains are likely to have boosted Q1 2007 results

We expect Q1 results to be boosted by IFRS40 valuation adjustments, which seem to have benefited from strong demand for residential portfolios and from the fact that Colonia Real Estate acquired the new 'Maximilian' portfolio at attractive prices. On this basis, we believe that IFRS40 adjustments could well account for €12.4m in Q1 2007, about twice the level of Q1 2006, when the company's portfolio was a fraction of its current size.

However, given the fact that it only bought the 'Maximilian' portfolio in Q1 2007, it might opt not to revalue the assets in the same quarter. In that case, we would expect it to post a net profit of €2.3m. This would, we believe, represent the first net cash profit in the company's history. In Q1 2006, the group reported a net profit of €4m, but stripping out the IFRS40 adjustments, this profit would have turned into a loss of c. €1m.

TABLE 1: **Q1 2007 earnings forecast**

Excl IFRS40	Q1 2007	Q1 2006	% change	Incl IFRS40	Q1 2007	Q1 2006	% change
Rental revenues	6.620	2.830	134%	Rental revenues	6.620	2.830	134%
AM&FM income	5.016	0.000		AM&FM income	5.016	0.000	
Other op. income	1.000	0.000		Other op. income	1.000	0.000	
WIP	0.000	0.000		WIP	0.000	0.000	
Total	12.635	2.830	346%	Total	12.635	2.830	346%
COGS	-2.759	-0.449	514%	COGS	-2.759	-0.449	514%
Personnel costs	-1.546	-0.306	405%	Personnel costs	-1.546	-0.306	405%
Other op. expenses	-1.550	-1.209	28%	Other op. expenses	-1.550	-1.209	28%
Total	-5.855	-1.964	198%	Total	-5.855	-1.964	198%
EBITDA	6.781	0.866	683%	EBITDA	6.781	0.866	683%
Depreciation	-0.010	-0.004	150%	Depreciation	-0.010	-0.004	150%
EBIT	6.771	0.862	685%	EBIT	6.771	0.862	685%
Interest costs	-3.308	-1.394	137%	Interest costs	-3.308	-1.394	137%
Interest income	0.000	0.000		Interest income	0.000	0.000	
Other financials	0.000	0.000		other financials	0.000	0.000	
IFRS40 valuation	0.000	0.000		IFRS40 valuation	12.414	6.018	106%
EBT	3.463	-0.532	-751%	EBT	15.877	5.486	189%
Taxes	-0.935	-0.500	87%	Taxes	-4.287	-1.428	200%
- Taxes paid	-0.935	-0.500		- Taxes paid	-0.935	0.000	
Net	2.528	-1.032	-345%	Net	11.590	4.058	186%
Minorities	-0.25	-0.007		Minorities	-0.25	-0.007	
Net	2.278	-1.039		Net	11.340	4.051	180%

Source: Colonia Real Estate, Commerzbank Corporates & Markets

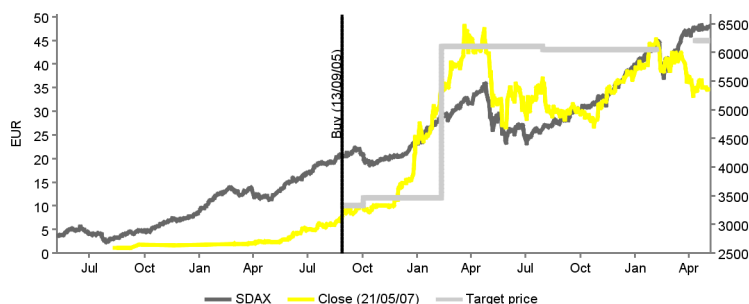
\* IFRS40 adjustments of €6.02m reported in 2006 excluded

## Conclusion: stock is attractive after an 11.8% rise in Q1 and a subsequent 12.1% fall

We assume that Colonia Real Estate will comment on its 2007 guidance when it releases the Q1 2007 results. Overall, we expect its cash earnings to be sufficient to cover all its costs, including interest costs. We also believe that the newly-formed asset management arm will emerge as one of Colonia Real Estate's core business lines.

Since the announcement of the capital increase, the stock has fallen by c. 12% and is now trading at around the same levels as the beginning of the year. We think that the stock suffered unduly from the effects of the capital increase. However, the company needs to show evidence that it can invest the proceeds from the capital raising quickly – and at prices similar to those at which it usually acquires portfolios. In recent large transactions (the Whitehall deal) Colonia Real Estate's Resolution GmbH was not part of the winning syndicate.

Colonia Real Estate should benefit in Q2 2007 from the positive cash inflow following the capital increase. It announced earlier that it might want to acquire the remaining 49% of the 'Maximilian' portfolio it doesn't own. Using its typical 20%-25% equity ratio, this would employ €36m-€45m of the cashed-in sum, leaving ample cash to continue its growth path in our view.

**Colonia Real Estate price chart**


Source: Commerzbank Corporates & Markets

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