

Transcript
H1 2024 Earnings Call
August 1, 2024

Rene Hoffmann

Thank you, Moira. – Welcome everybody to our H1 update call! Our speakers today are once again CEO Rolf Buch and CFO Philip Grosse. They will be happy to provide an update on the year so far and then answer your questions.

We felt that the Q1 call was very efficient and we have received a lot of positive feedback from both the sell side and the buy side, saying it should be the benchmark for future calls. That is why today's presentation is again more concise than in the past and much closer to Q1 in terms of focus and structure.

And again, we will limit the number of questions for the Q&A to two per analyst. I kindly ask for your support here and for your understanding. If you have more questions, especially as they relate to modelling, you know where to find me and the team after the call.

With that, over to you, Rolf.

Rolf Buch

Thank you, Rene. – Good afternoon also from my side as well! And happy holidays to all of you who are on holiday, so on the beach.

I would like to start with the highlights on page 3 of the presentation: In a nutshell, our balance sheet stabilization phase is largely completed and we are in the process of moving into a more positive environment after more than two quite challenging years.

Especially, it is these four points I want to highlight:

Disposals. Selling assets is still not a walk in the park but we are seeing continuous progress. Transaction volumes are picking up and the general interest of buyers is increasing. We remain fully committed to deliver the 3 billion of disposal volume this year and so far we have signed around 1.5 billion, so very much on track.

Over previous quarters we have always been able to sign larger disposals in a way that we were able to disclose them together with our earnings. Also because of the summer holidays – some of our customers are on vacation - this was not possible for more than one transaction for this H1 earnings call. That is why it is quite likely

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that we will announce further disposals before we report our 9M earnings in early November.

Valuation. Together with our external appraisers we did a full portfolio valuation as of the end of June and the result was a 1.4% decline for the first half year, so a clear continuation of the trend we have been seeing: the value decline got smaller and smaller with each valuation exercise. It appears to us that we have now reached the trough or are at least very close to it so that the period of value declines essentially seems to have come to an end. And if market yields are starting to stabilize, then the rent growth we deliver should have a positive impact on NTA and become a meaningful contributor to total shareholder return again.

The simple math remains unchanged: 4% of rental growth should translate roughly into 3 billion of value growth if market yields are stable. Our message has not changed, even if we show it now in the Appendix on page 26 of today's presentation.

What is equally important: once we are absolutely certain that we have passed the bottom of the cycle, we can stop playing defense and we can stop prioritizing liquidity over profitability. Our focus then can return to organic growth.

The summer months are usually a bit quieter, and this year is no different. We have been using this opportunity to work with our top management team to evaluate additional sources of growth other than traditional acquisitions. Our goal is to further mitigate the additional drag on EBT from higher interest costs over the next five years. When we report our 9M earnings in November we will be sharing with you our adjusted strategy on how we intend to bridge this period where we have an increased burden from more expensive refinancings.

Rent growth. The positive momentum clearly continues. Real market rents are growing faster than they probably ever have and that safeguards healthy rent growth for us for many, many years to come. As we will show you on a later slide, the gap between our in-place rents and what tenants are forced to pay in the wider market reality off the radar screen has probably never been bigger. Of course we cannot capture this reversion potential over night. But it does secure for us an extremely robust and long-term upward trajectory where we will be able to consistently grow rents at around 4% per year.

And finally the guidance for 2024. Based on what we have seen and achieved in the first six months we are confident enough to raise our guidance for rent growth,

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Adjusted EBITDA and Adjusted EBT to the upper end of the guidance range. All other elements remain unchanged.

Let's go to page 4 for an update on our disposal progress. We're now at 1.5 billion. Since our Q1 reporting in May we have signed agreements to sell assets for almost 500 million.

This includes three larger transactions in the Frankfurt Main region from our core, MFH, and non-core portfolio for a total of 298 million plus another 185 million in various smaller transactions and across different sales channels. All disposals were made at least in line with their respective fair values and yields. These yields were, of course, different, because these are different assets in different locations but every one of our transactions confirmed our book values. Again, we think it is quite likely that we will announce further disposals before we report our 9M earnings in early November.

With this, to Philip.

Philip Grosse

Thank you, Rolf, and welcome from my side.

Let's continue on page 5 for the H1 valuation. The results were very much in line with our expectation, and they confirm our view that this cycle has come, or at least is close to coming, to a turning point after which values are no longer expected to fall.

The bottom-line result of the H1 valuation is that values were marked down 1.4% across the entire portfolio. This puts the properties at an average gross yield of 4.2% or 2,217 euros per square meter. If we take a step back and look at the overall valuation decline since the peak in June 2022 until what appears to be essentially the trough at the end of H1 2024, then we will see a gross value decline of 23% - really unprecedented in the German market - which we managed to mitigate through rent growth and modernization down to a net impact of around 15%.

On the next page we have put together some market voices from a variety of sources. There is no point in reading them all out on this call but the bottom line is that we're clearly not the only ones who are seeing or expecting that German residential is turning the corner. Of course, this does not happen over night; it is

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a process and not an event. But the direction of travel in my view is pretty clear and that puts us in a much better position than we have been in over the past two years.

Moving on to page 7, on earnings and cash flow: As you can see, Adjusted EBITDA Total is down 2.6% because of the lower profitability in our disposal segments, that is Recurring Sales and Development to Sell. Here, we continue to see the consequences of our strategic decision to prioritize cash generation over profitability. Adjusted net financial result in H1 this year was about 16 million lower and that was mostly driven by the full-year effect of the 2023 financings. As a result, you see EBT down 6.2% in a year-on-year comparison.

If you look at the Adjusted EBT after minorities, the increase in minorities is of course related to the two Apollo JVs we entered into last year. And finally, our relatively new number, the Operating Free Cash Flow, so basically our "Vonovia FFO". In spite of a higher cash out for dividends to our JV partners – which were paid in Q2, slightly above 100 million euros – the Operating Free Cash Flow is up almost 5%, and that is largely the result of a slightly positive contribution from net working capital – so essentially our Development business – as well as a higher contribution from Recurring Sales. So this metric, in summary, does exactly what it is supposed to do. It tells us and our shareholders how much cash we generate in our operating business and represents a very helpful addition to the earnings view that we have with the Adjusted EBT.

Let's take a closer look at our largest segment, Rental, which contributed roughly 94% to total EBITDA as per H1.

As you can see – that is on page 8 – rent growth is accelerating, as we expected, and you can clearly see this in the contribution from Mietspiegel or the local comparable rent. Fluctuation is also a bit higher than in the previous period. I do not think that this is a trend, unfortunately, as this is still very much within the general range we have been seeing for this number for the past quarters.

Vacancy remains low, only a function of turnaround time in case of fluctuation. Similarly, the collection rate remains at very high levels, close to 100%. And finally, expensed and capitalized maintenance is very much in line with the prior-year period.

With that, back to you, Rolf.

Rolf Buch

Thank you Philip. – Let's go to page 9 of the presentation.

To me, this is by far the most relevant and consequential page of the deck. Because the positive implications from this page are key to understand the enormous long-term rent growth potential in our company. This also puts the initial yield debate in a different context.

What you see on this page is a comparison between our in-place rent compared to our reletting rent and, more importantly, the real market reletting rent.

We're showing the numbers for the full German portfolio, and for Berlin as our largest market and also the most extreme example. You'll find the data for all regional markets in the Appendix. We took the market data from Value Marktdatenbank (formerly empirica), which has probably the most detailed and comprehensive database for market rents. In our analysis we excluded furnished apartments and new constructions. And we show a range which is marked by the median on the low end and the 80% percentile on the upper end. This upper end is a good proxy for our modernized apartments in modernized buildings.

On this basis, the gap between our current in-place rent and the real market rent is between 53% and 96% for Germany. For Berlin, it is even between 94% and 175%. In a free market, that is where our rent level would be. In our rules-based system in Germany, this is where our rent is going to be over time. So what this data means is not that we will be able to realize this reversionary potential in the short term. Mietpreisbremse and Kappungsgrenze make that impossible. But it does provide us tremendous visibility on an extremely robust and long-term period of growing our rent at around 4% per year like we guided in our last call.

Now you may wonder, if it is a regulated market, especially in Germany, how can reletting rents be as high as 15 euros on average in Germany and 21 euros in Berlin? The answer is very simple: This is supply/demand imbalance trumping regulation. What you see is that tenants are prepared and willing to pay this rental level simply because there is no alternative in these supply-constrained markets and a good chunk of landlords act outside the radar screen and are not too religious about rental regulation. And keep in mind: There is no sanction if you ignore the Mietpreisbremse.

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But there is another important message in this data. Our current initial yield is 4.2% based on the in-place rent and the fair values in our book. There is a lot of debate in the market whether 4.2% is not too low and how it still needs to move out quite a bit. The reality is that the implied yield based on real market rents is already much higher. This explains why buyers are ready to pay our book values. For landlords, who are ready to ignore the Mietpreisbremse, the yield is not 4.2% but between 6 and 8% on average or even higher in Berlin.

With this, back to Philip.

Philip Grosse

Thanks, Rolf. – Before I come to the guidance let me update you on the debt KPIs and that is on page 10. We have, as you can see, a pro-forma cash position of 4 billion euros, consisting of 1.5 billion on the balance sheet, 0.8 billion of undrawn loans and 1.7 billion from disposals signed but not closed yet. For the majority, closing is expected by or around the end of this year. This is clearly sufficient to cover all our nearer-term maturities.

In addition, as a safety back-up, we also have a 3 billion RCF/CP on top which is undrawn. So our funding situation remains quite comfortable, especially when you look at the maturity profile for the next two years. The relevant debt KPIs are shown on the lower left-hand side, and while they are still elevated we are convinced that we have them under control.

With values essentially at the trough, the focus on LTV becomes less relevant in my view. Don't get me wrong – it remains a key debt metric for us, and we remain committed to come back into our target corridor. But contrary to much of the last two years, it clearly does not pose a meaningful risk any longer since the general outlook on values is rather clear at this point.

Our focus will therefore more and more shift more towards net debt to EBITDA and especially ICR, which require more attention in a higher interest rate environment. But don't forget that these are metrics we can influence more actively. By and large, rental growth is sufficient, actually slightly more than sufficient, to compensate the higher interest expenses we will be seeing in the next few years.

But the good news is that we have other segments that we will use to drive earnings growth. And the environment and conditions are clearly improving here. That

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is why we are very optimistic to turn the corner on these debt metrics soon as well.

As Rolf said at the beginning, we will provide more details on that with our Q3 Earnings Call.

Before I hand back to Rolf, let's quickly move to page 11 for our guidance.

There are three adjustments that we're making compared to our Q1 call. We are now guiding towards the upper end of the range for organic rent growth, Adjusted EBITDA Total and Adjusted EBT. All other guidance elements remain unchanged. As in prior years, you can expect our final guidance when we publish the 9M results in early November.

With that, back to you, Rolf.

Rolf Buch

Thank you, Philip. – Our key messages for this call are straightforward:

One. We are well on track to successfully complete our 3 billion disposal program. We have sold 1.5 billion so far and the market is moving more and more in our direction. Transaction activity is picking up, investor interest is increasing and the overall sentiment is improving.

Two. Values appear to have reached trough levels. Again, we don't have the perfect glass ball to predict that there will be absolutely no value decline in H2. But I am confident that, if at all we see a further decline, it will be insignificant in terms of balance sheet stability.

The turning point in valuation is of course significant. It will allow us to switch gears and stop playing defense. We will no longer need to focus on generating liquidity through sales but can instead focus on increasing our profitability and earnings profile.

We are very much aware that following our balance sheet stabilization phase our attention must return to organic earnings growth. And it will – I promise. That is why we are currently analyzing our potential including our non-core rental segments and we're looking forward to updating you on our outlook for this part of our business on our 9M earnings call on November 6.

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Three. The positive rent growth momentum continues. As we tried to show in this presentation, there is enormous reversionary potential. Sure, because of the regulatory framework in our business, largely ignored by some private landlords, it takes some time for us to realize it. But all this just means we have strong visibility on a very robust and long-term upward trajectory at an annual growth rate of 4% per year.

With that, back to Rene for the Q&A.

Rene Hoffmann

Thank you, Rolf and Philip. – I am going to give it back to Moira to open up the Q&A for us.

QUESTION AND ANSWER SESSION

Operator

The first question is from Thomas Neuhold from Kepler Cheuvreux. – Please go ahead.

Thomas Neuhold

Good afternoon! Thank you very much for the presentation and taking my two questions. The first one is on the additional growth apart from your Rental business. I was just wondering, are you talking about the existing ones, like the Development business or the Recurring Sales one, or are you also considering new ones? – That's the first question.

And the second question is: I was wondering if you can give us an update on the status of the nursing home disposal.

Rolf Buch

I think, Thomas, this is both for me. First, growth: Please understand that we are really giving you an update on the 6th of November. You know that this is a strategy. We also want to discuss before with our Supervisory Board and also to have it aligned. That's why it would not be appropriate to give you now some hints here.

But the answer is very clear: We are thinking about existing and also new growth opportunities. I think this I can say without telling you any secret.

And the second is the nursing. I think I mentioned in the call that we are normally tending to announce or to sign a few days before this date. This time it was not possible in all transactions. And that's why I announce that you will hear from us probably before the end of the summer some more transactions. And with this, I would leave it here because, otherwise, we are going too far.

Thomas Neuhold

Okay, understood. Thank you.

Operator

The next question is from Charles Boissier from UBS. – Please go ahead.

Charles Boissier

Good afternoon! Thank you for taking my questions. Two questions as well. First, you mentioned the 483 million sold were in line with fair values. I just was wondering what have been those portfolio values peak to trough relative to the rest of the portfolio? I think it's 15% for your overall portfolio. And can you tell us also more about the structure, the buyers and the relevant features of those deals?

This is still the first question, but on a related basis: You've done 7 billion disposals over 2023 or 2024 guided. But the employee count is actually 2% and it's continuing to rise in Q2, with the company size being smaller. And you're already quite a large organisation with 12,000 people. Where have you been doing those net hires?

Rolf Buch

First, for the buyer, the spectrum is wide. The Frankfurt portfolio, which actually consists out of three different buyers, is, I would say, rich individuals in Germany, which are close to institutional money. And the rest of the portfolio, these are small transactions with a value of three or even bigger. It's a mixture of everything. We see institutional investment. We see normal private money. So nothing which is really special. So it's a good mixture. What we do not see is listed companies. But this is not a surprise.

The employee question: To be very clear, this is good news because we are hiring in our craftsmen organisation. If the employees are going up, actually this shows that we are able to do more in-house, which has a higher profitability than to do it externally. So that's why looking on employees is probably misleading, if you look at it on total, because it's mainly in the craftsmen organisation.

Charles Boissier

Right. But maybe this tells us something about the 9M announcement.

Second question: On page 10, the financing, Philip mentioned the LTV becomes less relevant. I guess this is probably the metric that pointed more to room for

growth. I hear you also on the ability to influence net debt to EBITDA and ICR, but they still don't seem to allow for significant firepower. So how do you reconcile those targets with the "end of playing defense" point you made, and are these targets going to be reviewed also with the nine months? – Thank you.

Philip Grosse

For us, what is becoming a key priority going forward is that next to the Rental segment we also grow EBITDA outside the rental business and that ideally in a less capital-intensive manner. That is going to be the package of stuff you know, but also some stuff you don't know yet. We're talking about it in more detail in November. But that is essentially earmarked to grow EBITDA at a larger pace than our interest expenses will grow and thereby returning to overall profitability.

And that obviously helps tremendously the net debt to EBITDA and the ICR, which, as I said, is becoming more of a focus point for us, which then will accordingly travel in the right direction again.

Charles Boissier

Very clear. Thank you.

Operator

The next question is from Véronique Meertens from Van Lanschot Kempen. – Please go ahead.

Véronique Meertens

Thank you all for taking my questions and thank you for the presentation.

I was wondering, why are you still so committed to finishing the 3 billion disposal target if you actually are quite confident in also selling the nursing home business before the end of the year?

Values troughing and becoming a buyer again, is it per se so necessary to finish the 3 billion disposal target?

Secondly, on the Value-add segment and also the Recurring Sales, we've seen an improvement or an acceleration in Q2 on both businesses. Do you expect it to

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accelerate further in the remaining quarters? Something that we should spread out over the year? – Thank you.

Rolf Buch

On the first question, the disposal target: First of all, we are German and we are doing what we have promised. So we have promised the 3 billion and that's why we will deliver it.

But to be more practical: As I said, I think, in the last call, a disposal process takes some time. I think I spoke about between nine and six months. So literally, what I'm saying is that this disposal is already in negotiation. And part of it, as you understand me right, is in very close-to-finish negotiation. So to stop this negotiation would be crazy. That's why, in the end, we are actually negotiating to an end all the disposals we have started.

This means we are very clear that the 3 billion will be delivered. But I don't think it is fair to tell people who have invested in due diligence, who have divested a lot of money, who are getting financing now, that we are not selling anymore. This would kill our reputation.

Philip Grosse

Before I answer your second question, let me also add: If you look at the clustering of disposals, 2.4 billion euros is actually considered non-core, nursing and other non-core stuff. And development, in our view, in this market is more recycling of inventory, if you will. So, we are equally selling here because there's no need of newly built product to be put on our balance sheet.

Now, your second question in terms of profitability: If you look at our existing segments, the Recurring Sales and Development business is somewhat depending on the market environment, which is improving, but still not an easy one, as we explained.

So while I do expect some pickup also on those segments, the key driver really is in Value-add where we are benefiting from our improved investment program in the craftsmen organisation, but also in other service business, including energy and multimedia. Yes, I do expect a further acceleration and growth in the second half.

Véronique Meertens

Okay. That's very clear. Thank you very much.

Operator

The next question is from Valerie Jacob from Bernstein. – Please go ahead.

Valerie Jacob

Hello, good afternoon! My questions have been mostly answered, but I've got two small follow-up questions.

The first one is: There is a lot of talks in the press about subsidies, and I was wondering if you could clarify if any of these applied to you in terms of energy, new builds, and if you can benefit from them and if this is significant.

And my second one is: You're sort of returning to growth and focusing less on cash now. Does that mean that you're going to change your KPI? – Thank you.

Rolf Buch

The first one, the subsidies: Actually, it's no new subsidy in this quarter because all the politicians have holiday.

It's clear to repeat that, for the heat pump, it's not a direct subsidy, but we can charge 10% and not 8. And you know that we get for heat pumps more subsidies, which actually reduce the burdens for the tenants.

There's probably also this Wachstumschancengesetz which we have not talked about in detail, which actually means that a private investor who is buying an apartment from us, which is the traditional Buwog development business, is actually allowed to depreciate 5% of the assets in addition to the normal depreciation. And this means he actually can compensate it again with his personal income tax, which is of course a subsidy – not for Vonovia, but for our customers. And that's why we are optimistic that we will also pick up in the development results, because this Wachstumschancengesetz opens a new corridor for the developers who are still alive, which we are.

Philip Grosse

And there is no change envisaged on our KPIs. Clearly, as we said, we will focus on growing EBT on a per-share basis. But equally, that requires investments, requires significant investments in a capital-intensive business. And for that reason, generating the cash in order to fund the investments or the equity portion is a relevant, very relevant topic for us and balancing that out with the requirement on the investor side to also get some decent return in terms of dividend. So the operating free cash flow is a second metric to complement that.

Valerie Jacob

Thank you.

Operator

The next question is from Jonathan Kownator from Goldman Sachs. – Please go ahead.

Jonathan Kownator

Good afternoon! Thank you for taking my questions. Two questions, if I may. First of all, on operating free cash flow: It's obviously been quite lumpy this quarter. Can you remind us where you expect working capital contribution to be? As you say, obviously, you are investing in development, we should be expecting a flat contribution from working capital. That would be my first question.

Can you just confirm on the dividend to minorities, whether most of it has now been paid? This is the first question, please.

And the second question: Can you help us understand the contribution of solar at this stage? Is it still negligible or is it growing? And is it part of the Value-add reporting? – Thanks.

Philip Grosse

Jonathan, thanks. First of all, on cash paid to Apollo. That is confirmed, slightly above 100 million euros. It's a Q2 event. That indirectly will positively impact operating free cash flow in the second half because that payment is done and dusted.

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On the details of our guidance in terms of operating free cash flow: You have that on page 25. The biggest unknown, as usual, is the change in net working capital and that is predominantly driven by balancing out investments in developments by cash we receive from our disposals.

Our ambition is, which we have achieved already in H1, to make that at least a zero. If things move better than expected, it might be a slight positive. But that's kind of the intention. And if you make the math, with all the guidance items we have given, you will come out at an operating free cash flow comfortably above the 1.4 billion euros last year. If you do the math, you are more in a region of 1.7 billion euros.

Rolf Buch

Your second question about the solar panels: I still remind you that, on the 6th of November, we will go more in detail on this as well. To be very clear, we have understood that we have to think solar panels and heat pumps together, and this gives an opportunity. But of course, the biggest issue is to find enough electricians. So if anybody in the call knows an electrician in Germany who would like to work for the market leader, you are highly welcome to inform us, because this is really something which we have to build up.

Jonathan Kownator

Okay, thanks. Just one clarification: You said, I think, you have a billion of the dividend capacity or something. I can't remember how you claim that. Is it just a matter of taking that number and divide it by the number of shares, the dividend capacity? Is that going to give us about the dividend for this year?

Philip Grosse

Essentially, yes. You take the EBT guidance, 50% of that, plus the implicit guidance I've just given on the operating free cash flow. And if you look at our formula, that is what it's translating into precisely.

Jonathan Kownator

All right. Thank you.

Operator

The next question is from Bart Gysens from Morgan Stanley. – Please go ahead.

Bart Gysens

Hi, good morning! I know that it's difficult for you to answer questions on what you're going to announce in November. But more broadly, you say that you're going to stop playing defence no later than next year and focus on profitability rather than liquidity. What does it actually mean? I mean, it sounds good, but what does it actually mean? Your balance sheet is still quite levered.

Should we expect you to be a net investor? Can you talk a bit more broadly on what that means from a capital allocation perspective?

And then secondly, if I remember correctly, at the end of last year, you've taken – or better: Deutsche Wohnen has taken – the valuation of some of the non-core assets, the nursing homes, down quite substantially at year end. I thought something like a 20% write down. Have you taken or has Deutsche Wohnen taken further write downs in some of the non-core assets that you're trying to sell? Therefore, can you break that 1.4% average down by core and non-core? – Thank you.

Rolf Buch

On the first question: I think you have seen our model in the last years where it was very easy. We bought assets, put it on the balance sheet and get profit because the interest rates were lower than the initial yield and then the yields were going up. And this was a nice world where we bought Deutsche Wohnen.

Even going forward and even after the stabilisation, we will not come back to this. If we continued to buy assets for 4% yields and were financing it with a debt of 4%, it doesn't work. So it is very clear that the strategy we are working on is to find ways to improve EBIT, EBITDA and cash flows with activities which are less capital-intensive. This is the consequence of this analysis. And this will happen.

Of course, this activity needs the same stability of cash flow as the Rental business. And this will happen as well.

With this, I think, I will end and will remind you that the 6th of November will be an interesting day.

Philip Grosse

Bart, on your second question, in terms of valuation, just directionally: If I look at H1, that also includes a further write down on the nursing side, which was at around 4%, slightly below 4%, I think, 3.6, 3.7%. This is a function of a market which is in particular challenged by concerns around the operators in a very fragmented business where you have seen some bankruptcies. That is demanding higher yields and is putting more and more pressure on yields.

If I look at our pure residential business, in rough terms, there is no big difference percentage-wise in the revaluation of core/non-core. It's around the same magnitude. To be very clear, it is market which is driving the valuation, not our intention to keep it on the balance sheet or to dispose it.

Bart Gysens

Okay. Thank you.

Operator

The next question is from Manuel Martin from Oddo BHF. – Please go ahead.

Manuel Martin

Thank you, gentlemen. Just one question left from my side on the Value-add business. I understand that this will accelerate in the second half of the year. You are hiring craftsmen. My question would be: Where do you get the craftsmen from? Because this seems to become a rare good. And the more you have, the better it might be. It could be one of the drivers supporting the growth, if I'm not wrong. Maybe you can give us some colour there.

Rolf Buch

I know we have given you a lot of speculation where this is coming from. So we are all predicting now what happens on the 6th of November. But of course, it is clear: You know that we are recruiting electricians even from Morocco. So it's not only a German way of recruiting a lot of electricians from Germany but, of course, from Morocco.

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So we are getting ways where we actually solve also an issue for Germany because this is not a Vonovia problem. It's probably easier for us than for a lot of others to recruit because we have a good brand name and we have a big company and we have a lot of advantages. So yes, but it's still hard. And you are right, this is a challenge. I think we get means to find them.

To be very clear why electricians are so important: We have a shift in technology. We used to heat buildings with gas and now we have this heat pump. So the people who were trained to build a gas boiler are not the same ones who are doing a heat pump. So this is a dramatic change in qualification we need. You cannot take somebody who was able to instal a gas boiler to put in a heat pump. And this is the same with the solar panel. So this is a challenge, but we will work on it.

Manuel Martin

Okay. Thank you.

Operator

The next question is from Andres Toome from Green Street. – Please go ahead.

Andres Toome

Good afternoon! First question: I'm just wondering, how do you envisage your leverage profile when you do decide to return back to growth? I guess what I'm getting at is: What have been the lessons that you've learned from this downturn and how are you going to implement those on your capital structure going forward?

Philip Grosse

First of all, how do I look at it going forward? In terms of LTV, more comfortable, given that we think we have reached trough values and given the rental increases we see really over the long term, this will translate into organic rent growth of roughly 3 billion euros and also contribute to organic deleveraging on the LTV side. Net debt to EBITDA, ICR is, for me, not so much a function of reduction of the debt side, but increasing the EBITDA side where we have a lot of ideas.

What are the key lessons learned? Broadening the system of debt KPIs, not only focusing on a simple LTV metric, but on LTV net debt to EBITDA plus ICR and defining ranges which basically translate into a triple B+ rating.

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If you had done so at the outbreak of the crisis, we would have started with 3, 3.5 billion more equity – not sufficient, in hindsight, to cover all problems. But I think we would have started the crisis in a far more comforting situation.

Rolf Buch

And probably to add from my side: I think the big learning looking backward is: If you have seen our transactions and acquisitions we have done since 2018, we have, of course, always for the big transactions raised little equity, but we always used our balance capacity to the maximum. So we levered up with all these transactions, especially in the Deutsche Wohnen where we started with 39 point something and ended up with above 45 by not raising enough equity. I think the learning of this management team is that we should not do and never do this again.

Andres Toome

Thank you very much. My second question is relating to provisions that you've taken, I think, in terms of ancillary expenses. But you also know that there are actually no changes in terms of tenant payment behaviour. So what's behind that?

Philip Grosse

Basically, that's roughly 20 million euros of provisioning we could get rid of last year and which was positively impacting the cost base and therefore resulting, comparing H1 with H1, in higher operating cost this year. We essentially had a positive net debt last year, which is not sustainable.

Andres Toome

Okay. Thank you very much.

Operator

The next question is from Neeraj Kumar from Barclays. – Please go ahead.

Neeraj Kumar

Good afternoon everyone! My first question is regarding your ICR. I see a big drop from 4x to 3.6x, and it's getting close to your target range of at least 3.5x. I heard you mentioned growth opportunities, that you want to bring more EBITDA. But in

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terms of your financial cost, is there any plan to reduce them through other instruments like convertible bonds, etc.?

Philip Grosse

For the time, it's really focusing on the EBITDA side. My expectation is that, even in 2024, ICR will already start to recover.

Neeraj Kumar

Okay. So no plans of debt instruments like that?

Philip Grosse

Currently no plans.

Neeraj Kumar

Got it. And my second question is regarding your growth opportunities. As you mentioned, you're looking at other than traditional acquisitions. Just to clarify, does this strategy include potentially buying back minority stakes from your JV partners and simplify the company structure? A bit of an idea on how you plan to fund those growth opportunities?

Rolf Buch

No, I think this is too early. We just have done the joint venture. The time period is five years from now. I think this is too early to speculate.

Now we have to really work hard and find new sources and exploit the existing sources. This is not financial engineering which we want to do to increase EBITDA. This is by real work and real business.

Neeraj Kumar

Got it. And is it fair to say that there may be an element of an equity support for those growth plans, instead of just debt from previous perspectives?

Rolf Buch

I said the growth has to come from less capital-intensive activities.

Neeraj Kumar

Got it. That's helpful. Thank you.

Operator

The next question is from Thierry Cherel from Natixis. – Please go ahead.

Thierry Cherel

Hi! Thank you for taking my questions. Congratulations on this good result! I'm happy to see that Vonovia is back in the field. Two questions, first on ICR: Even if you answered it clearly on the former question, I just wonder how you could be so sure that you won't go below 3.5. I'm struggling not to break this level by next year.

You mentioned it's about EBITDA. Is it because there's huge growth on other than Rental business? – Maybe it's related to the question of Kempen.

The second question is more about Development to Sell. I'd like to know if the margin is still very low. I would like you to just comment, if you can, on the market reality. You mentioned that it's excluding the newly built apartments. What's the market reality yield, please? – Thank you very much.

Philip Grosse

On your question on ICR: The good thing is that in terms of increases in the interest line, we are basically done because most of the refinancings and the effect is already reflected in the numbers. So it's a bit more than 2x what you've seen in H1, but it's not much more than that. At the same time, what I'm implicitly guiding with that is that we see an overproportionate contribution on the EBITDA side in the second half of this year. This is also a key driver why we are more optimistic on the guidance side and are now guiding towards the upper end. That will essentially help the ICR.

Longer term, you're right. If I look at the Rental business, that 4% top line growth is going to eat up almost the entire EBT growth, considering the increase in interest expenses, but with the ideas we have and the return of a more normal environment, we think also medium to longer term, we are able to mitigate that.

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Development to Sell, your second question: If I look at the market for new builds in the locations we are present, we are talking typically about yields of 4%, slightly above 4%. If I look at our business, volume-wise, we have not done much, but gross margin-wise, it's 15%.

If I look at the disposal of newly built products to individual owners, we are even above 20%. So volume-wise, again, it's kind of tough. But we already start to see that profitability is also coming back in the Development segment.

Rolf Buch

I think in your question there was a second element which you are referring to, the slide which I showed you about the rental reversionary potential where we excluded the new builds and the refurbished buildings. I don't know the exact figure, but if you include the new build and the refurbished business, the picture would look extremely different, even more extreme. The reversionary potential would be much higher, but I think it is a wrong comparison because you should compare apples with apples and not existing buildings with new buildings.

Thierry ChereI

Thank you very much.

Operator

The next question is from Neil Green from J.P. Morgan. – Please go ahead.

Neil Green

Hello, good afternoon! Thank you for taking my questions.

The first one is just on your marginal cost of your debt, please. We've seen obviously the 2029/2030 bonds coming quite notably this year. So I was wondering if you are seeing a similar trend when you discuss financing with banks, please.

Secondly, I appreciate it's only August 2024, but once you've completed the 3 billion of disposals, might we expect further volume targets on disposals for 2025 or will they be more kind of opportunistic next year, please? – Thank you.

Rolf Buch

The second question is easy to answer: We will continue to have a non-core portfolio, which we have to sell anyway. But, of course, then we are selling it to optimize the price and not to deliver liquidity. But non-core doesn't belong to us long term. That's why it has to be disposed. So we are not stopping disposal at all. We will continue to dispose non-core. And we will do a resorting of the portfolio every year, like you were used to it. And therefore we will always have some non-core.

Philip Grosse

Marginal cost of debt, secured as unsecured, is slightly below 4% for a ten-year tenor, so it slightly moved in our favour.

Neil Green

Thank you.

Operator

The next question is from Simon Stippig from Warburg Research. – Please go ahead.

Simon Stippig

Hi, good afternoon! Thank you very much for taking my questions. The first topic would be with regard to the Development sector. We all know that, in Germany, it is still in a very deep crisis. Even though the segment is not a meaningful contributor to EBITDA, it turned positive quarter over quarter. So therefore, do you already see early signs of recovery in your business and also in the broader development sector in Germany? And then what would that mean for you?

Then you mentioned that you have at Vonovia development-to-sell assets in the amount of 1 billion. Have you already started to sell them and are there any sales figures? What's the remaining investment volume for 2025?

The second question would be with regard to the Deutsche Wohnen synergies. Is your last guidance you gave still relevant? What would you expect for this year and also for next year in a run rate? – Thank you.

Rolf Buch

To be very clear, the Deutsche Wohnen synergies are done. This is forgotten. Deutsche Wohnen is integrated. We have delivered it. So nothing will happen in the future. This is a done deal.

For the development: I think we don't see any signs at the moment that the development volume in Germany is picking up. Controversially, it's still going down. It's not Vonovia, but the announcement of the institution is saying that we will probably see a new construction rate of 170,000 apartments by 2026. So it is going down still further, which will of course have an impact on smaller developers because they are actually then out of business.

You know that the need in Germany is roughly 500,000. So they need to change something. Otherwise, Germany will have a problem. It's a big call. I'm not sure if the government of today is still able to take the right decisions. You know that we have an election next year. I am looking forward that the next government will take the right decisions because the situation in Germany is not sustainable.

This is another way of saying that good developers will be desperately needed in the long-term future.

Operator

The next question is from Paul May from Barclays. – Please go ahead.

Paul May

Hi guys! Thanks very much for taking my questions. Rolf, you mentioned earlier that the low investment yield is no longer attractive to acquire assets given the financing cost.

I am just wondering, if it's not attractive for Vonovia, who are most likely the best operator and best owner of those assets, how does it work for others?

And as a result, how can you be still confident over your valuations at those very, very low initial yields if, as you say, it doesn't work as an investment?

It would be great to answer my first question and I'll come then to my second.

Rolf Buch

Actually, I think Philip will say something to this, but it's probably also for me. I think I have done this page exactly to show you. This is what we see at the moment: The people who are buying these assets are ignoring the Mietpreisbremse. There is no sanction on it. So there's no consequence. You can just charge a higher rent and your yield is double. So it's very simple.

For the apartments which we are selling in Frankfurt, for example, the prognosis is that they will see another rent in the future.

Paul May

And you can't do that because you're a public entity? Is that kind of the message?

Rolf Buch

We are respecting the law.

Paul May

Cool. Thank you very much.

The second question, just on that rental reversion. I appreciate the churn of the portfolio is about 8%. You mentioned obviously all the regulation there, and you're going to stick to the regulation in terms of capturing that. Over how many years would you expect to be able to deliver that level of growth? And is there a risk to the market growth? Because I think some forecasts expect the German population to decline quite materially over the coming years and having peaked, I think, this year, possibly into next year. Is there a risk on the demand side from a declining population in Germany, given the economic situation is not particularly attractive and potentially might get worse and therefore economic migration may stop, again putting an impact on population levels?

Do you see that as a risk, or are you very confident that rental growth will continue upwards? – Thank you.

Rolf Buch

Paul, actually, I don't know what this analysis that the German population is shrinking is all about. I don't know this analysis. The German population has to grow for a very simple reason: because of the demographic change. My generation will go into pension in the next ten years. The next generation is only one quarter of this. We all will not die after we go on pension, but we will hopefully live for a long period and the life expectancy is even higher than lower.

This means, if Germany wants to replace all of this workforce, we need immigration. So there is no other choice. I think this is even understood by everybody in the government except the very far right which have no majority. There is no other alternative. That's why all prognosis I know is saying that the German population will increase and not decrease. It was ten years ago where we probably had a different prognosis. But this was a long time ago.

So there is no way and even if the population would not increase, which will not be the case, the demographic will show that the number of single-person apartments is increasing. Even with a stable population – and the population will not be stable, but even if it would be stable – the number of apartments will go up. I think this is a fundamental on German resi which is out of question.

Paul May

I'm sorry. Just following up on the number of years to capture the reversion potential that you highlight on slide 9.

Philip Grosse

This is just looking at today's rent and growing that by 4% per annum because this is what we expect longer term. And that puts you to like 15 years across Germany, even longer in the Berlin market. It is long term, but it's very robust and stable and based on rent levels also within the affordability ranges.

Paul May

Perfect. Thank you very much.

Operator

The next question is from Marc Mozzi from Bank of America. – Please go ahead.

Marc Mozzi

Thank you. A very good afternoon, and thank you for taking my questions. I have two.

The first one is on the EPRA matrix. I am just wondering if you can give us a clue on what is the LTV under EPRA consideration of calculation at end of June or pro forma? – Number one.

Number two: What is the growth underlying or in your EPRA EPS at the end of June?

And more broadly, I'm just wondering why, as a leader in the European real estate industry, you're not considering providing, not as your own KPI, every quarter or at least every half year EPRA metrics, which I think should be part of your role to lead by example for the rest of the industry and help international investors to be in a position to compare Vonovia towards a peer. That's my number one question.

And my number two question is around growth. You're back to growth mode, which makes absolutely sense as soon as we reach the trough. I think one of the areas of easy, light capital-intensive growth is new developments. If that's the case, what sort of change in working capital requirements should we expect for 2025? You're moving to something like zero this year.

Probably, if you have to grow to something negative again next year, have you ever thought about the size of that change in working capital requirements for 2025? – Thank you.

Rolf Buch

The second question: Yes, Marc, we have thought about it. We have analyzed it. But again, I understand that you're all interested in it, but I think it is proper to discuss it internally first before we go to the market. That's why, please, understand that we are not getting in this any more in detail. Please wait for 6th of November.

Philip Grosse

Let me just add: It's an add-on business. What we will always be sensitive about and what we have also mentioned many times is that we put the right weight on the Development business vis-à-vis the overall balance sheet. So we will not, through development, change the entire risk profile of the Vonovia business.

To your second question on the EPRA metrics: It's with annual results that we publish all the various EPRA metrics. We have never done that on a quarterly basis, and there is no intention to do so.

Marc Mozzi

Okay. Thank you very much.

Operator

The next question is from Rob Jones from BNP Paribas. – Please go ahead.

Rob Jones

Hi, team! Just a quick follow-up question on the ICR. Obviously, you give net debt to EBITDA and LTV on a pro-forma basis, which is really helpful. I just wonder if you've got a figure for ICR also on a pro-forma basis.

Then linked to that: Philip, you said at the Q1, you expect ICR to come down slightly from 4x to maybe 3.8, 3.9 and that was your expectation for FY 2024. I just wondered if you're still happy with that as an FY 2024 expectation or whether you think, realistically, it could be lower than that? – Thank you.

Philip Grosse

As I said, I expect ICR to slightly increase towards the remainder of the year and recover from current levels. So I'm not too concerned around ICR.

We are not showing that on a pro-forma basis because that is then including too many assumptions, also on refinancing, on the interest rate side, which is why we have not done so. But I think with all the guidance I've given here on the call, you should have a pretty good grip as to the direction of travel on that metric and those two components.

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Rob Jones

Okay. Thank you very much.

Operator

That was the last question. I would now like to hand the conference back over to Rene for any closing remarks.

Rene Hoffmann

Thank you very much. That's it from us for today.

We hope to see you and speak with you in the coming days and weeks. Until then, as always, stay safe, happy and healthy.

Good day everyone!

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