Transcription
Q1 2019 Earnings Call
May 7, 2019

Rene Hoffmann

Welcome everybody to our earnings call for the first quarter 2019. Your hosts today are CEO Rolf Buch and CFO Helene von Roeder. I assume you have all had a chance to download the presentation. Just to be sure, the earnings call presentation for today is available on our IR website in the section "latest publications".

The management will lead through this results presentation on the basis of the agenda on page 2 and will then, of course, be happy to take your questions. So without further delay, let's kick it off and I am handing you over to Rolf.

Rolf Buch

Thank you, Rene. – Also from my side a happy welcome and thank you very much for participating in this call.

Let me start with the highlights of Q1 2019. Performance: You know that this is the first quarter in which we managed the company based on our four segments: Rental, Value-add, Recurring Sales and Development. I am happy to say that in all four segments we are well on track and this is actually a good start into the year 2019. Later, Helene and myself will guide you by segment, but this will come later.

NAV & Valuation: Actually, as you know, except Sweden, we don't have a revaluation in Q1. That is why NAV growth is mainly coming from the investment and is nothing special. We highlight that the next portfolio valuation will be in Q2 2019 and our current indications suggest a stronger valuation uplift than what we have seen in the first half year in 2018. This means actually that at the moment we don't see any change in trend of valuation. In some cities, actually, it is the opposite: Valuation is going up stronger than last year.

Capital Structure: There is nothing special to mention here; I think Helene will go through this later.

Guidance: We want to give you a guidance update. We are increasing our guidance for Adjusted EBITDA Total and Group FFO. EBITDA guidance is up by 50 million. This is basically driven by two factors. One is performance growth and the other is the result of a change in IFRS accounting policies.

I am sure that you are much more familiar with the new IFRS 16 and I am happy to have Helene close to me because I am not ready to answer all detailed questions about IFRS 16. For our numbers it means an additional EBITDA contribution of an estimated 30 million due to the fact of IFRS 16 for the year 2019. Since the underlying activity does not change, we adjust for this effect in the FFO and do not include any positive IFRS 16 contribution in our Group FFO, as this is the basis for our dividend guidance.

I understand that some of our peers do it differently. So I want you to look out for this when you compare FFOs. I think, also as a member of EPRA – I am acting as President – this is also a topic which we should discuss in EPRA because we have to make sure that the definition – even FFO is not an EPRA KPI – should be similar. I think this will be a topic for the future.

25 million of the increase in Group FFO come from normal performance growth and we will show you how this will develop in the future.

Based on these very positive results and our visibility down the road, we feel we are well positioned to continue our upward trend and we are very confident in our ability to deliver sustainable growth in 2019 and beyond.

With this, I hand over to Helene.

Helene von Roeder

Good afternoon! Page 4 is the central page because it shows how much the individual segments contribute to Adjusted Group EBITDA and how we get to Group FFO as the basis for dividend distribution.

You can see that we have shown growth across all segments, which is, of course, partly driven by the inclusion of Buwog and Victoria Park, which were not included in our Q1 last year. You also see that while Recurring Sales and Development make a considerable contribution to overall EBITDA, and will continue to do so, the operating business with Rental and Value-add clearly remains the largest part of our business.

Almost 30% more EBITDA in Q1 this year, of course, means that cash taxes are higher and since we financed Buwog mostly with debt, the interest expenses have gone up year-on-year as well. Bottom-line Group FFO, so the basis for our dividend, is 20% higher in absolute numbers in Q1 and 13.5% on a per-share basis.

Let’s have a closer look at the Rental segment on page 5. Rental income is up 20% on the basis of a larger portfolio and rental growth; maintenance expenses increased by broadly the same magnitude. On a per-square-meter basis, as you will see on a later page, maintenance expenses did not change.

The increase in operating expenses needs a bit more explanation. In Sweden, rents are reported on a gross basis, so net cold rent plus ancillary costs are all in one number. The concept of a net cold rent does not really exist there. For Victoria Park this means that the roundabout 9 euros rent per square meter are the all-in rent, 6 to 6.50 euros of which are net cold rent and the remaining 2.50 to 3 euros ancillary costs.

It’s impossible to break this down to the last few cents, but that is broadly it. In Sweden, these ancillary costs are included in the rental income and, because they are basically a pass-through item, also in our operating expenses. Rough math shows that it is about 10 million for the first quarter. The impact of these 10 million in the rental income line is not material, but it is so in operating expenses and it distorts the comparison. I will get back to this on the next page and show that the actual operating expenses in terms of efficiency have continued to improve. Also improved has our EBITDA operations margin which is 78.4% for Germany and at 76% overall now.

Slide 6 proves what I have just said regarding the operating expenses and efficiency of our business. You know the structure of this slide very well by now, I guess. These numbers are Vonovia Germany, so excluding Sweden and excluding Austria, but including the German portfolio we acquired from Buwog.

The average portfolio size was 4.1% larger compared to Q1 last year and we managed to grow the rental income by 8.3% or 34.4 million because of rental growth and better portfolio quality. At the same time, operating expenses only grew by one million which shows that we have managed to integrate Buwog’s German portfolio at very little additional cost.

If we then include the growth in Value-add, we get to an EBITDA Operations growth of 12.6% on the basis of a portfolio that only grew by 4.1%. To manage your expectations, we might be showing this slide for the last time. While we like how it demonstrates our efficiency improvements, we run operations not just in

Germany but in Sweden and Austria as well and we want to show you how things are improving not only in Germany but across the entire operating business.

Page 7 shows the main operating KPIs for the Rental segment. Organic rent growth was 4.0% year-on-year and in line with our expectations. As you will see on the guidance page later, we remain optimistic about our full-year guidance and a rental growth of around 4.4%.

The vacancy rate is basically unchanged and remains low at 2.9%. This number, as I am sure you know, is mostly the result of our investment activities. And then finally, the maintenance per square meter is on the same level as in the prior-year period. Allow me to repeat at this point: Both the maintenance expense and the capitalized maintenance are money that we spend for the repair and maintenance work to protect our EBITDA. And given the longevity of our properties we believe it is wiser to err on the side of caution and better spend a touch more than not enough.

But neither expensed maintenance nor capitalized maintenance results in any rent growth. The only difference between them is how they are treated in the accounting: Maintenance expense goes through the P&L and is a direct cost and capitalized maintenance is capitalized on the balance sheet. But please do not confuse capitalized maintenance with our investment program. The investment program leads to rent growth and has a yield. I do know it is sometimes difficult to keep the two apart because most of our peers report capitalized maintenance and modernization investments as one number. But they are really two very different things and should be kept separate.

Page 8 is on our investment program. We are well on track here with the majority of the investments completed or kicked off. As a reminder, the investment program includes our development to hold, upgrade building and optimize apartment investments, but it does not include development-to-sell investments. Our neighborhood development projects, which usually include all three types of investments, are allocated across these three categories.

We continue to guide a total volume between 1.3 and 1.6 billion for this year and currently see us at about the middle of this range by year end. But there is still more than half of the year to go; so we want to keep the flexibility and the range for the time being.

While yields and IRRs differ between the three elements, we continue to expect a 9 to 10% average IRR across all investments, in line with previous years. So there will always be cases and reasons for shifting capital from one investment bucket to another; but at the end of the day, we remain confident in our ability to invest the 1.3 to 1.6 billion at an average IRR of 9 to 10%.

With that, over to Rolf.

Rolf Buch

Thank you, Helene. – I am talking about the portfolio because historically I always have done it; it's part of the Rental segment. Page 9 and 10 are also two pages which you are very familiar with. Normally, we put them in the annex, but I think Rene thought that it is a good idea to put them in the main. That is why on page 9 you see our portfolio cluster; you are familiar with this. It shows that 60% of our portfolio is earmarked for investments, actually more than that because many units undergo investments twice, once for upgrade building and once for optimize apartment.

Since we cannot double count them, however, each unit is, of course, only included once in the pie chart. What is important, though, is that we have plenty of opportunities, at least for the next 10 years.

Another takeaway from this page is that we sold 713 non-core units in Q1 with a fair value step-up of almost 16%, which is a good indicator of what I have indicated in the beginning: that the dynamics of the German house resi price market are still unbroken and remain very strong.

Don't be afraid: I will not go into the details on page 10, of the regional cluster. There is a lot of data; that is why it used to be in the annex. But I would like to spend some time on telling you that there is probably an interesting relation which you should regard; that is the relation between rental levels and in-place multiples on the one hand and purchasing power on the other hand. This also gives you an indication why we at the moment in Berlin have so much political pressure, because obviously rent is growing faster than the purchasing power.

What is also very interesting is the reversionary potential. We have been reletting apartments during the last twelve months at 36% higher than the previous rent. Of course, this is largely the result of our optimize apartment investment strategy. Without the investments, we are bound by the 10% rental cap, of course, and we do respect the German rental regulation.

Finally, the rent growth of what is left in the non-core portfolio was 0.6%. It is now a very small number of apartments. But I think also this rent growth shows why it is non-core.

Let me turn to page 11; this is the page where we describe the Value-add segment, actually a new boring business: very predictable. We have seen a significant increase in EBITDA in comparison to the last quarter. Keep in mind that this is mainly still Vonovia; only a very small amount comes from the addition of Buwog. As you know, we are targeting around 20 million growth in 2019 and if you look at these figures, we are well on track to achieve it. We are very relaxed about this.

The next page is about the Recurring Sales segment. Page 12 shows the result of this. We sold 809 individual apartments for gross proceeds of 109 million euros. The average sales price increased by 19% in comparison to last year. The fair market value step-up was 37.2% on average, almost 10 percentage points higher than last year. This is partly driven by recurring sales in Austria where fair-value step-ups are considerably higher than in Germany.

All in all, Recurring Sales contributed 26.3 million of Adjusted EBITDA, more than double the volume of last year. Also this shows you that we still have an unbroken trend in value-uplift.

Coming to the Development segment on page 13, this segment includes all new constructions of apartments by way of building entirely new buildings. We distinguish between development to sell and development to hold for our own portfolio. The bottom-line Adjusted EBITDA was 10.4 million in Q1 which is probably a bit lower than the run rate you can expect for the rest of the year. This has also something to do with the fact that finished construction normally is not so strong from January to March; so we will see more finished building in the summer.

Page 14 gives you more color on the new construction activities. In the new constructions to hold we have around 29,000 apartments in the overall long-term pipeline; so don't think that this will be built very soon. Based on the opportunities in our portfolio today, we want to deliver between 1,500 and 2,000 this year.

All of these units are built for our own portfolio and we capture the spread between construction cost and initial valuation in our EBITDA development. The development-to-sell part is a useful addition to the to-hold developments. On the one hand it generates attractive margins, but what is maybe even more important is that you often need the higher margins from the to-sell projects to cross-finance the lower margins of to-hold development in order to make an entire development project work. So often you have one third development at some form of subsidized rents, one third at market rents and one third for sale and the for-sale volume basically carries the land cost.

This is the way how the big cities today allow you to do construction permissions: They ask you actively to do one third of subsidized, one third of normal rent and one third to sell. So, at the moment Vonovia is the only company in the market which is able to use all three models for itself. Others are either forced to sell the for-sale segment or, more often with developers, not to operate themselves, but to sell it in a block which, of course, can generate significant discounts. The pipeline for the development to sell is around 6,700 units.

With this, I hand over with a lot of fun to Helene to discuss the IFRS 16.

Helene von Roeder

This is what you all have been waiting for. Wrapping up the segment reporting, let me say a few things about IFRS 16, which came into effect on 1 January 2019.

IFRS 16 governs the accounting, valuation and reporting of lease business. It basically has the idea of making companies that buy and that lease more comparable. For Vonovia as a lessee, this means that leasing expenses are capitalized on the balance sheet, representing an asset which in turns leads to a right-of-use on the liabilities side.

In the profit and loss statement, lease expenses are no longer reported. Instead, the P&L only shows the interest expense and any depreciation or fair value adjustments.

Like others, we have applied IFRS 16 in Q1 2019 for the first time. We are reporting an impact of 7.5 million positive in our P&L for the first three months. For the full year 2019, we expect the IFRS 16 impact to be approximately 30 million euros. Prior-year numbers remain unadjusted.

Now, after lots of discussion, the way we implement this new regulation is that the impacts are, of course, included in the IFRS accounts and also in our Adjusted EBITDA Total. But because IFRS 16 does not have any impact on the liquidity or cash situation, we are excluding any IFRS 16 contribution from Group FFO and LTV.

We do understand that some of our peers do not adjust for this in their FFO; so you want to bear this in mind when you compare FFOs, which form the basis for dividend payouts, between companies.

Slide 16, Net Asset Value: The Adjusted NAV increased by 1.5% in the first quarter. Our next portfolio valuation will be at the end of Q2 and in line with last year will cover approximately two thirds of our portfolio via the 26 largest cities in Germany plus Vienna and a full portfolio valuation in Sweden.

Based on our current estimates, we expect the H1 value uplift – excluding investments – to be stronger than in H1 2018.

With respect to goodwill – I had already indicated that in the full-year call in March where we reported goodwill impairment of around 700 million, that to the extent yield compression continues, we will likely see more impairments in 2019 going forward.

To page 17: Our LTV as of March 31 was 42.4%, so 40 basis points down from Q4 2018 and right in the middle of our target corridor. As I have said in the past and experienced on roadshows, different market participants have different LTV comfort zones. We continue to argue that even after the yield compression we have seen, the in-place values of our portfolio remain conservative if you not only look at transaction prices, but especially replacement values and we really do not see a scenario in which these values would come under material pressure.

So, at this point we believe our target range of 40 to 45% still gives investors enough of a security buffer while at the same time not putting an undue burden on our equity yields.

Many of you also look at debt to EBITDA in addition to LTV and so do we. When you take our Total EBITDA of the last twelve months and put it in relation to the average net debt over the same period, we are at 11.4 times, which to us is a relatively sensible level if you look at the stability of the cash flows.

The cash number for Q1 2019 is quite high, but please bear in mind that this is at the end of Q1, so before the repayment of the 700 million debt hybrid, which we have done so in the meantime.

Page 18 gives you more color on the capital structure and debt instruments. Interest cover ratio is 4.7 times and thus very healthy above the minimum levels required in some of our debt instruments.

Almost all debt is fixed or hedged, so any interest rate increase would affect our numbers only slowly, as no more than 12% of the total debt become due in any given year because of our smooth maturity profile. And thanks to the robust topline growth there is plenty of interest rate increases we can absorb before we feel the pain on our earnings and dividend capacity.

We are happy with the maturity profile and overall financing mix. As always, we potentially look at all available sources of capital to finance our business and try to choose the most attractive type of capital at any given time.

Finally, page 19 for the 2019 guidance. We are increasing the guidance for Adjusted EBITDA Total by 50 million. As I indicated before, this is about 30 million from IFRS 16 and 20 million from performance growth. We are increasing the guidance for Group FFO by 25 million. So Group FFO per share is now guided 5 cents higher, between 2.25 and 2.35 euros; and by definition, the implied dividend guidance at approximately 70% of Group FFO is also higher now.

To avoid confusion: We are excluding the positive impact from IFRS 16 in our Group FFO, but our understanding is that not everybody in the peer group follows this approach. So you want to be careful when you compare FFOs between companies.

With that, to Rolf.

Rolf Buch

Thank you, Helene. – One last slide for the Management Board changes. Klaus Freiberg, as you probably have seen yesterday, has decided to step down from Vonovia’s Management Board, effective from the end of the Annual General Meeting. You know he served for Deutsche Annington in the beginning and later for Vonovia in total nearly close to ten years. It was a very intensive and very positive cooperation between me and him. So I am very sad that he is leaving.

But I have to accept and to honor the fact that he is arguing and saying: I worked now for ten years in this industry. I have changed a lot and I think it is time for me to do a little bit less. – So he will stay in contact with Vonovia. We can use him in some specific cases as a consultant. I'm very happy that he was ready to work for such a long time for this company.

I think the very good news is that we have the next generation, Arnd Fittkau. The very special effect is that this is the first time, I think, in Deutsche Annington's and Vonovia's history that we were able to develop a Board Member out of our own people. So I think this is a very good sign. We are able to get enough calibers also in the second line which are able to sit in the Board. Arnd Fittkau is 46, so significantly younger. He has worked for the company actually nearly the whole career, since 2002. He is a specialist, he was well prepared. Actually, he is the General Manager of the whole operating rental development. I think this was a preparation for the long term. I am very happy to see Arnd on the Board and to work together with him.

For your information: As you know, we have now four Executive Board Members; it is myself and Helene, it is Arnd Fittkau as Chief Rental Officer and Daniel Riedl as Chief Development Officer.

With this, we hand over to Rene.

Rene Hoffmann

Right, and I am happy to open the Q&A.

QUESTION AND ANSWER SECTION

Operator

The first question is from Thomas Neuhold, Kepler Cheuvreux.

Thomas Neuhold

I actually have four. Firstly, on the organic rent growth, the 1.2%: The market-driven like-for-like rent increase is rather at the lower end of the historic range. I wonder if this was mainly driven by the first-time consolidation of Buwog and its Austrian portfolio where rent increases are lower. Or have there been also other drivers in place which were dragging down on the like-for-like market-driven rent growth in Q1?

Rolf Buch

I think it's only a quarter. So this is why we think you should not overestimate it. There are probably a few elements coming into this. One element you mentioned is probably Buwog, but overall don't overestimate it. We stick with our guidance for 2019. So probably this is a little bit early.

In general, as you know, we are probably also pushing rent not as hard as we were pushing before because of the overall political debate. This might also have a little bit of an impact.

Thomas Neuhold

Thank you. – My next question is on Sweden. I was wondering if you can give us an update on key trends in the market in Sweden. What potential do you see for acquisitions like we saw them in the first quarter in Sweden during 2019?

Rolf Buch

First of all, I think the situation in Sweden is completely different from what we have in Germany at the moment. In Sweden, you know, there is a new government and actually tenant associations are ready this year to accept higher rental growth than in the years before. So we will see probably in Sweden a positive surprise from rental growth during the year 2019.

The imbalance between supply and demand, of course, is completely unchanged. The fundamentals in Sweden are at the moment, surprisingly, very positive. Unfortunately, we don't have such a big portfolio in Sweden. That's why it doesn't drive totally the Vonovia figures. You have seen us buying portfolios at the end of the last year. We are able, if the price is right and fits our acquisition criteria, that we will continue to buy in Sweden because we feel that we are the only natural consolidator in Sweden. But we are not in a hurry, as you know. So that's why we have to take care about prices and about opportunities.

Thomas Neuhold

My next question is on rent regulation in Germany. The planned change of the "Mietspiegel" observation period from four to six years has not been implemented yet. Why do you think this is the case? Do you have any realistic timeframe for the implementation of this change?

Rolf Buch

No, not really. At the moment, it is not a real topic in the debate. Actually, I have not heard anything about politicians talking about this. I think you know we have the debate in Berlin which is probably overlaying everything else. I think we have to wait now for the election in Europe. Then, I think, there is also the possibility that we have changes in government in Germany.

So I think this is not a topic at the moment. From my point of view, it's too small to be passed as an individual law. So it has to be part of another law. We don't see at the moment anything that is coming up soon.

Thomas Neuhold

My last question is on a recent press article which stated that a court ruling in Bavaria was that Vonovia has to pay back a portion of ancillary expenses charged to a tenant, as there seemed to be a lack of transparency regarding the calculation of the services rendered.

The article also claimed that there might even be some kind of class action lawsuits coming which could be initiated by the tenant organizations in Bavaria. What is your view on this?

Rolf Buch

I think you are referring to this court in Munich which actually forced us to pay back around 300 euros for ancillary expenses, so not a really big amount. Actually, the court did not say that we cannot do value-add services. And it also did not say that we cannot do on-site inspections as non-recoverable expenses. So on the contrary: Actually, it confirmed the way how we do it and it confirmed the way how today we prove it to the tenants in general.

But the court requested a level of transparency on the internal cost structure calculation that we are not prepared to show because also any independent third-party provider would ask not to disclose his internal cost calculation. For example, one thing is: The court asked us to disclose the individual salary of any caretaker which, I think, from data protection law we should not disclose.

So that's why we will go in front of the next higher-ranking court. Our legal department is very confident that we will win this court case. I think a bigger risk is not there, at least according to our lawyers.

Thomas Neuhold

Thank you very much.

Operator

The next question is from Sander Bunck, Barclays.

Sander Bunck

Two questions from me, please. The first one is on the FFO guidance. Can you just give a bit more detail on what has led you to upgrade the guidance, i.e. which segment is performing better than initially estimated and why is that?

Helene von Roeder

I think, ultimately, as we said at the beginning of the call, we see all segments performing extremely well. Please don't be too disappointed if we don't want to point to a particular segment which is leading this improvement. It is actually really truly across the board of all four.

Sander Bunck

I mean, the sales from this quarter was particularly good; that was pretty much in line or slightly better than expectations. But that's not the sole driver of it?

Helene von Roeder

No. I mean, it's really across all four businesses where we see significant improvements which sort of leads us to increase our guidance.

Sander Bunck

The second one I had was on the like-for-like rental growth as well. Again, there is a slight slowdown at the moment and the full-year guidance was left unchanged at 4.4%. Can you just give a bit more detail on how you are looking to bridge this gap over the remainder of the year? For example, will new construction make a more material impact this year or how are you thinking about the composition of those 4.4%?

Rolf Buch

I think, again, it is early. It's the first quarter. We have told you that there is nothing fundamental. Of course, a little bit more will come from more construction. You know finished buildings are not coming in January till March because there is weather. So there are a lot of elements which actually can explain that we are a little bit lower.

We stick with our guidance. I am very positive that we will reach the guidance. There is no doubt at all.

At the moment, in the political debate in Germany, I am actually happy that this is a little bit lower because that's easier to sell.

Sander Bunck

I do get that. But, ideally – I guess this is also in their interest – if e.g. you could make the bridge with additional new construction, that would be a win-win for everyone, I guess. Do you expect a more material acceleration e.g. in that segment that could potentially bridge? You leave the other numbers pretty low, which makes everyone happy, but if you could accelerate the new construction, this would also be pretty good for everyone.

Last year, obviously, it was difficult to get to your run-rate numbers to ramp up, mainly because it took time to get the permits. Is there a possibility that this year is going to be more material from that angle?

Rolf Buch

I think the fact that it is difficult to get construction permissions is not changing at all. Please don't expect that this will change short term. So we are still fighting with the same problems.

Yes, I think we are sticking to these up to 2,900 units or 3,000 units as a maximum in this year. We are optimistic that we will deliver it. But, please, we think that all other factors also will deliver growth, as we have announced it. So we are not dependent on the new construction.

Sander Bunck

Thanks very much, guys.

Operator

The next question is from Christopher Fremantle, Morgan Stanley.

Christopher Fremantle

You have given some helpful color on the trajectory of your valuation. Can I just ask if you have received any color that you are willing to share, at least on the trajectory for Berlin, and how that might compare to the Group guidance you have given? I appreciate you may not want to give that, but any color that you can give on Berlin versus rest would be helpful, please.

Rolf Buch

I think it is too early. We are in the middle of the process. It's not finished. I can just tell you that probably the phenomenon that you have seen that big cities are contributing significantly to the value is also due this year or this half year. I think we have a good development everywhere, but in our big locations you see a high, strong value uplift.

Christopher Fremantle

Okay. Then, secondly, we are expecting an announcement on the "Mietspiegel" quite imminently. Can you give any color on what your expectations are for that and how that might impact your like-for-like rental growth guidance?

Rolf Buch

You are probably referring to the "Mietspiegel" in Berlin.

Christopher Fremantle

Yes.

Rolf Buch

We have a lot of "Mietspiegel", but there is a "Mietspiegel" in Berlin coming out. To be very clear: I think in our guidance we have a very low expectation anyway for this "Mietspiegel". So we will not be surprised. In the existing political situation which we have in Berlin, I would be very surprised if the "Mietspiegel" comes out very high. This would definitely be suicide for the left-wing government there. So they will do everything to keep it down.

Christopher Fremantle

That's helpful, thank you.

Operator

The next question is from Jaap Kuin, ING.

Jaap Kuin

A couple of questions also from my side; I think three, hopefully not more. The first one is on trying to still get to a FFO1 type of calculation. In Q3 2018, you gave a guidance for EBITDA on Sales and Development of between 130 and 160 million. I was wondering if that is still a valid statement or whether that has also changed with the update today.

Helene von Roeder

I think we discussed it before. I am actually absolutely incapable of splitting out taxes and interest rates. This is why we stopped giving FFO1 guidance. Whatever you want to calculate, I am fine. But we will stick with Group FFO because, as we discussed this, any attempt to divide interest rates and especially taxes according to the four business lines would be truly arbitrary. If I did such division, we would be discussing without ends on whether that division is correct.

So we stick to Group FFO because we think it's the right number. And then I leave everybody to try and come up with a smarter way of splitting up taxes and interest rates.

Jaap Kuin

Okay, but just basically disregarding FFO1 then: Would you say your expectation at the end of last year with regard to EBITDA on Sales and Development is still correct?

Helene von Roeder

I am not sure I get the question.

Rolf Buch

Actually, what we have said is that in all segments we are doing a little bit better than we thought.

Jaap Kuin

Okay, then that's clear.

Rolf Buch

Because this was the second time the question was asked: I think you keep in mind that we were in the last year giving you a guidance on a completely new format, with four segments. That in this case we probably are a little bit more prudent giving guidance is normal. We still have some prudence today in the guidance because also we have to learn better how the segments are working.

Jaap Kuin

Okay, that's very helpful. Thank you. – Maybe then moving to page 6 of the presentation. I was just wondering: The Adjusted EBITDA Operations for the German operations is shown there at 350. Is that actually including the IFRS 16 impact of 7.5 million or is that excluding that impact?

Helene von Roeder

That's now including because it's an IFRS number. We would be then including the IFRS 16 effect to follow the accounting philosophy.

Jaap Kuin

My last question will be on your valuation guidance. You suggest that there is also a likely impairment of goodwill associated with the valuation uplift. Obviously, that's very hard to predict for us. Do you have any sensitivity to offer in terms of whether that goodwill impairment is proportional to valuation uplifts like last year or higher or lower? Is there any way you can help us try to understand the likely size of the goodwill impairment?

Helene von Roeder

To tell you the truth, I am little bit relaxed about this. Why? Because we always have the adjusted NAV. If I look at the capital market, that's what the capital market seems to be looking at. So the EPRA NAV including the goodwill seems to be a number, but the capital market doesn't seem to be looking at that.

So I am not sure I can give you this guidance because the model is very, very sensitive. But, again, as we expect a valuation uplift, we will also expect an impact on goodwill. Ultimately, what it means in my mind is: When my predecessor and Rolf bought portfolios, they actually did the right thing and the value catch-up is now sort of proving the colleagues right.

Jaap Kuin

Okay, thank you very much.

Operator

The next question is from Aaron Guy, Citi.

Aaron Guy

Just a couple of quick questions, please, mostly around the political environment in Berlin, potential for nationalization etc. Can you just talk a bit about what your view is on that and the potential impact on your German portfolio?

Just related to that: Political climate: Can you just give an update on what you are hearing in that sort of "inner circle"? Is the discussion changing from, say, increased regulation to other new solutions or is it still heading down that kind of same track of more regulation and that sort of thing?

Rolf Buch

I think what you have to understand is: Nobody is afraid, at least not on the professional side, that a nationalization of the portfolios will happen in reality because this does not solve the issue, it is very expensive, the State of Berlin cannot afford it. So I think there is no real risk in the end that the portfolios will be taken away.

The problem with this debate is more that it shows that the political climate in Berlin which is special anyway in Germany, because you still have a big part of former East-German people, who worked for the East-German state. They are still living in Berlin, e.g. in the Karl-Marx-Allee. On the other hand, in West Berlin, you have people living, which were used to live on subsidies forever because West Berlin was completely subsidized for decades in Germany. So there is a very special climate.

What is probably more interesting is that the debate in Berlin about the housing and the nationalization actually is opening a lot of other debates which is, of course, going in more regulation, it's going in more restrictions in the rental business and most recently led actually to a nationalization debate of BMW.

They are a little bit irrational in Berlin and we have to live with this effect. Of course, this does not ease the business. This debate will not help to do less regulation, but in reality, I think, in the current government in Germany, we also don't think that there is massive more regulation. So it's a lot of noise.

The disadvantage is that at the moment management teams in the companies have to spend much more time to answer questions regarding this noise. So this is actually something where I am spending much more time at the moment on the political agenda than before.

Aaron Guy

Just a second question related to that: If your property valuation is, as you mentioned, possibly stronger in H1 this year than last year and if the valuations continue on the same annual trajectory as the last few years, so house prices have roughly doubled within a sort of sevenish year kind of period.

How do you think about the business with a ten-year view if the valuation of the NAV is kind of peak at that point? Do you have to think about potentially shareholder returns, the total return coming from other areas, development, more increased privatizations etc.? Obviously, the EPS takes long to capture that possibly what will be priced into the house prices in the short term. But longer term, if that trajectory happens, how do you think about the business?

Rolf Buch

To be very clear: There are good reasons why we are not giving you a guidance on value uplifts. Because I think this is not our job, it’s the job of the valuers. So we are not giving you a guidance for the full year.

What we said is – because we have now a more clarity – that the half year will be higher than last year. Of course, if everything is not changing, there is also a fine hypothesis, that’s the trend. What I am saying is: The trend is not broken. As long as the trend is not broken – we don’t see that the trend is broken – there will be a positive development in the future.

For me this is not a surprise at all. We have all this political debate because of the simple effect that in the big cities we do not have enough housing. If you don’t have enough housing, prices for housing are going up. This is something which should not shock us, which is actually the normal reaction on the market on a shortage of a product. Since we are not solving the imbalance between supply and demand, we will see price increases. This is it, it’s very simple.

At the moment, salaries in Germany are also significantly increasing. I don't think that we have a significant impact in purchasing power. So I think a big part of our tenants also can afford higher rents.

Aaron Guy

Perfect, thank you.

Operator

The next question is from Jonathan Kownator, Goldman Sachs.

Jonathan Kownator

A couple of questions from me, the first one on cost inflation. Perhaps you can update us on that point as you are still seeing the same development in inflation that you were seeing last year more or less.

Also perhaps to come back and look at the debate from the broader angle, perhaps on the regulation: Are you seeing any more response from either the local law or, probably more likely, the national government on any sort of measures debated that could actually stimulate a development? We see that obviously you are still talking about how difficult it is to get permits at the local level. But are there some voices to try to help on that debate and think about any program perhaps to help development?

Rolf Buch

Coming back to your last question: Of course, at the moment, if you follow the German politicians, they have an issue, they don't want to have nationalization because the majority is against nationalization. So they are talking about putting more money in the system. So higher subsidies, helping for more construction, more spending for social housing.

We are ready to take this money. We are not against it. The problem is: It's not solving the issue because the issue is not money. Today, in the regime in North Rhine Westphalia, we are able to build social housing with a completely normal return, so fully social housing. It's a subsidy program in North Rhine Westphalia, there is no problem. The same is in Saxony, in Dresden. We are building there social housing; it’s a good model. It delivers the same returns as in the normal rental business.

A lot of people are talking now to put more money in. But the problem is not the money, the problem is land and construction permissions.

Jonathan Kownator

If you look at land. Obviously, you do have quite a bit of land. Some of the cities like Berlin or others are not necessarily super-highly densely built this way. Is it really the permitting issue? Do you see local or national authorities trying to put more resource in that?

Rolf Buch

I think it’s even going a little bit more down. You are right: Berlin is not condensed. Actually, no German city is condensed. So if you are coming from New York or London, you are thinking this is a mid-sized city, which in reality it is. It’s not condensed. The condensification potential not only in Berlin but in all other big cities is there.

We are always talking about construction permissions. In the end, the point is that politicians are not strong enough explaining the people that we need construction. “Not in my backyard” – I think you know this phenomenon all over the world. Every time you are doing construction, there are some people who are against this construction. At the moment in Germany, politicians are obviously not strong enough to explain to the people that this is necessary and in the interest of the whole city.

I don’t know if you see this phenomenon in other parts of the world. In Germany, at the moment it’s a very big phenomenon. To solve this issue, politicians have to become stronger. They have to be more leaders, they have really to lead also the discussion and they need to explain to the people that no construction is not an option in a city where people are moving in.

Jonathan Kownator

Is there perhaps a more federal answer to that as well? Obviously, you need to streamline processes. Perhaps also people need to be involved-less in the decision-making process. They can appeal to it. Is this something that is happening at all or not really at this stage?

Rolf Buch

No. You know, what happened was: Around 2000 and a little bit later in the consequence where Germany thought that we are finished, we actually gave the whole power for construction processes, for local regulation, for all this to the "Länder". So the central government actually has no power. Even the "Bauordnung" which discusses how you have to build is actually decentralized today.

So the Federal Minister of Construction who is at the same time the Minister of Interior Affairs actually doesn't have too much decision power left. It's all local and I don't see at the moment a willingness in Germany to change it, to give more power to the federal government. So it's a deadlock situation.

Jonathan Kownator

You are saying, people don't want more construction in their backyard. Is that a national phenomenon or do you see some Länder that are more open perhaps than some others?

Rolf Buch

Actually, again, the construction permission is not given by the Länder, but by the municipality, which is the third level. So the framework legislation is done by the Länder, then the construction permission is done in the municipality.

I would say, in all big cities you see the same framework: Not in my backyard. But, of course, cities are reacting differently. In Berlin, they are actually asking for nationalization. In Munich, they are just talking together with their politicians and telling them that they don't want to have the construction permission. Actually, the cities are a little bit different. But in the end, the phenomenon is the same: People don't want to have changes.

Jonathan Kownator

Perhaps one last question, if I may, on your services business: Can you give us an update on that? Are you saying, they are trying to develop additional services? Obviously, you have talked about the increase of that business. Do you have anything new to say or new services that you are developing?

Rolf Buch

No. As you see, we are very well on track. You noticed probably that I am very optimistic there in the guidance to deliver the 20 million more.

At the moment, we are working hard on the energy piece because this is the next big thing.

Jonathan Kownator

You mentioned insurance as well?

Rolf Buch

No, I am talking about energy. Energy is actually the piece of business where, of course, there is a massive potential. But this will not change from one quarter to the next.

Take this business as a very stable, growing business for years after years. We make it boring. So we are not taking … becomes very boring, but it's a very, very stable business.

Jonathan Kownator

Thank you very much.

Operator

The next question is from Kai Klose, Berenberg Bank.

Kai Klose

I have got two quick questions. The first one is on page 18, regarding the debt expiry profile. Could you just share your thoughts what you aim for the upcoming debt expiries, in particular regarding lengthening the debt maturity and/or changing the exposure to unsecured and secured funding?

The second question would be on page 27, regarding your recent acquisition opportunities you looked into. Could you indicate of these three foreign units where you are currently in the due diligence process if this also includes a higher portion of development land or if you are interested to buy more land rather than existing properties in order to beef up your development pipeline?

Rolf Buch

Can I do the second question first and then I hand over to Helene because … is a little more complex.

It is very clear: On the acquisition, there is no land. This is just apartments, there is no land reported.

Kai Klose

Alright.

Helene von Roeder

Kai, we are really opportunistic about this. You may have seen that the spreads have come in significantly. So at this point in time, even with the long maturities, euro bonds do look quite attractive. But, again, I am keeping it open. I can do secured and I can do euro bonds. I will just decide as and when time comes due to refinance the bond.

Clearly, as you know, with the Deutsche Wohnen disposal and now the repayment of the hybrid, I don't have a lot of refinancing to go for the remainder of the year.

Kai Klose

Okay, thanks so much indeed.

Operator

The next question is then from Robert Woerdeman, Kempen.

Robert Woerdeman

A number of higher-level questions: First of all, where are we on France? You have been studying the market now for one and a half years. What are currently your findings so far, after also taking your first stake in a French company?

How can we expect Vonovia to take place in the French market? Is it going to happen in the next three to five years? Any views?

Rolf Buch

First of all, I think we are positively surprised, but unfortunately it is not shown in the figures because it is too small. It is the development of 10% of the 4,000 units. They will definitely be better than we expected. But this, of course, you will not see, unfortunately, in our figures because it is too small.

We are learning. We are still having very interesting and teaching debates with the French government. There are always opportunities coming. But, again, I think you mention in your question correctly, it is three to five years. I think I would be very positive that Vonovia is bigger in three to five years from now in France. I am not sure if it is five years or three years and I am not sure how much is "much bigger".

I think this is a long-term project and nothing has changed in a way that we say we would revise completely what we have said in the last quarter.

Of course, the protest of the yellow vests is not helpful for the liberalization of the market. On the other hand, the government is putting more money in the system now. New construction is not working really. These are all indicators that the system is not sustainable in the long run. It soon will, because then it will change and then this gives, of course, opportunities. It's not short-term.

Robert Woerdeman

But the fact that you mention "better than expected" on the only 400 units that you have indirectly means that this is a market that you are going to grow in.

Rolf Buch

No, I cannot tell you because we are not continuing to buy 400 units.

We actually are positively surprised. We learn that you can manage it. This is what the message is. There are no bad surprises; everything is doing well.

It doesn’t make sense for us to own 4,000 or 8,000 units just to be in France. As you know, this was research and development. So research and development is performing well. The opportunity will come if the market is changing because you know we are talking here about housing for the mass of the people. Housing in the high-end caliber in Île de France, in the center of Paris, is a completely different market. This is definitely not a market for us.

Robert Woerdeman

With the current knowledge that you have, how should we expect your medium-term capital being allocated between Germany and Sweden? Where do you expect to see the most growth for you?

Rolf Buch

In relative figures, because of the small base, at the moment I would say, in Sweden probably at the moment we will grow the portfolio faster percentage-wise. But I think this is a no-brainer. This depends on a lot of things. It depends on the development of prices in Germany, it depends on the willingness of owners in Sweden to sell.

We are completely opportunistic there because in the end the question is: Where do we want to acquire more? We should be completely opportunistic because otherwise we are putting pressure on us which we don’t need and which is not helpful for the shareholders. You know my story.

Of course, since we are still so small, if you buy a portfolio of 1,000 units in Sweden, you are growing the company by 5 or 6%. That is why I think it is obvious that Sweden will grow a little bit faster percentage-wise.

Robert Woerdeman

Yes, of course. Have you already identified a number of portfolios you are interested in?

Rolf Buch

Actually, it's the same as in Germany. We have plenty of opportunities. It is a lot about KPIs. You can calculate a lot of portfolios. It's very easy. If it is just too expensive, then we are not buying. If it is fine, we are buying. We are not in a hurry. We never promised to be in Sweden with 30,000 units next year. So we are not under pressure.

Robert Woerdeman

Perhaps a tricky one: You mentioned yourself that prices are going up quite rapidly in the urban areas including Berlin. With the recent unrest in Berlin, this has led to quite a derating of certain stocks. If this were to continue, is this for you a good opportunity to step in again?

Rolf Buch

I think there are two answers. Politically, it would probably be suicide because I would be the most hated man in Germany. Imagine that they want to nationalize and somebody else would make an offer. I think this is probably something which is not possible.

Again, I think we have learned in 2015 very clearly that a transaction like this only works if two CEOs agree that this is a good transaction. I don't see any change in attitudes here. So we have taken our learnings. That is why I think nothing has changed; nothing is new there. You know, probably one day, in around 10 or 15 years, some of our successors will reopen the discussion.

Robert Woerdeman

Excellent. Many thanks.

Operator

The next question is from Manuel Martin, ODDO BHF.

Manuel Martin

Thank you. I have a question regarding the tenants in your portfolio. If you have a look at your tenants, what do you think could be right now more or less the share of rent which they have to pay versus their disposable income? Has that increased? Where could that level be in the future? Of course, I think that might be different in the different countries, I admit.

Rolf Buch

Actually, I cannot answer that completely because we don't know the detailed income of the tenants. Technically, we are not allowed to ask.

You can actually talk about the country as a whole. I don't know the exact salary of my tenants. Actually, I don't want to know it from month to month because, I think, we as a non-state company should not know every detail of our tenants.

I know that Sweden has a completely different view on this.

What you see in general is: Rent as a disposable income of Germany in general in the country is actually a little bit decreasing. This is clear because rent is normally growing lower than the inflation rate. This means that disposable income, which is more or less coming with inflation rate, is actually growing faster than the rent. Of course, this is the average. There is a portion of people where this is not the case.

But you know, e.g. in Germany, we have an average – but this is the whole country – of below 24% disposable income, while e.g. in France you have 26% or in the UK you have 27%. Renting an apartment in Germany is still relatively cheap if you compare it to other countries. It is getting more expensive in the big cities in comparison to ten years ago.

To give you just one reminder: If you look at our average rent, which is 6.50 euros and we are mainly focused in big cities. If you look at this and if you compare it to other markets, you know by yourself that this is still very cheap in Germany.

Per square meter. For the Americans in the call: The 6 euros is per square meter and not per square foot.

Operator

As there are no further questions, I would like to hand back to Rene for some closing words.

Rene Hoffmann

Thank you, Judith, and thanks everyone for joining.

In terms of timing and what is ahead of us: As a reminder, the H1 2019 results will come out on 2 August. Until then we will be on the road quite a bit. We also have our Capital Markets Day on 5 June in Frankfurt with the dinner to kick it off on 4 June. Certainly, we hope to speak with you on one occasion or the other before that.

As always, please do reach out to me or the team with any questions and comments you have. With that, that's it from us for today. Have a great day everyone!

Rolf Buch

Thank you very much.

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