

Franconofurt

Real Estate

12 July 2006

Buy

Price EUR12.5 / Fair Value EUR15.70



LOCAL SHARPSHOOTER IN THE FRANKFURT RESIDENTIAL MARKET

Franconofurt (FFM) is the specialist in a profitable segment of Frankfurt-based residential properties: buying representative multifamily houses, often in the Wilhelminian style, in selective citylocations and selling the apartments unit-by-unit after a moderate refurbishment to owner-occupiers or private clients seeking a financial investment. Hence, the company realizes a margin above 30% with the disposal. By building up a high-yield standing portfolio in the surrounding Frankfurt area, FFM leverages its real estate expertise and stabilizes its income stream.

OUTSTANDING MARKET EXPERTISE

The company founders have been in the Frankfurt residential real estate market as one of the growth areas for more than 15 years and know the right locations for suitable properties.

HIGH-MARGIN BUSINESS BUT DEAL-DRIVEN...

FFM creates value by selling the apartments of the selected property and realizing margins above 30%. Its dependence on ongoing deal flow is high but it is not a trading business and is made more stable by focusing on retail clients and high-quality properties instead of block trading.

...NOW STABILIZED BY IPO CANDIDATE

Within the "FFM REIT", the company is currently building up a standing portfolio in the total value of €105m and collects stable income. FFM intends to launch it on the stock exchange in H2 2006 based on the situation at the equity markets.

PROFITABLE GROWTH

We think that FFM's attractive growth perspectives are not reflected in the current share price. By running a DCF and peer group valuation, we come to €15.70 as the fair value, reflecting upside potential.

50

12 month high/low €	18.29/5.40
Rel. % 1m -1.7 3m -2.8 12m 57.2	
Abs. % 1m 1.0 3m -10.9 12m 93.0	

Market Data

Reuters	FFMG.DE
Bloomberg	FFM GR
Market cap. €bn	0.1
Number of shares m	6.6
Free float %	56%
Daily turnover shares	1,000

Next Events

Interim results	August November
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Rel. Sector

+

Key Changes

EPS %
Rating

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Key Data

	2004	2005	2006e	2007e	2008e
EUR					
Revenues	5	7	23	30	36
EBIT	1	1	7	11	16
Net profit	0	0	4	6	9
adj. EPS	0.44	0.11	0.53	0.93	1.33
Dividend	0.50	0.17	0.37	0.30	0.35
PER	0.0	56.5	23.5	13.4	9.4
Div. yield %		2.7	3.0	2.4	2.8
EV/EBITDA	9.3	33.4	15.2	11.4	9.2
EV/Revenues	1.6	5.1	4.5	4.2	4.1
Price to book	0.0	2.6	2.4	1.5	1.0
EBIT margin %	16.7	15.1	29.8	37.1	42.8
ROE %	12.8	4.4	9.7	11.0	10.3
ROCE %	6.9	5.1	11.9	11.1	10.2
EPS CAGR 04-08: 32%					
Equity ratio 06: 58%					
Gearing 06: 58%					

STRATEGY AND PORTFOLIO

We regard FFM's business model as attractive for the following main reasons:

Convincing equity story

___ Leading market position in an attractive segment of the Frankfurt residential markets with high-quality properties in top locations

___ Focus on wealthy retail clients leads to higher sustainability and higher margins

___ Strong reputation for potential buyers and sellers simultaneously

___ Strong expertise of the residential property markets in the Frankfurt

___ Tight network to institutional and private clients leads to stable deal flow of investment opportunities

___ Leveraging its knowledge by building up a standing portfolio as potential IPO candidate

___ Profitable from the very beginning including dividend payments

No start-up

Founded in 2000, FFM went public in 2005 in order to generate equity inflow for future growth. The company has been profitable from the very beginning and drives its activities by keeping a clear focus on residential real estate only.

Attractive margins by focusing on wealthy clients and high quality buildings

The business model is quite straightforward: acquiring high-quality residential properties in top locations in the City of Frankfurt for €1,000-1,600/m², always with the clear view to sell the apartments individually to private clients for €2,000-2,300/m² after a moderate refurbishment of the façade or corridors but not of the apartments themselves. The interested buyer either acquires the apartment for its own use or to rent as a financial investment. FFM is therewith neither dependent on portfolio trading with institutional clients nor on public subsidy, such as the abolished "Eigenheimzulage" for privatizing the apartments to tenants. While a prompt disposal of all apartments is always intended (after one to four years), the company is not pressured to sell or make price concessions, because the rents cover all operating and financing costs. FFM prefers properties with a higher vacancy rate to start with the disposal of the apartments and then pays remaining tenants a small amount to move out. Of course, the rents are increased to market levels as it is allowed.

Frankfurt residential markets attractive

The Frankfurt area is one of the growth centers in Germany with an expected increase in population of 10% until 2040. The ownership quota in Frankfurt of 16% is only slightly higher than in Berlin (13%) and significantly below the average in Germany of 43%, whereby it has to be noted that the catchment area is large and the fluctuation due to the multinational population is high. At the same time, the purchasing power is above-average, reflected in the demand for residential properties in top locations – the focus of FFM.

“Local hero”

Due to the company’s presence in the market for a couple of years, FFM has built up a stable network to find attractive properties. FFM buys mainly from private owners or the community of heirs, but also from insurance companies and local housing associations. By focusing on single properties, FFM does not compete with large institutional investors and only has local agents as competitors, though the latter do not have the same capital resources and standing in the market as FFM. Thus FFM’s target market is below the radar screens of the large institutional investors while at the same time FFM’s business focus is too large for smaller players in the local market so that the company can prosper successfully in its business segment.

Realistic growth rates

Value is created by selling the apartments after a short holding period. In our model we estimate an investment volume of €20m in 2006, after €12m in 2005. As an average acquisition price, we take €1,600/m² incl. acquisition costs and €2,300/m² as the disposal price and estimate a selling process over four years. It has to be noted that the price range is widespread in the existing portfolio but the realized margin is stable has been stable to at least 35%. We regard these assumptions as realistic and see significant scale effects that allow a higher volume without the necessity to increase the capacities significantly.

Attractive margins in core business

	2005	2006e	2007e	2008e	2009e	
Investments	12,000,000	20,000,000	25,000,000	30,000,000	33,000,000	
consisting of						
Units	12	20	25	30	33	
average price per unit	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000	
apartments	82	160	200	240	264	
average size per apartment	91	91	91	91	91	
average price/m ²	1,600	1,632	1,665	1,698	1,732	
value creation						
buying at €m ² incl. acquisition costs	1,600	1,632	1,665	1,698	1,732	
refurbishment €m ²	100	1,700	1,732	1,765	1,832	
Selling with 35% margin for €m ²	35%	2,295	2,338	2,382	2,473	
Disposal schedule						
Year 1	15%	12	24	30	36	39.6
Year 2	40%	33	64	80	96	105.6
Year 3	30%	25	48	60	72	79.2
Year 4	15%	12	24	30	36	39.6

Source: Oppenheim Research

Strategic development with low-risk subsidiary

As its second pillar, FFM created the “FRANCONOFURT RheinMain AG” to build up a standing portfolio consisting of properties in the surroundings of Frankfurt, such as in Offenbach, Mainz or Wiesbaden etc. Therefore, the company raised €2m equity that allows to build-up a portfolio of €105m until year end 2006. The company intends to achieve at least 8% rental yield.

Standing portfolio in "FRANCONOFURT REITS"

	2006e	2007e	2008e	2009e
	60	105	130	160
Rental income	4.8	8.4	10.4	12.8
Income from disposals	1.1	2.5	3.1	3.9
Maintenance, material expenses	0.6	1.1	1.3	1.6
EBITDA	5.3	9.9	12.2	15.1
Depreciation	0.3	0.5	0.7	0.8
EBIT	5	9.3	11.6	14.3
Interest expense	2.4	4.2	5.2	6.4
EBT	2.6	5.1	6.4	7.9
Tax	1.0	1.9	2.4	3.0
Net profit	1.6	3.2	3.9	4.9

Source: Oppenheim Research

FFM follows two objectives with this subsidiary:

53

IPO of FFM REIT
attractive but not decisive
for future growth

_____ Stabilize the income stream and leverage the activities built on its expertise in the defensive residential portfolio. It acquires single properties or small portfolios and does not compete with larger institutional investors. FFM is rather a potential buyer for the smaller units of their portfolios.

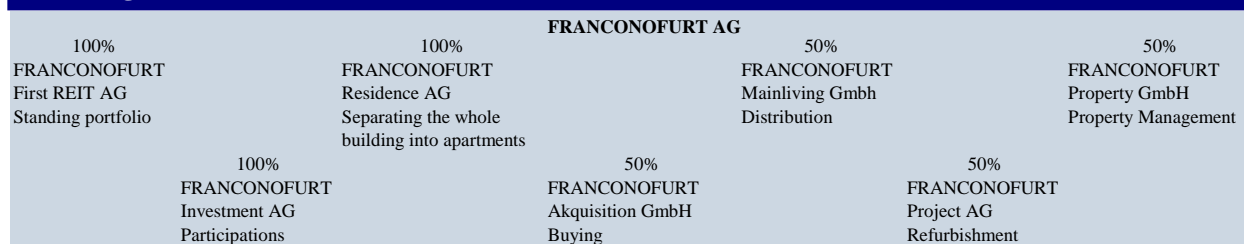
_____ Based on the respective market situation, FFM is going to launch its "FFM REIT" in the second half of 2006 to collect equity for its further growth and for the expansion of FFM itself. On an operational basis, FFM will always remain the Frankfurt local sharpshooter, but it has identified comparable local players in Hamburg or Munich that are still privately owned and could be a potential acquisition target.

In our valuation, we do not take the intended IPO into account due to the current market environment, but we appreciate that FFM is widening its activities as a logical consequence and thereby stabilizing its income stream by keeping its defensive profile. It has to be noted again that the IPO is not essential for the company's future growth but it could leverage its activities again.

One-stop shop for
residential properties

FFM follows a clear organizational structure and has all the relevant features in-house:

Clear organization structure

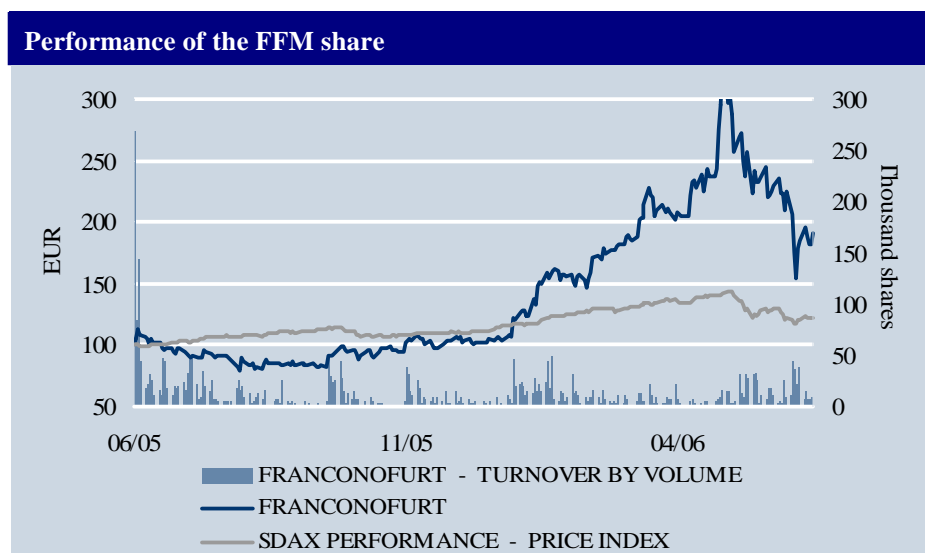


Source: FRANCONOFURT

THE FFM SHARE

Attractive performance
but low liquidity

Since its IPO in June 2005, the FFM share has shown attractive performance that has come down in weeks in accordance with the total equity markets. The volatility is high because of the low liquidity in the stock.



Source: Datastream

The free float has already increased to 56%; the two founders and board members Christian Wolf and Carsten Siegert each hold 21% and 23% respectively and are locked up until 2009.

VALUATION

Our valuation is based on a DCF model as the preferred method and a peer group comparison. A NAV-based valuation will be suitable for the FFM REIT but not for FFM due to the focus on a buy-and-sell strategy. We regard our estimates as conservative leaving room for further upside.

Valuation based on DCF
preferred

In the DCF model, we derive the beta on the basis of weighted fundamental factors. We expect profitable growth in the disposal of apartments with high margins and we use a beta for the fundamental factor of cyclicity of 1.3, weighted at 20%. However, the forecast risk is high because of the successful disposals needed to keep the growth rate, but diminished by the stable rental income coming from the standing portfolio, which comes out with a beta for forecast risk of 1.3, weighted at 30%. We take 1.5 for the company size, weighted at 35%, and 1.2 for the financial structure, weighted at 15%, leading us to a fundamental beta of 1.4. The DCF calculation derives a fair value of €15.60 per share.

Peer group does not fit totally

In the peer group comparison, we integrate VIVACON, Deutsche Wohnen, PATRIZIA, and Colonia Real Estate. We think that the only common denominator is being active in the residential property business while having different strategies and risk profiles. After Deutsche Wohnen, we think FFM is the most defensive stock.

Peer group					
Company	Price	Market Value	P/E06e	P/E07e	Dividend Yield
VIVACON	17.49	302.8	7.2	6.2	0.0
DEUTSCHE WOHNEN (XET)	251	1004.0	46.3	33.8	3%
COLONIA REAL ESTATE	35.8	546.0	32.7	22.5	0.0
PATRIZIA IMMOBILIEN(XET)	19.01	924.3	23.6	13.8	0.0
Average			27.5	19.1	
Median			28.1	18.2	
FRANCONOFURT	11.55	52.0	23.5	13.4	3%

Source: Datastream, Oppenheim Research

56

Rating: Buy
Fair value: €15.60

For initiation of coverage we focus on the DCF-calculation with a fair value of €15.70 per share with a **buy** rating. The company has to keep its speed whereas the downside is only limited. It has to be noted there is still a limited liquidity in the stock that could lead to a higher volatility.

Franconofurt – P&L (Total cost)

EURm	2004	2005	2006e	2007e	2008e
Revenues	4.6	6.9	22.8	29.7	36.5
Invent. changes & intern. prod. assets	0.0	0.0	0.0	0.0	0.0
Total output	4.6	6.9	22.8	29.7	36.5
Cost of materials	2.8	3.7	11.7	13.9	16.0
Personnel costs	0.5	0.5	1.0	1.0	1.1
Other depreciation/amortization	0.0	0.0	0.0	0.0	0.7
Other operating income/expenses	-0.5	-1.7	-3.3	-3.7	-3.1
EBITDA	0.8	1.1	6.8	11.0	16.3
EBIT pre exceptionals	0.8	1.0	6.8	11.0	15.6
Exceptionals	0.0	0.0	0.0	0.0	0.0
EBIT	0.8	1.0	6.8	11.0	15.6
Participation result & other fin. result	0.0	0.0	0.0	0.0	0.0
Interest result	-0.2	-0.2	-0.6	-1.1	-1.5
Financial result	-0.2	-0.2	-0.6	-1.1	-1.5
Other income/expenses	0.0	0.0	0.0	0.0	0.0
Earnings before tax	0.6	0.8	6.2	9.9	14.1
Taxes	0.2	0.3	2.7	3.8	5.4
Tax rate %	27	43	44	38	38
Profit/loss for the year	0.4	0.5	3.5	6.1	8.7
Minority interest	0.0	0.0	0.0	0.0	0.0
Net profit	0.4	0.5	3.5	6.1	8.7
Adjustments	0.0	0.0	0.0	0.0	0.0
Adjusted net profit	0.4	0.5	3.5	6.1	8.7

Key ratios and numbers

Data per share					
Number of total shares (m)	1.0	4.0	6.6	6.6	6.6
EPS (reported)	0.44	0.11	0.53	0.93	1.33
adj. EPS	0.44	0.11	0.53	0.93	1.33
Dividend per share	0.50	0.17	0.37	0.30	0.35
Sustainable FCFPS			0.00	0.00	0.04
FCFPS	0.46	2.57	6.11	7.28	9.52
Book value per share	2.93	2.43	5.11	8.14	12.49
Growth rates %					
Revenues change		51.3	230.1	30.2	22.92
EBIT change		36.7	551.2	62.2	41.9
Earnings before tax change		32.7	684.3	58.9	42.4
Net profit change		3.2	671.2	75.4	42.4
adj. EPS change		-74.2	367.4	75.4	42.4
Margins %					
Gross margin	38.4	46.5	48.7	53.2	56.2
EBITDA margin	17.2	15.4	29.9	37.2	44.7
EBIT margin	16.7	15.1	29.8	37.1	42.8
Net profit margin	9.6	6.6	15.4	20.7	24.0
ROE	12.8	4.4	9.7	11.0	10.3
ROCE	6.9	5.1	11.9	11.1	10.2
Expense ratios %					
Personnel Costs to Revenues	10.6	6.9	4.2	3.5	2.9
Material Costs to Revenues	61.6	53.5	51.3	46.8	43.8
R&D to Revenues	0.0	0.0	0.0	0.0	0.0
Depreciation to Revenues	0.5	0.2	0.1	0.1	1.8
Other ratios					
Interest cover	4.7	4.2	12.2	9.9	10.3
Equity ratio %	30.5	47.3	57.7	52.5	50.7
Gearing %	213.1	94.4	57.6	77.4	79.6
Net financial liabilities/EBITDA	9.5	10.5	3.7	4.3	4.7

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Franconofurt - Statement of Cash Flows

EURm	2004	2005	2006e	2007e	2008e
Cash flow from operating activities					
EBIT	0.8	1.0	6.8	11.0	15.6
Depreciation / amortization	0.0	0.0	0.0	0.0	0.7
Change in other provisions	0.0	0.0	0.0	0.0	0.0
Non Cash Items	0.0	0.0	0.0	0.0	0.0
Taxes / tax refunds	0.2	0.3	2.7	3.8	5.4
Change in other assets & liabilities	0.0	0.4	0.0	0.0	0.0
Change in Working Capital	0.0	-9.5	-27.8	-35.8	-45.4
Extraordinary result	0.0	0.0	0.0	0.0	0.0
Cash flow from operating activities	0.6	10.5	31.9	43.1	56.3
Cash flow from investing activities					
Investments in tangible assets	0.0	0.0	8.5	6.0	8.0
Investments in financial assets	0.0	0.0	0.0	0.0	0.0
Investments in intangible assets	0.0	0.0	0.5	0.0	0.0
Disinvestments	0.0	0.0	0.0	0.0	0.0
Changes in other L.T. assets / acquisitions	0.0	0.0	0.0	0.0	0.0
Cash flow from investing activities	0.0	0.0	9.0	6.0	8.0
Cash flow from financing activities					
Financial result	-0.2	-0.2	-0.6	-1.1	-1.5
Change in financial liabilities	0.0	4.1	14.4	22.4	29.5
Change in shareholder's Equity	0.0	8.5	24.6	15.3	22.5
Change in pensions and similar provisions	0.0	0.0	0.0	0.0	0.0
Dividend payments in previous year	0.0	-0.7	-2.4	-2.0	-2.3
Other	0.0	0.0	0.0	0.0	0.0
Cash flows from financing activities	-0.2	13.0	40.8	38.6	52.7
Change in cash and cash equivalents	0.5	23.5	81.7	87.7	117.1
Cash and cash equivalents (begin. of period)	0.0	0.2	1.3	4.7	4.8
Cash and cash equivalents (end of period)	0.0	23.7	83.1	92.4	121.9

Ratios and key figures

Free cash flow to entity	0.6	10.5	40.9	49.1	64.3
Free cash flow to shareholder	0.5	10.3	40.3	48.0	62.8
FCFPS	0.46	2.57	6.11	7.28	9.52
Free cash flow yield		40.1	48.9	58.3	76.2
Sustainable free cash flow to entity	0.0	0.0	0.0	0.0	0.2
Sustainable free cash flow to shareholder	0.0	0.0	-0.5	-1.1	-1.3
Sustainable FCFPS			0.0	0.0	0.0
Sustainable FCF yield			0.0	0.0	0.3
Operating cash flow/Capex			-3.7	-7.2	-7.0
Operating cash flow/avg. net financial pos.		1.2	2.1	1.3	1.0
Maintenance capex/revenues	0.0	0.0	0.0	0.0	0.0
Depreciation/capex			0.0	0.0	-0.1
Net working capital/revenues	2.4	2.9	2.1	2.8	3.5

Franconofurt - Balance Sheet					
EURm	2004	2005	2006e	2007e	2008e
Assets	11.2	21.9	62.7	106.1	167.1
Fixed assets	0.3	0.2	9.3	15.3	23.3
Intangible assets	0.0	0.0	0.5	0.5	0.5
thereof goodwill	0.0	0.0	0.0	0.0	0.0
thereof act. development expenditure	0.0	0.0	0.0	0.0	0.0
Property, plant + equipment (PPE)	0.0	0.0	8.5	14.5	22.5
Financial assets	0.2	0.2	0.2	0.3	0.3
Other items in fixed assets	0.0	0.0	0.0	0.0	0.0
Items btw fixed and current assets	0.0	0.0	0.0	0.0	0.0
Current assets	11.0	21.6	53.4	90.8	143.7
Inventories	7.9	17.9	43.1	75.1	117.5
Accounts receivable	2.9	2.4	5.6	11.0	16.3
thereof trade receivables	2.5	2.1	5.3	10.7	16.0
Marketable securities	0.0	0.0	0.0	0.0	0.0
Cash and cash equivalents	0.2	1.3	4.7	4.8	9.9
Other current assets	0.0	0.0	0.0	0.0	0.0
Deferred income + prepaid expenses	0.0	0.0	0.0	0.0	0.1
Deferred tax assets	0.0	0.0	0.0	0.0	0.0
Other assets	0.0	0.0	0.0	0.0	0.0
Total assets	11.2	21.9	62.7	106.1	167.1
Liabilities & Shareholders' equity	11.2	21.9	62.7	106.1	167.1
Shareholders' equity	3.4	10.4	36.1	55.7	84.7
Capital subscribed	1.0	4.0	6.6	6.6	6.6
Reserves	0.0	5.5	27.5	42.8	65.3
thereof additional paid-in reserves	0.0	0.0	0.0	0.0	0.0
thereof retained earnings	0.0	0.0	0.0	0.0	0.0
Other equity capital	2.4	0.9	2.0	6.3	12.8
Minority interests	0.0	0.0	0.0	0.0	0.0
Items btw shareholders' equity + debt	0.0	0.0	0.0	0.0	0.0
Debt	7.8	11.5	26.5	50.4	82.3
Provisions	0.3	0.3	0.3	0.4	0.4
Pension provisions	0.0	0.0	0.0	0.0	0.0
Other provisions	0.3	0.3	0.3	0.4	0.4
Liabilities	7.5	11.3	26.2	50.1	82.0
Financial liabilities	7.5	11.1	25.5	47.9	77.4
thereof short-term financial liabilities	0.0	0.0	0.0	0.0	0.0
Other liabilities	0.0	0.1	0.7	2.2	4.6
thereof trade liabilities	0.0	0.1	0.7	2.2	4.6
Deferred income	0.0	0.0	0.0	0.0	0.0
Deferred tax liabilities	0.0	0.0	0.0	0.0	0.0
Other liabilities	0.0	0.0	0.0	0.0	0.0
Total liabilities	11.2	21.9	62.7	106.1	167.1
Ratios and key figures					
Current assets %	97.6	98.7	85.1	85.5	86.0
Long-term assets %	2.4	1.1	14.8	14.4	14.0
Equity ratio %	30.5	47.3	57.7	52.5	50.7
Book value per share	2.93	2.43	5.11	8.14	12.49
Gearing %	213.1	94.4	57.6	77.4	79.6
Interest cover	4.7	4.2	12.2	9.9	10.3
Net working capital	10.8	20.2	48.0	83.8	129.2
Net financial position	-7.3	-9.8	-20.8	-43.1	-67.5
Net financial liabilities/EBITDA	9.5	10.5	3.7	4.3	4.7
Enterprise value	7.3	35.4	103.3	125.6	149.9