



Results analysis: Schroder European Real Estate

SERE offers a high yield with a fully covered dividend...

Update
12 December 2024

- Schroder European Real Estate has reported a NAV total return of 0.4% for the year ending 30/09/2024, having paid dividends per share of 5.92 euro cents. The dividend was 103% covered by EPRA earnings, which were up 3% on the previous year thanks to rental growth outpacing interest costs.
- Dividends offset a decline in the portfolio value of 3.6%, due primarily to outward yield movement in the first half of the year. The manager notes that recent evidence suggests a stabilisation of values, and has observed an increase in investment volumes for smaller lot sizes in desirable cities.
- During the year, the company strengthened its balance sheet, completing all near-term refinancings which means the average interest cost is just 3.2%. No debt is due to expire until June 2025.
- The loan-to-value is a modest 25% net of cash, and the manager has c. €25 million of cash available for investment or other uses. Management is working on the disposal of Seville, which if successful, will reduce gearing to 22% net of cash.
- Over the period, SERE’s discount has narrowed but still stands at an attractive c. 33%. This compares to a c. 21% average for the AIC Property – Europe sector and 22% for the AIC Property – UK Commercial sector.
- The manager is focusing on capitalising on portfolio reversion to enhance earnings. There are key lease regearings pending which management believe will strengthen the income profile and drive a re-rating.
- The board notes that the French tax authorities are proceeding with a tax audit. Although they note the potential exposure is up to €12.6m (excluding penalties), they do not believe an outflow is probable, based on professional advice, so have not recognised a provision in the NAV.
- Sir Julian Berney Bt., chair, said: “Looking ahead, we expect to continue reaping benefits from a high-quality portfolio with strong occupancy rates located in key European cities.

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As inflation eases and interest rates fall, we expect sentiment to continue to improve and larger economies and cities are poised for enhanced growth.”

Kepler View

Schroder European Real Estate’s (SERE) main attraction is the high yield which is magnified by the current wide discount. The fully-covered dividend would equate to a c. 7.2% yield on the share price at the time of writing. This is backed by a portfolio which is 96% occupied, and after 100% of rent due was collected for the year. Management completed 16 new leases or re-gears over the 12 months under review with a weighted average life of 8 years.

The income outlook is also supported by the attractive gearing position. SERE has a modest level of gearing which locks in a low average rate of 3.2% over a weighted average life of 2.8 years. The



rearranged facilities marginally increased the average cost of debt (to 3.2%) but positively extended the weighted life by 13 months. Also of note is the indexation of the portfolio income: around 80% of the company's income is indexed to inflation, with the remainder linked to a hurdle rate, typically of 10%. A key issue for investors to watch will be what happens as the two largest tenants reach the end of their leases. The lease of KPN, which pays 18% of the portfolio income, is up in 2.3 years, and that of Hornbach, which pays 11%, is up in 1.3 years. We think any positive news on new terms could be significant when it comes to investor perception of risk and the appropriate share price discount. Additionally, we think that there is scope for the discount to narrow if there is a positive outcome from the tax audit.

A small decline in the value of the property portfolio over the period was expected and modest, but hopefully reflects the end of a tough period for real estate amid high inflation and interest rates. Almost all the write-down was taken in the first half ending in March, which therefore pre-dates the ECB's rate cuts which began in June and have taken the key lending rate from 4.5% to 3.4%. It is encouraging to hear from the manager his observations that a pick up in activity seems underway, and further rate cuts are widely expected which should improve the backdrop even more.

There are concerns around the outlook for European economies, but SERE should benefit from a relatively defensive positioning in high quality locations and properties. Approximately 33% of the portfolio by value is offices, which are in supply-constrained locations and leased off affordable rents. The industrial exposure of 30% is a mixture of distribution warehouses and light industrial accommodation in growth cities within France and The Netherlands. The retail exposure is limited to 17% and comprises DIY and grocery investments rather than fashion and other discretionary sectors. SERE also has 9% of the portfolio allocated to the alternatives sector, comprising a mixed-use data centre and a car showroom. Substantial cash on the balance sheet provides firepower for asset management initiatives, buybacks or other measures.

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