Lar España Real Estate

Real estate | Update | 24 October 2024

Undervalued by offer

We believe that the revised bid of €8.30 per share for Lar España Real Estate, from a consortium that includes its manager Grupo Lar and US private equity firm Hines, still undervalues the company and its future prospects. The enterprise value implied by the bid price of €1,130m is a considerable discount to the value of the portfolio of €1,304m (at 30 June 2024) and a substantial spread to the portfolio yield (7.8% to 6.6%) and the prime market yields in the wider Spanish retail sector.

The company had commenced an asset recycling programme, which included selling properties where value-add opportunities had been exhausted, and was on the verge of buying shopping centre assets with significant value enhancing potential. These would have been both NAV- and earnings-accretive, adding to the company's impressive long-term total return record. We feel that the current offer price, which is an 18.8% discount to the most recent reported EPRA net tangible assets, does not do justice to a company of Lar España's standing and track record.

Sector	Real estate
Ticker	LRE SM
Base currency	EUR
Price	€8.22
NAV	€10.22
Premium/(discount)	(19.6%)
Yield	9.6%

Offer at 18.8% discount to NAV undervalues the company and its prospects

Offer's implied yield for the portfolio out of line with market

Asset recycling programme had potential for further NAV and earnings growth

Exposure to Spanish retail

Lar España Real Estate aims to grow its EPRA net tangible assets (NTA) through active asset management of Spanish commercial real estate, and deliver high returns primarily through the payment of considerable annual dividends.

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Contents

Domicile	Spain
Inception date	5 March 2014
Manager	Grupo Lar
Market cap	€688.8m
Shares outstanding (exc. treasury shares)	83.7m
Daily vol. (1-yr. avg.)	113.3k shares
Loan to value	33.4%

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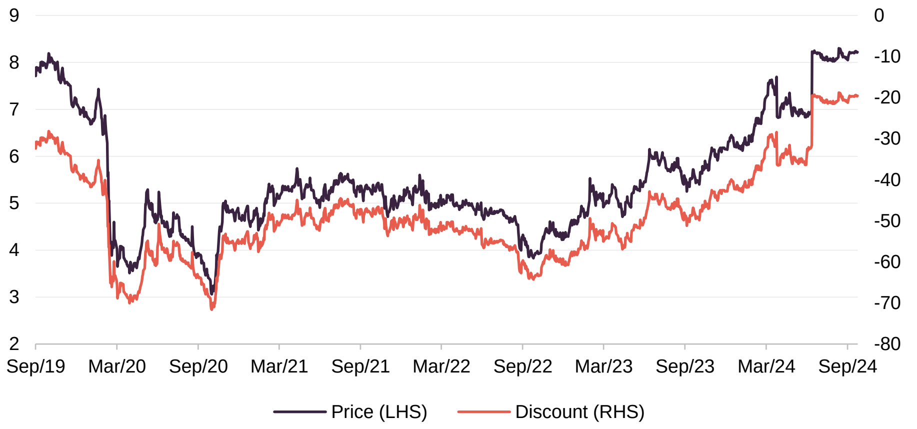
At a glance

Share price and discount

Lar España's discount to NAV plunged from an already wide level at the onset of the COVID-19 pandemic in early 2020 and only really started to recover over the past 12 months. Its share price still lingered at a discount of 31.6% on 11 July 2024 (the last day before the initial offer for the company).

Time period 30 September 2019 to 22 October 2024

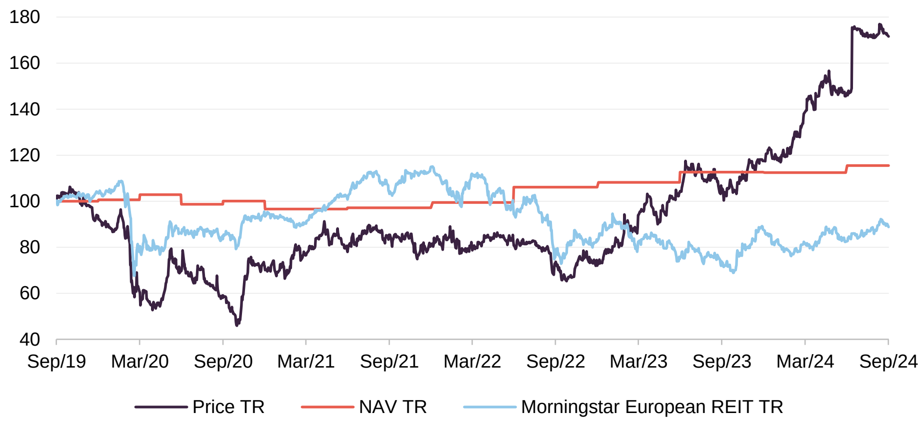


Source: Bloomberg, Morningstar, Marten & Co

Performance over five years

Lar España's NAV total return has comfortably beaten that of its peer group of European retail landlords over five years and its share price total return performance is way ahead of the Morningstar European REIT Index.

Time period 30 September 2019 to 30 September 2024



Source: Bloomberg, Morningstar, Marten & Co

Year ended	Share price total return (%)	EPRA NAV/NTA total return (%)	Peer group NAV total return (%)	Morningstar European REIT total return (%)
30/09/2020	(41.0)	0.0	(5.7)	(15.3)
30/09/2021	44.6	(2.9)	(7.0)	21.8
30/09/2022	(13.7)	9.2	4.1	(23.3)
30/09/2023	43.7	6.2	(3.4)	(6.7)
30/09/2024	62.1	2.5	3.7	20.3

Source: Bloomberg, Morningstar, Marten & Co

Offer for the company

Revised offer of €8.30 per share on 4 October

Following an initial bid in July of €8.10 per share for Lar España by a consortium comprising Hines European Real Estate Partners and Grupo Lar (Lar España's manager), the joint venture partners (JV) made an improved offer of €8.30 per share on 4 October after discussions with the company's largest shareholder, Castellana Properties.

Castellana has agreed to sell its 28.8% shareholding to the consortium at that price. To become effective, the offer needs the support of a minimum of 56.38% of Lar España shareholders to which the offer is made (i.e. all shareholders, excluding the 10.15% of shares owned by Grupo Lar). Including Grupo Lar, the offer has the support of just over 50% of shareholders, but still needs to be reviewed and cleared by the National Securities Market Commission (CNMV), the Spanish merger control authority.

In this note, we set out the details of the offer and our view on its merits.

Background to the bid

Offer values company at €694.7m, an 18.8% discount to EPRA NTA

On 4 October, Lar España received a revised bid from the JV that valued the company's shares at €8.30 per share and the company at around €694.7m and an enterprise value of €1,130m.

The offer price was a premium of 18.7% to the closing price before the initial offer in July, but also a substantial discount of 18.8% to the company's EPRA net tangible assets (NTA) of €10.22 per share at 30 June 2024.

The JV has been set up as a Spanish special purpose vehicle (SPV) named Helios Real Estate, with 62.5% of its share capital indirectly owned by the Hines European Real Estate Partners III fund and the remaining 37.5% directly owned by Grupo Lar. The consortium said that it will fund the offer with a combination of equity and external debt financing. It added that it intends to add further debt to the capital structure of Lar España and to increase leverage to around 60% loan to value (LTV).

Company has suffered a persistently wide discount

The consortium argues that shareholders would not have been able to achieve such a price in normal market conditions due to the company's small/mid-cap size and the illiquidity of its stock. As we have noted in previous notes, the company has traded at a persistently wide discount to NAV even before the COVID pandemic, as illustrated in Figure 1.

Figure 1: Lar España's premium/(discount) to EPRA NTA

Source: Bloomberg, Morningstar, Marten & Co

> We believe offer undervalues company and its prospects

Its discount to NAV plunged from an already wide level at the onset of the COVID-19 pandemic in early 2020 and only really started to recover over the past 12 months, but its share price still lingered at a discount to NAV of 31.6% on 11 July 2024 (the last day before the initial offer for the company).

As we have argued before (see page 10 for links to previous notes), the share price has materially undervalued the company (which has been proven by the JV offer) and we believe that the discount to NAV would have continued to narrow given the quality nature of the portfolio, strong performance metrics, the company's impressive dividend history, and the potential for further earnings and valuation gains from the planned deployment of capital into value-add assets.

We believe that the current offer still undervalues the company and our detailed reasons are set out below.

Our opinion

Public markets have traditionally prescribed a discount to the independently valued portfolio of real estate companies, mainly due to the fact that valuations are by their nature backward-looking and can be perceived to be notional.

For a property sub-sector such as retail, the discount has been greater than the wider market for a number of years, due firstly to the hangover of the shift to online retailing, and then the impact of COVID, while high interest rates over the past two years has impacted the wider real estate sector. We feel that the discount prescribed to Lar España has been overdone, however.

Implied yield out of line with market

Lar España's portfolio, which is split 71% shopping centres and 29% retail parks, was valued at €1,304m on 30 June 2024, reflecting an EPRA net initial yield of 6.6% and a topped-up net initial yield of 6.9%. Its shopping centre portfolio net initial yield was 6.8% (topped-up 7.0%), while retail parks was 6.3% (6.6% topped-up). This was in line with the wider Spanish retail sector where, according to valuation and property advisory group CBRE, prime shopping centre yields at June 2024 were 7.0% and prime retail park yields were 6.5%.

Further proving the validity of its portfolio valuation, the company sold two retail park assets – Vistahermosa and Rivas Futura – for €129.1m in July 2023, at a slight premium to their book value at 31 December 2022.

After a lean few years in the Spanish retail investment market, volumes are starting to increase again, with Knight Frank stating that €1.3bn was transacted in the Spanish retail sector in the first half of 2024, back in line with pre-pandemic levels. The majority of this (just over 60%) was in the shopping centre sector, with investors attracted to the returns on offer.

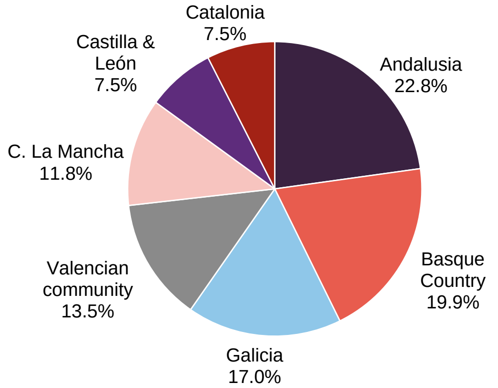
Implied yield of offer of 7.8% compares to portfolio yield of 6.6%

The offer price for Lar España implies a yield of 7.8%, which seems wholly generous. As the current offer price stands, Lar España shareholders would in our view be giving away substantial value, especially in an improving market and macroeconomic environment.

Strong portfolio characteristics

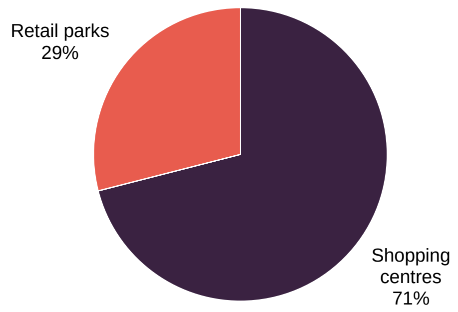
Lar España's portfolio comprises nine shopping centres and three retail parks. It has a diverse range of tenants, as shown in Figures 2 and 3, with more than 1,000 leases and an occupancy rate of 96%. Its top 10 tenants account for 34% of the company's rental income, while 65% of leases have expiries beyond 2027. The portfolio has a WAULT of 2.4 years.

Figure 2: Portfolio by region (% by value)



Source: Lar España, Marten & Co

Figure 3: Portfolio by type (% by value)



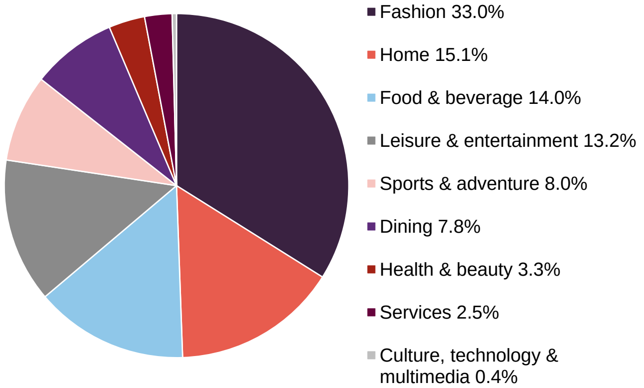
Source: Lar España, Marten & Co

Figure 4: Lar España's portfolio

Asset	Location	Gross leasable area (sqm)	WAULT (years)	Income by asset (%)
Shopping centres (GAV: €925.8m)				
Lagoh	Seville	69,734	2.9	20.1
Gran Vía	Vigo	41,496	1.8	9.7
Portal de la Marina	Alicante	40,302	2.3	9.7
El Rosal	León	50,811	2.1	8.4
Ànec Blau	Barcelona	29,098	3.3	7.8
As Termas	Lugo	35,149	2.4	6.8
Albacenter	Albacete	27,199	2.2	4.6
Txingudi	Irún (Guipúzcoa)	10,712	2.4	2.4
Las Huertas	Palencia	6,265	1.1	1.0
Retail parks (GAV: €378.2m)				
Bilbao Megapark	Barakaldo (Bilbao)	81,021	2.6	17.5
Parque Abadía	Toledo	43,109	1.7	7.1
VidaNova Parc	Sagunto (Valencia)	45,568	2.0	4.9

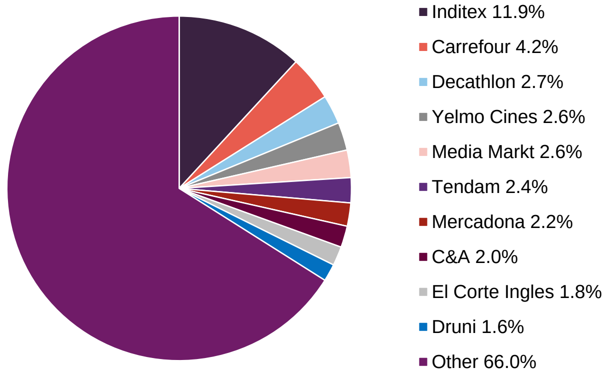
Source: Lar España, Marten & Co

Figure 5: Tenant mix by rental income (%)



Source: Lar España, Marten & Co

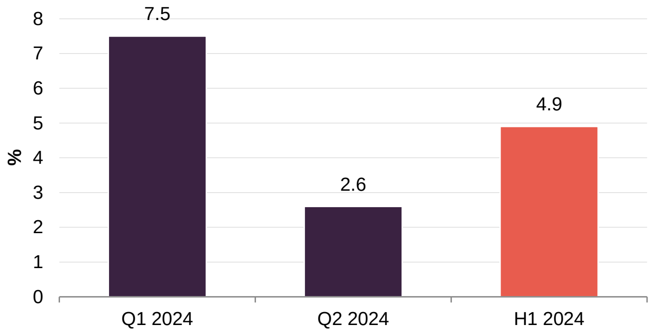
Figure 6: Tenants by rental income (%)



Source: Lar España, Marten & Co

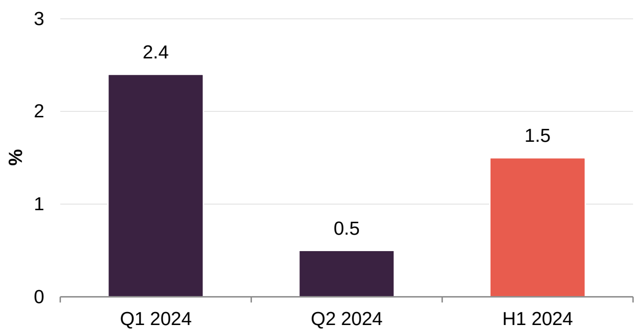
Operational metrics across Lar España's portfolio have been strong and returned to pre-pandemic levels. Sales in its shopping centres and retail parks were up 4.9% in the first six months of the year compared to the same period in 2023, as shown in Figure 7, reaching €472.3m. Footfall was also up across the period, shown in Figure 8, with 33.7m visits to its assets in the six months.

Figure 7: Sales in Lar España assets versus same period in 2023



Source: Lar España

Figure 8: Footfall in Lar España assets versus same period in 2023



Source: Lar España

The strong performance data stems from the quality of Lar España's portfolio of properties, which are mostly categorised as 'dominant' – large centres, in large catchment areas with little competition. The effort rate – a key retail performance metric that measures the ratio between the total cost to the retailer (including rent and charges) and the turnover generated at the property (also known as the occupancy cost ratio) – was at a comfortable level of 10.1%.

To highlight the strength of the portfolio and its appeal to retailers, the company carried out 74 lease agreements during the first half of the year (12 new lettings, 26 re-lettings and 36 renewals), which achieved an average rental uplift of 4.8% (excluding the inflation-linked uplifts already baked into the leases).

Future growth prospects

Asset rotation strategy underway to capture growth opportunities

Lar España had embarked on an asset rotation strategy, where it planned to sell properties where it had completed its asset management strategies and exhausted value-add opportunities and use the proceeds to acquire higher-yielding assets with value creation opportunities – either through the leasing of vacant space, refurbishments, or extensions.

After the sale of two mature retail park assets – Vistahermosa and Rivas Futura – for €129.1m in July 2023, the company's portfolio asset rotation strategy was well underway. It has around €215m in cash reserves and was in advanced discussions over a large shopping centre acquisition before the offer for the company was announced.

Sales of other mature assets in its portfolio and the redeployment of capital into higher yielding, undermanaged shopping centres could have resulted in substantial NAV and earnings growth over the medium term.

Peer group

Lar España has consistently been among the best-performing listed property companies focused on the retail sector, as shown in Figure 9. We have put together a comparison of Lar España's listed peers in Europe, including pan-European and country-specific retail landlords and a Spanish peer. The peer group we have assembled consists of: Klepierre, Eurocommercial and Carmila (which are pan-European); Hammerson (UK), Deutsche Euroshop (Germany) and Mercialys (France), which are country-specific; and Merlin (which owns Spanish real estate predominantly in the office sector). We have also used the Morningstar European REIT Index as a comparator on share price returns.

Lar España ranks among the top three over every time period in NAV terms, which has been reflected in its share price recovery over the past five years.

Figure 9: Peer group analysis

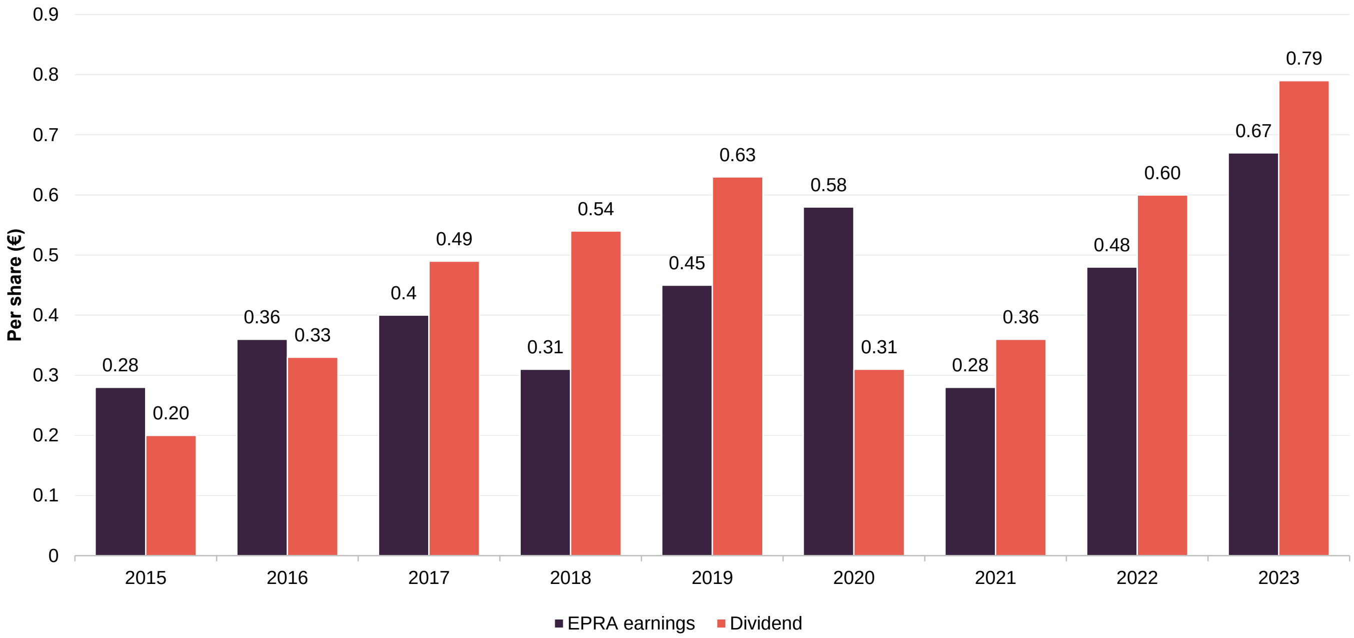
	1-year NAV TR (%)	3-year NAV TR (%)	5-year NAV TR (%)	10-year NAV TR (%)	1-year price TR (%)	3-year price TR (%)	5-year price TR (%)	10-year price TR (%)
Lar España	2.5	13.3	13.7	61.5	55.5	94.6	61.3	98.1
Klepierre	10.8	22.2	2.0	65.8	30.8	85.4	25.7	66.3
Eurocommercial	9.3	10.5	6.5	71.2	27.8	70.0	42.8	39.0
Carmila	1.9	14.5	8.5	-	30.0	67.0	64.7	-
Hammerson	(24.7)	(42.8)	(70.6)	(61.1)	33.3	9.3	(72.3)	(82.2)
Deutsche Euroshop	(0.3)	(5.4)	(13.6)	46.5	40.0	71.6	13.8	20.2
Mercialys	(0.7)	2.6	(3.7)	51.6	49.6	73.9	47.0	66.4
Merlin	1.3	9.3	18.5	-	42.9	50.1	8.0	-
Lar España rank	**3/8**	**3/8**	**2/8**	**3/6**	**1/8**	**1/8**	**2/8**	**1/6**
Morningstar European REIT index					20.3	(13.9)	(11.2)	36.7

Source: Bloomberg, Morningstar, Marten & Co. Note: performance calculated to 30 September 2024

Dividend

Another facet that shareholders would miss is Lar España's exceptional dividend. Shareholders approved the payment of the highest ordinary dividend in the company's 10-year history of €0.79 per share for 2023, which equated to a dividend yield of 12.9% based on the share price at 31 December 2023. The dividend was made up of 100% of ordinary EPRA earnings in 2023 (€0.67 – also the highest in its history and up 39.6% on 2022) plus 50% of the capital gains obtained from the disposal of the two retail park assets (mentioned earlier). The company has paid out a total of €391.2m in dividends over its 10-year history.

Figure 10: Dividend history since launch



Source: Lar España, Marten & Co

Borrowings

Debt has an average cost of 1.8% and average maturity of 3.3 years

Shareholders have also become accustomed to one of the strongest balance sheets in the European real estate sector. The majority of Lar España's borrowings is made up of two bonds. It raised €700m through the issuance of two unsecured senior green bonds in 2021 (€400m in July and €300m in October). The €400m bond matures in 2026 and has a fixed annual coupon of 1.75%, while the €300m bond has a fixed annual coupon of 1.84% and matures in 2028. During 2023, Lar España bought back €119m of bonds, leaving the total value of bonds in circulation of €581m.

The company also has €70m of corporate green loans, which mature in 2026 and 2027. The group's total debt stands at €651m, equating to a net loan to value (LTV) ratio of 33.4% at June 2024. The debt has an average cost of 1.8% and an average maturity of 3.3 years. Rating agency Fitch renewed its investment grade of BBB (stable) rating to both Lar España and the green bond issues in July 2024.

Next steps

As well as Castellana Properties, the offer is thought to have the support of Brandes Investment Partners, which owns 5.0% of shares, and other smaller shareholders, but still below the 56.38% required (excluding Grupo Lar's shareholding).

The offer still needs to be reviewed and cleared by the National Securities Market Commission (CNMV), the Spanish merger control authority. Lar España's board said that it would express its opinion on the offer after the CNMV's authorisation and within 10 days of the commencement of the offer acceptance period.

Previous publications

QuotedData has previously published five notes on Lar España. You can read them by clicking the links below.

Figure 11: QuotedData's previously published notes on Lar España

Title	Note type	Publication date
Built to last	Flash note	3 December 2020
Ducks in a row	Flash note	16 November 2021
Dominant assets make a resilient business	Initiation	14 March 2023
Defying the retail gloom	Update	19 October 2023
10-up and more growth to come	Annual overview	17 May 2024

Source: Marten & Co

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