

# Taliesin Property Fund Limited

1 October 2008

United Kingdom/Other Financial Services  
Investment Research

## Buy

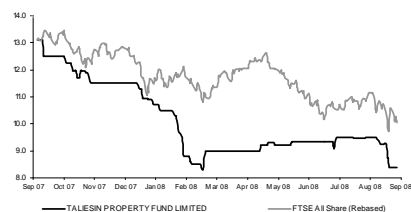
Recommendation unchanged

Share price*: EUR	7.88
Target price: EUR	12.17

Target Price unchanged

Reuters/Bloomberg	TPF.L/TPF LN
Accounting Standard/Since	IFRS/2007
Market capitalisation (EURm)	30.0
No. of shares (m)	3.6
Free float	0.0%
Daily avg. no. trad. sh. 12 mth	160
Daily avg. trad. vol. 12 mth (m)	0.00
Price high 12 mth (EUR)	13.25
Price low 12 mth (EUR)	8.30
Abs. perf. 1 mth	-11.8%
Abs. perf. 3 mth	-10.4%
Abs. perf. 12 mth	-36.8%

(EUR)	12/07	12/08e	12/09e
Revenue	4,197	5,378	5,798
Op. expenses	(3,659)	(3,728)	(3,467)
Op. profit before FVA	538	1,650	2,331
FVA including acq costs	7,506	4,144	2,109
Net finance costs	(884)	(1,960)	(1,979)
Tax charge (inc. def tax)	(1,058)	(801)	(283)
Profit from cont. op.	6,102	3,033	2,178
Exceptional gain/ (loss)	(1,057)	0	0
Att to equity holders	5,044	3,033	2,178
NAV	41,821	45,341	47,420
EPRA NAV	42,945	46,706	49,150
P/E(adj.)	5.54	11.09	15.45
P/NAV	77%	72%	68%
EPS (diluted)	1.7	0.8	0.6
NAVps	12.17	13.0	13.7



Source: Expert  
**Shareholders:** Rytu Invest AB 13%; RAB Special Situations Master Fund 11%; Sarastro Limited 8%; F&C UK Dynamic Fund 6%; Standard Bank nominee 5%; EB Trustees Limited 4%; J.A Haller 4%; Citco Global Custody NV JPMS 4%; M Milbourn 4%; F&C UK Special Situations Fund 3% & Weistal Business Inc 3%

\*closing price as of 30/09/2008

## Deeply undervalued

- **H1 2008 in-line with our expectations:** Despite getting hit by AIM listing expenses of €378,460 and rental arrears of €113,000, Taliesin's adjusted NAV per share rose to €12.23 from €12.17 at FY 2007 – notwithstanding the fact that no revaluation was done of its properties. The Company benefited from positive average rental reviews. The average vacancy rate and the level of non-payers as a proportion of total rent also showed marked improvement. The cost of funding remained well-capped at 5% with continued access to mortgage finance.
- **Potential for NAV uplift:** We believe adjusted NAV per share will see an uplift at FY2008e as the Company revalues its portfolio. The positive fundamentals of the Berlin residential market remains intact with 8 out of 12 districts of the city showing a positive outlook for rent development – see page 5. We believe that a minimum of 3% uplift in property values is likely by the year-end, which will increase adjusted NAV per share to €13.
- **Berlin remains insulated:** Berlin continues to avoid the worst of the credit crunch, mainly induced by property devaluation in a number of geographies. Berlin residential market, which remains deeply undervalued as compared to other European cities, is seeing a positive rental growth supported by positive demographics – see page 5.
- **Comfortable with our estimates:** We remain comfortable with our estimates. However, we have revised down our cash balance to €1.8m from €10.7m. This is mainly due to acquisition of 9 buildings during the year. The Company still has €4m undrawn agreed facility from Eurohypo.
- **Conclusion & Action: Reiterate Buy.** Given its pure Berlin exposure and the quality of its portfolio, the current share price does not justify a 31% discount to its H1 2008 NAV – which we believe is greater given the properties were not revalued at the half year to 30 June 2008. We believe the stock provides an attractive entry point for property investors willing to take advantage of the Berlin property market without the difficulties attached to it. *Also see our detailed initiation note 'Berlin: Attractive Choice for Capital'.*

## Company profile

Taliesin Property Fund Limited (Taliesin) is a Jersey domiciled, AIM quoted property investment Company. The Company was formed to exploit growth opportunities in the residential property market of Berlin and in other cities in the former German Democratic Republic. Taliesin received its first subscriptions in March 2006 and was listed on AIM on 28 August 2007. To date the Company has raised €37.8m of equity and the portfolio consists of 53 properties valued at €90.6 m.

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**Figure 1: Triple NAV (NNNAV)**

	2006	2007	2008e	2009e
NAV (EUR '000)	21,824	41,821	45,341	47,420
Deferred Taxation	703	1,760	2,001	2,366
Goodwill	(1,692)	(636)	(636)	(636)
<b>European Public Real Estate Association NAV*</b>	<b>20,835</b>	<b>42,945</b>	<b>46,706</b>	<b>49,150</b>
<b>Number of shares</b>	<b>2,287,650</b>	<b>3,537,650</b>	<b>3,537,650</b>	<b>3,586,020</b>
Shares issuable in lieu of performance fee	0	48,370	48,370	0
Adjusted shares	2,287,650	3,586,020	3,586,020	3,586,020
<b>EPRA NAV per share (EUR) *</b>	<b>9.11</b>	<b>11.94</b>	<b>12.98</b>	<b>13.66</b>
<b>EPRA NAV (adj. NAV) *</b>	<b>20,835</b>	<b>42,945</b>	<b>46,706</b>	<b>49,150</b>
Less: Fair value adjustments for debt and derivatives	0	0	0	0
Less: Deferred taxation and capital allowances	(1,334)	(2,579)	(3,376)	(3,656)
Less: Intangibles	(1,692)	(1,455)	(2,011)	(1,927)
<b>EPRA NNNAV *</b>	<b>17,809</b>	<b>38,912</b>	<b>41,320</b>	<b>43,567</b>
<b>EPRA NNNAV per share *</b>	<b>7.78</b>	<b>10.81</b>	<b>11.48</b>	<b>12.11</b>

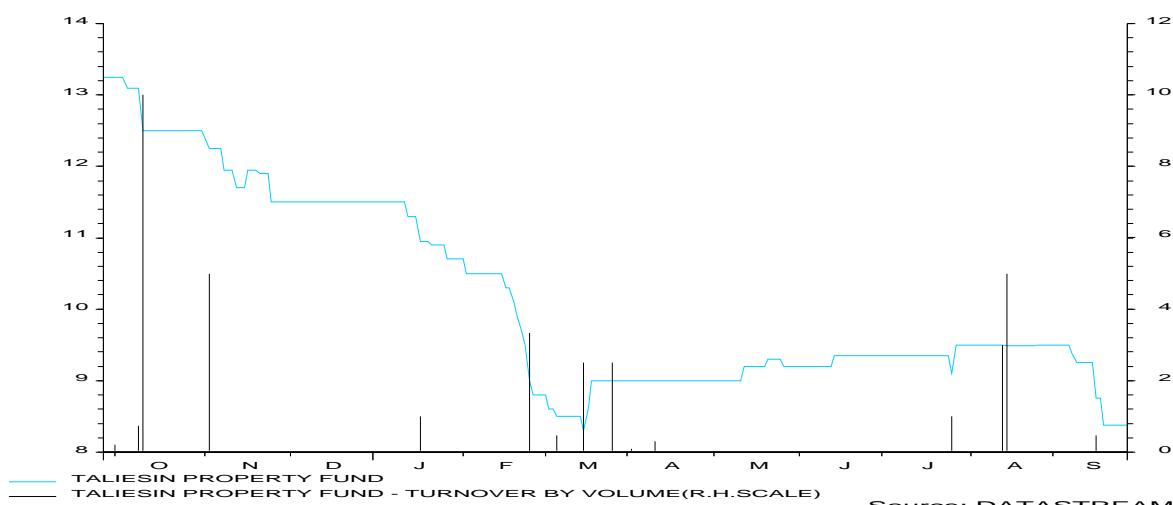
\* NAV calculated as per EPRA guidelines

Source: Company Accounts, NCB

**Figure 2: SWOT Analysis**

STRENGTHS	WEAKNESSES
<ul style="list-style-type: none"> <li>Experienced management with local market presence.</li> <li>The Company's acquired portfolio is below its replacement cost.</li> <li>Backdrop of improving jobless trend and good German economy.</li> </ul>	<ul style="list-style-type: none"> <li>German ZEW survey indicates that the German economy is entering a period of weaker growth.</li> <li>Property may not be an attractive investment given the world financial system is actively de-leveraging.</li> </ul>
OPPORTUNITIES	THREATS
<ul style="list-style-type: none"> <li>Young population with rising income are demanding quality apartments. Taliesin can successfully exploit this opportunity and increase its rental income.</li> </ul>	<ul style="list-style-type: none"> <li>Credit crisis affecting a number of property investors, which may lead to a lack of demand for properties or result in forced sales, which could depress property prices.</li> <li>Interest rates are expected to rise further to curb Euro zone inflation rate.</li> </ul>

**Figure 3: Historic price performance**



Source: DATASTREAM

Source: DataStream

## H1 2008: in-line with our expectations

### Key highlights

- **Slight uptick in NAV despite no revaluation:** Adjusted NAV per share increased marginally to €12.23 compared to €12.17 at FY 2007. It is worth noting that, consistent with the Company's policy, the property portfolio was not revalued at the end of the six months to 30 June 2008. We believe there will be a minimum of 3% uplift in property values by the year-end, which will increase adjusted NAV per share to €13 at FY 2008e.
- **New acquisitions at attractive prices and yields:** Taliesin acquired 9 buildings in January 2008, at a cost of €22.9m. These properties, all based in Berlin, were acquired at attractive initial rental yields with an average acquisition price of less than €1,000 per sqm – well below their replacement costs.
- **Continued access to mortgage finance:** The Company continued to enjoy access to mortgage finance at attractive rates. Average cost of borrowing is capped at 5%. Taliesin's primary lender is Eurohypo, which has provided a €37.5m credit facility against which €33.5m had been drawn at the reporting date.
- **Cash/cash equivalent balance of €1.5m:** Taliesin had cash/ cash equivalent balance of around €1.5m at H1 2008. We believe this cash position will marginally increase to €1.8m at FY 2008e.
- **Declining vacancy rates:** Vacancy rates also showed positive movement. The current vacancy rate across the portfolio is approximately 6.1% as compared to 6.5% at FY 2007.
- **Benefited from new property managers:** The Company's appointment of new property managers resulted in a marked improvement in non-payers rate – currently at less than 2.5% of total rent, and lower vacancy rates.

The acquisition of new properties, reduction in vacancy rates and improvement in non-payers combined has boosted operating revenue by circa 48% as compared to last year.

## Portfolio update

	30 Jun 2008	31 Dec 2007
<b>No. of properties</b>	<b>53</b>	<b>44</b>
- Berlin	39	30
- Potsdam	6	7
- Dresden	4	4
- Leipzig	4	3
<b>Market value/purchase price</b>	€90.6m <sup>see Note (a)</sup>	€63.6m
<b>Borrowings</b>	€50.7m	€35.5m
<b>Adjusted net assets per share</b>	€12.23	€12.17
<b>Cash</b>	€1.5m	€14.7m
<b>Average rent yield</b>	7.03%	6.80%
<b>Vacancy rate</b>	6.1%	6.5%

### Additions:

28 January 2008

Four residential buildings in Berlin, located in Friedrichshain, Kreuzberg, Wannsee and Spanda, for €6.55m. The seller has provided a rent guarantee and the portfolio has been extensively refurbished. Based on the rent guarantee the expected yield is 7.2% and there is scope for rent increases through active asset management.

Seven residential buildings in Berlin with a slightly lower initial yield of 6.2%. The management believes that the properties have the potential capacity for higher rents. These buildings were acquired for a sum of €13.25m.

Two buildings in the Berlin's borough of Pankow were acquired for a sum of €2.49m. The buildings are modern apartment blocks containing 30 residential and 2 commercial units. The management believes that the properties can achieve yields of over 7.5%.

### Worth noting:

#### Note (a)

**Properties are not revalued:** Consistent with the fund's policy, Taliesin Property Fund has not revalued its existing properties at the half year to 30 June 2008 and these are carried in the accounts at their 31 December 2007 year end valuations. Newly acquired properties are carried at cost with acquisition expenses capitalised.

**Outlook: Berlin**

Berlin as compared to other metropolitan cities of Europe has been relatively less affected by the global credit crunch. The market fundamentals remain sound and the significant undervaluation of property provides a cushion against the market uncertainty.

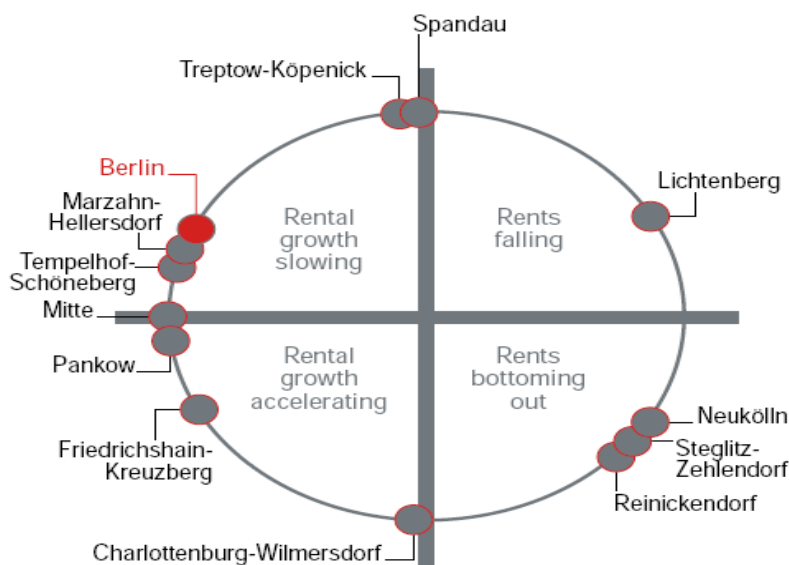
**Rents are rising**

Low ownership of property – a modest 13%, can easily make Berlin, the city of tenants. Jones Lang LaSalle report that the average rental offer prices increased in Berlin as well as in the majority of its districts in the first half of 2008. The average monthly rental prices were 5.90-6.20 €/m<sup>2</sup>. The highest rental prices are currently achieved in the Charlottenburg-Wilmersdorf district, where average monthly prices range between 6.95-7.45 €/m<sup>2</sup>. The increase in the most commonly achieved rental prices was 2.5% in comparison with the previous half year. The highest growth rates were achieved in Charlottenburg-Wilmersdorf (7.2 %) and Friedrichshain-Kreuzberg (5.0 %). However, the recent low level increases in certain areas can be explained by the fact that many investors have realised rent increases for their properties within the last three years. This led to a significant increase in average rental offer prices, but in future the continued demand for modern living space will likely lead to further rent increases. On the property clock, eight of the twelve districts showed positive rental price development.

**Figure 4: Residential Property Clock**

**Residential Property Clock**

Source: Jones Lang LaSalle GmbH



Source : Jones Lang LaSalle

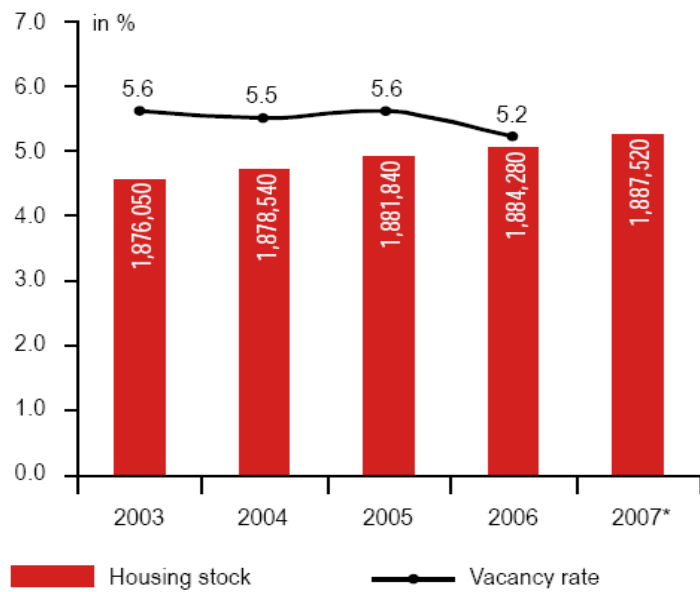
**Positive demographic development is changing the demand:**

Jones Lang LaSalle attributes the positive demographic trends to two key factors: (a) on one hand the expected change in the population and on the other the changes in household size, which has had tremendous effects on the housing market in Berlin. Of the 1.9m Berlin households, more than half are single-person households. Particularly in the last six years the number has grown significantly. In the districts of Friedrichshain-Kreuzberg (57.5 %), Charlottenburg-Wilmersdorf (54.4 %), Pankow (54.1 %) and Mitte (52.6 %) the number is well above the average. (b) Meeting the accommodation requirements of this target group represents a new challenge for the Berlin housing market. This currently results in comparatively high rental offer prices for smaller apartments.

However, Residential stocks in Berlin grew only slightly in the past few years, due to the continued low level of building activities. At the beginning of 2008, total stock stood at 1.89 million residential units. In comparison with the previous year this represent growth of 3,240 units or 0.2 %. The vacancy rate has decreased to around 98,000 residential units according to the Techemempirica vacancy index, representing a rate of 5.2 %.

This supply/demand mismatch is resulting in lower vacancies, which is positively affecting the rental income.

**Figure 5: Housing stock and vacancy rate**



Sources: Statistics Office Berlin-Brandenburg, Techem-empirica vacancy index

\*The vacancy index for 2007 will be published in autumn 2008

Source : Jones Lang LaSalle

## NCB Forecasts

### ➤ Capital values

We expect the property value to rise by 3.3% in FY2008e and by 2% in FY2009e.

### ➤ Rental Values

We expect Taliesin rental income to rise in-line with the inflation rate. Active asset management by the investment manager should also enhance the rental potential. Nevertheless, we have assumed the vacancy rate for 2008e and 2009e to be similar to that of 2007.

### ➤ Shares in issue

We have assumed the shares in issue to remain similar to that at the end of 2007 with an exception to the investment management fee paid to TML in the form of shares in 2008.

	2006	2007	2008e	2009e
Shares in issue	2,287,650	3,537,650	3,586,020	3,586,020
Basic weighted number of shares (m)	1,932,970	3,537,650	3,586,020	3,586,020
Diluted number of shares (m)	1,932,970	3,537,650	3,586,020	3,586,020

### ➤ Expenses

Taliesin experienced higher expenses last year as it listed on AIM. We expect expenses to decline in 2008e and gradually increase in 2009e.

### ➤ Finance costs

Taliesin benefits from a fixed rate funding at 5%. The Company's funding is fixed for 5 years.

### ➤ Cash balance

Taliesin had €14.7m in cash at FY2007. Since then the Company has acquired more properties. We estimate that Taliesin will have a cash balance of around €1.8m at FY2008e. It is worth noting that Taliesin has an undrawn agreed facility of around €4m with Euro Hypo Bank.

## Financials

### P&L Analysis

Profit and loss account (Euro '000)	2006	2007	2008e	2009e
<b>Revenue</b>	<b>FY</b>			
Rental Income	1,019	4,190	5,370	5,789
Other operating income	2	6	8	9
<i>Service revenue as proportion to net rental income</i>	<i>0.20%</i>	<i>0.15%</i>	<i>0.15%</i>	<i>0.15%</i>
<b>Total operating revenues</b>	<b>1,021</b>	<b>4,197</b>	<b>5,211</b>	<b>5,798</b>
Organisational costs	(121)	0	0	0
Administrative costs	(88)	(151)	(400)	(440)
Investment advisory	(415)	(731)	(900)	(966)
Performance fee	0	(927)	(240)	(160)
Bank Charges	(7)	(9)	(15)	(17)
Director fees	(45)	(104)	(120)	(122)
Legal and professional fees	(281)	(584)	(280)	(288)
AIM admission	0	(252)	(378)	0
Other operating expenses	(57)	(542)	(806)	(868)
Provision for bad debts	(54)	(185)	(333)	(336)
Exempt Company fees	(2)	(2)	(2)	(2)
Audit fees	(18)	(170)	(255)	(267)
Foreign exchange difference	(1)	(3)	0	0
<b>Total administration expenses</b>	<b>(1,088)</b>	<b>(3,659)</b>	<b>(3,728)</b>	<b>(3,467)</b>
<i>Tot admin. expenses as % of rental income</i>	<i>106.57%</i>	<i>87.18%</i>	<i>69.32%</i>	<i>59.79%</i>
<b>Operating profit</b>	<b>(67)</b>	<b>538</b>	<b>1,650</b>	<b>2,331</b>
<b>Op. profit before gains/(losses) on inv. Prop.</b>				
Net gains from FVA on investment properties	(1,154)	9,417	5,314	1,871
Property acquisition costs	(418)	(1,902)	(2,374)	0
FVA gains/ (losses) on financial assets	(18)	(9)	1,203	238
<b>Operating profit</b>	<b>(1,656)</b>	<b>8,044</b>	<b>5,794</b>	<b>4,440</b>
<i>Net operating margin</i>	<i>-162.22%</i>	<i>191.68%</i>	<i>107.73%</i>	<i>76.58%</i>
Finance income	177	749	574	474
Finance costs	(174)	(1,633)	(2,534)	(2,453)
<i>Interest Cover (x)</i>	<i>-8.48</i>	<i>5.38</i>	<i>2.51</i>	<i>2.00</i>
<b>Total finance costs</b>	<b>2</b>	<b>(884)</b>	<b>(1,960)</b>	<b>(1,979)</b>
Exceptional gain/ (loss)	0	(1,057)	0	0
<b>Profit before tax</b>	<b>(1,654)</b>	<b>6,102</b>	<b>3,834</b>	<b>2,461</b>
Taxation - current	369	(1)	(4)	(2)
Taxation - deferred	0	(1,057)	(797)	(281)
<b>Tax charge on profit</b>	<b>369</b>	<b>(1,058)</b>	<b>(801)</b>	<b>(283)</b>
<i>Tax rate - current</i>	<i>22.33%</i>	<i>0.01%</i>	<i>0.10%</i>	<i>0.10%</i>
<i>Tax rate - deferred</i>	<i>0.00%</i>	<i>17.33%</i>	<i>20.79%</i>	<i>11.41%</i>
Profit from continuing operations	(1,285)	5,044	3,033	2,178
Discontinued operations:				
Loss from discontinued operations after tax	0	0	0	0
<b>Profit for the period from continuing ops</b>	<b>(1,285)</b>	<b>5,044</b>	<b>3,033</b>	<b>2,178</b>
<b>Retained profit for the year</b>	<b>(1,285)</b>	<b>5,044</b>	<b>3,033</b>	<b>2,178</b>
Basic earnings per ordinary share (€)	(0.66)	1.72	0.84	0.61
Diluted earnings per ordinary share (€)	(0.66)	1.69	0.84	0.61
Dividend per share (€)	-	-	-	-

## Balance Sheet

Balance Sheet (Euro '000)	2006	2007	2008e	2009e
<b>Non-current assets</b>				
Investment properties	33,650	63,638	93,569	95,440
Property acquisitions yet to complete	737	518	12	12
Goodwill	1,692	636	636	636
Deferred Taxation	631	819	1,374	1,290
Investments held at fair value through profit or loss	865	567	863	949
Derivative financial assets	0	411	1,614	1,852
	37,575	66,588	98,069	100,180
<b>Current assets</b>				
Cash and cash equivalents	3,153	14,774	1,855	1,905
Investments held at fair value through profit & loss account		247	1,562	1,718
Other receivables	705	1,983	2,578	2,733
<i>Debtors as percentage of rental income</i>		47.33%	48.01%	47.21%
	3,858	17,005	5,996	6,357
<b>Total assets</b>	41,433	83,593	104,064	106,537
<b>Non-current liabilities</b>				
Borrowings	(16,013)	(34,818)	(49,948)	(49,948)
Deferred income tax	(1,334)	(2,579)	(3,376)	(3,656)
	(17,347)	(37,396)	(53,324)	(53,604)
<b>Current liabilities</b>				
Financial liabilities	(952)	(643)	(730)	(436)
Other liabilities and payables	(1,310)	(3,126)	(4,064)	(4,470)
	(2,262)	(3,769)	(4,794)	(4,907)
<b>Total liabilities</b>	(19,609)	(41,166)	(58,117)	(58,511)
<b>Net Assets</b>	21,824	42,427	45,947	48,026
<b>Equity Capital and reserves</b>				
Share Capital	0	37,877	38,443	38,443
Other reserves	22,876	556	477	378
Retained earnings	(1,285)	3,388	6,421	8,600
<b>Minority interest</b>	233	606	606	606
<b>Total equity</b>	21,824	42,427	45,947	48,026
Adjusted NAV (p)	9.0	12.1	13.0	13.7
Statutory NAV (p)	9.4	11.8	12.6	13.2
<i>Growth in NAV</i>	na	25.3%	6.6%	4.6%
Adjusted gearing	90.8%	120.8%	114.5%	109.8%

## Cash flow Analysis

Cash flow Euro '000)	2006	2007	2008e	2009e
<b>Operating profits/ (loss) for the period</b>			3,033	2,178
Add back: deferred tax			297	281
Add back: net interest expense <i>(deducted below)</i>			2,602	1,979
Add back: non-cash element of performance fee			0	0
<b>Adjustment for non-cash item:</b>				
Fair value adjustments			(6,518)	(2,109)
Property Acquisition Costs <i>(included below)</i>			2,374	0
<b>Changes in working capital</b>				
Other payables			938	406
Other receivables			(595)	(155)
<b>Net cash flows from operating activities</b>	763	(224)	2,131	2,580
<b>Net cash generated from operating activities</b>	763	(224)	2,131	2,580
<b>Cash flow from investing activities</b>				
Purchase of investment properties	(22,237)	(20,115)	(27,644)	0
Refurbishment of investment properties held	(209)	(237)	(506)	(0)
Acquisition of subsidiaries	(4,792)	0	0	0
Interest received	177	291	504	680
Investment income received	17	42	0	0
<b>Net cash outflow from investing activities</b>	(27,044)	(20,019)	(27,646)	680
<b>Cash flows from financing activities</b>				
Proceeds of issues of share capital	22,876	15,000	0	0
Organisational costs	(121)	0	0	0
Proceeds from borrowings	6,616	19,504	15,130	0
Loan repayments	(53)	(1,007)	0	0
Interest paid	(174)	(1,633)	(2,534)	(3,210)
<b>Net cash inflow from financing activities</b>	29,144	31,864	12,596	(3,210)
<b>Net increase in cash and cash equivalents</b>	2,863	11,621	(12,919)	50
Cash and cash equivalents at the beginning of the year	290	3,153	14,774	1,855
<b>Cash and cash equivalents at the end of the year</b>	3,153	14,774	1,855	1,905





## ESN Recommendation System

The ESN Recommendation System is **Absolute**. It means that each stock is rated on the basis of a **total return**, measured by the upside potential (including dividends and capital reimbursement) over a **12 month time horizon**.

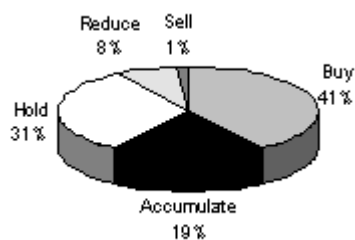
The ESN spectrum of recommendations (or ratings) for each stock comprises 5 categories: **Buy, Accumulate (or Add), Hold, Reduce and Sell (in short: B, A, H, R, S)**.

Furthermore, in specific cases and for a limited period of time, the analysts are allowed to rate the stocks as **Rating Suspended (RS)** or **Not Rated (NR)**, as explained below.

### Meaning of each recommendation or rating:

- **Buy:** the stock is expected to generate total return of **over 20%** during the next 12 months time horizon
- **Accumulate:** the stock is expected to generate total return of **10% to 20%** during the next 12 months time horizon
- **Hold:** the stock is expected to generate total return of **0% to 10%** during the next 12 months time horizon.
- **Reduce:** the stock is expected to generate total return of **0% to -10%** during the next 12 months time horizon
- **Sell:** the stock is expected to generate total return **under -10%** during the next 12 months time horizon
- **Rating Suspended:** the rating is suspended due to a capital operation (take-over bid, SPO, etc) where the issuer of the document (a partner of ESN) or a related party of the issuer is or could be involved or to a change of analyst covering the stock
- **Not Rated:** there is no rating for a Company being floated (IPO) by the issuer of the document (a partner of ESN) or a related party of the issuer

### NCB Stockbrokers Ratings Breakdown

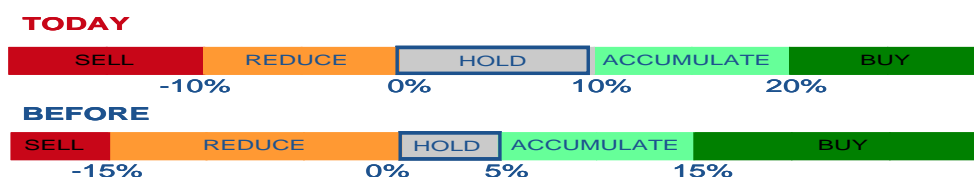


### History of ESN Recommendation System

**Since 18 October 2004**, the Members of ESN are using an Absolute Recommendation System. Prior to then, ESN followed a Relative Recommendation System to rate any single stock under coverage.

**Since 4 August 2008**, the ESN Rec. System has been amended as follow.

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