START ANALYSIS CRESUD

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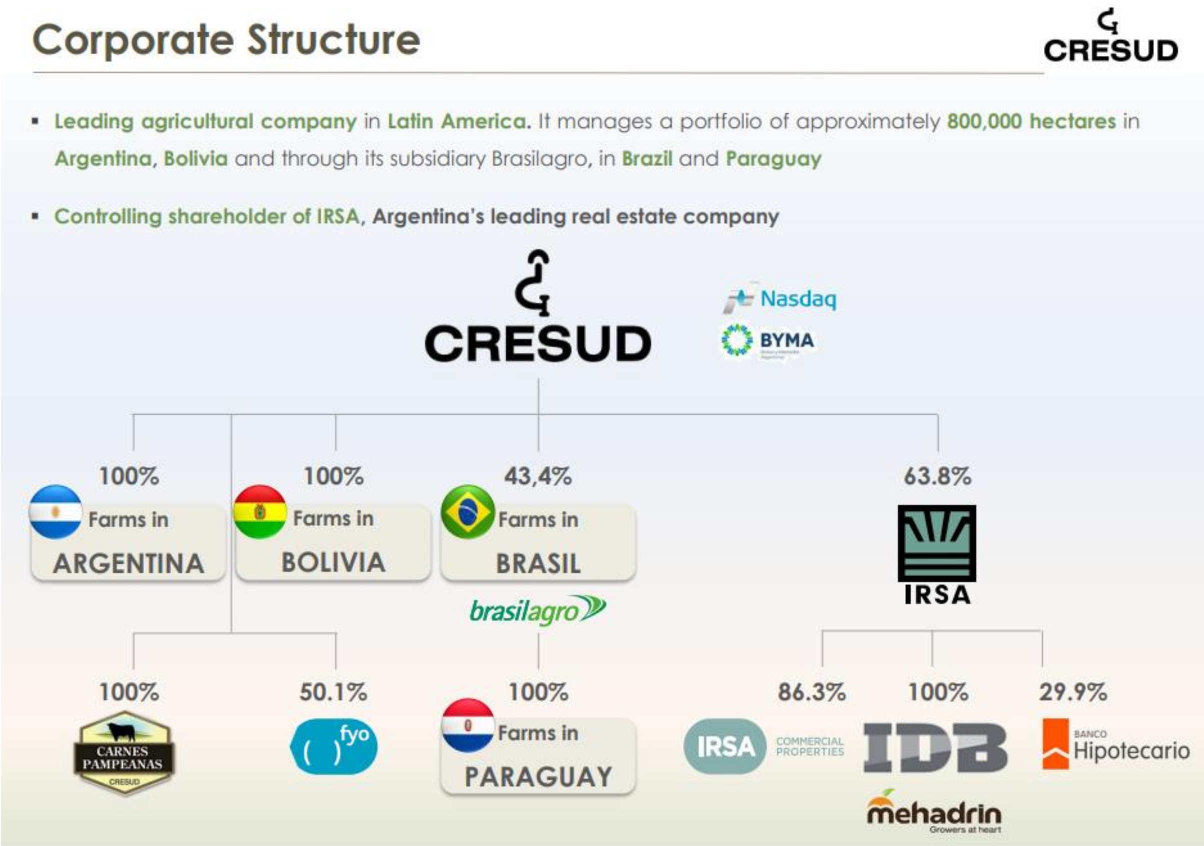


IRSA PROPRIEDADES COMERCIALES – NASDAQ: IRCP

NOTE: TRADED ON NASDAQ AND BYMA WITH TICKER IRCP – 1 ADS equals 4 common stock

Capital stock: 126,014,050 common shares = 31.5 million ADSs

Introduction

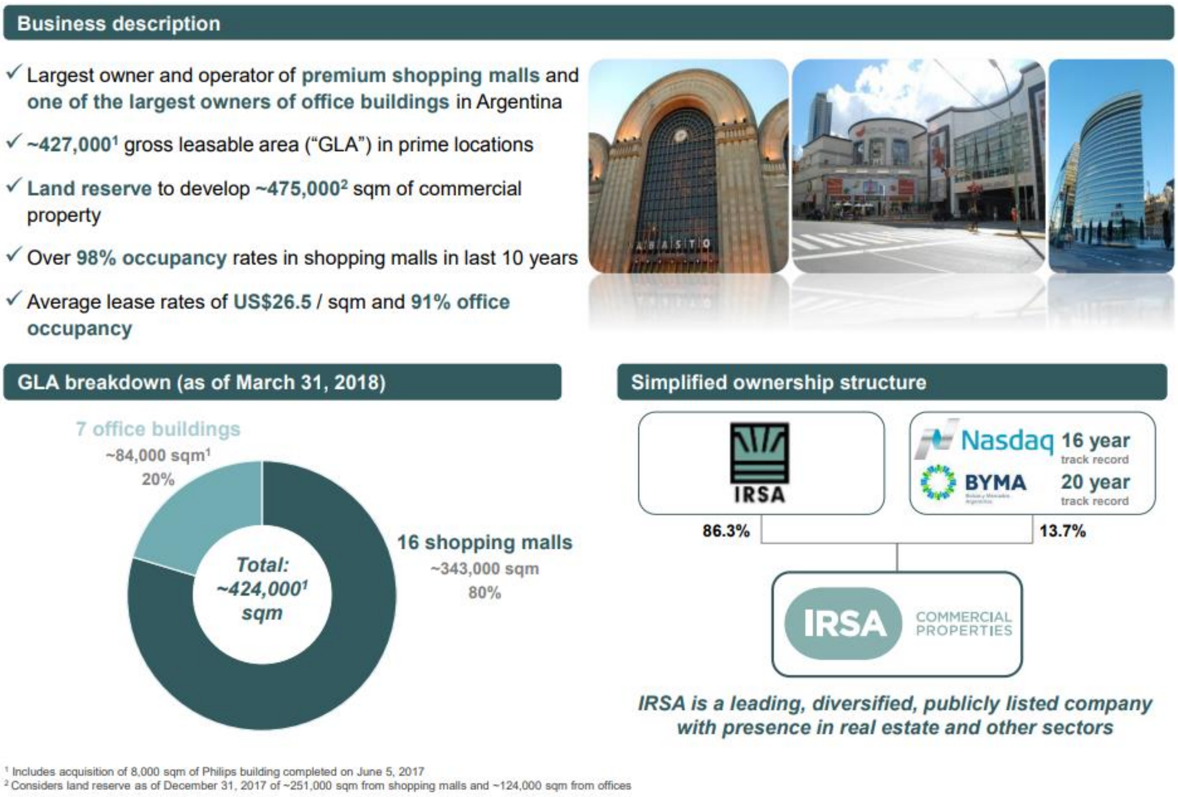
IRCP is owned by IRSA which is consequently owned by CRESUD (CRESY). This is part of my full bottom up analysis on CRESY. IRSA owns 86.3% of IRCP while the remaining is traded on the NASDAQ stock exchange and in Argentina. (this will be used later when we make the sum of parts and cash flow value of CRESY)

IRCP is an Argentine real estate company that is mostly invested in malls in Argentina. It is not really a REIT as the US net income distributions rules do not apply on IRCP. However, with REITs and real estate the keys to look at are the properties, the strategy, the debt and the cash flows or AFFOs (adjusted funds from operations). AFFOs give a better picture than earnings as those are skewed due to depreciation. Real estate usually goes up in value and doesn't depreciate except for accounting benefits. Cash flows can be used for various things so AFFO is the best measure and most commonly used.

Company overview and growth plans

IRCP owns mostly shopping malls and 20% of gross leasable area (GLA) is for office buildings. All in Argentina.

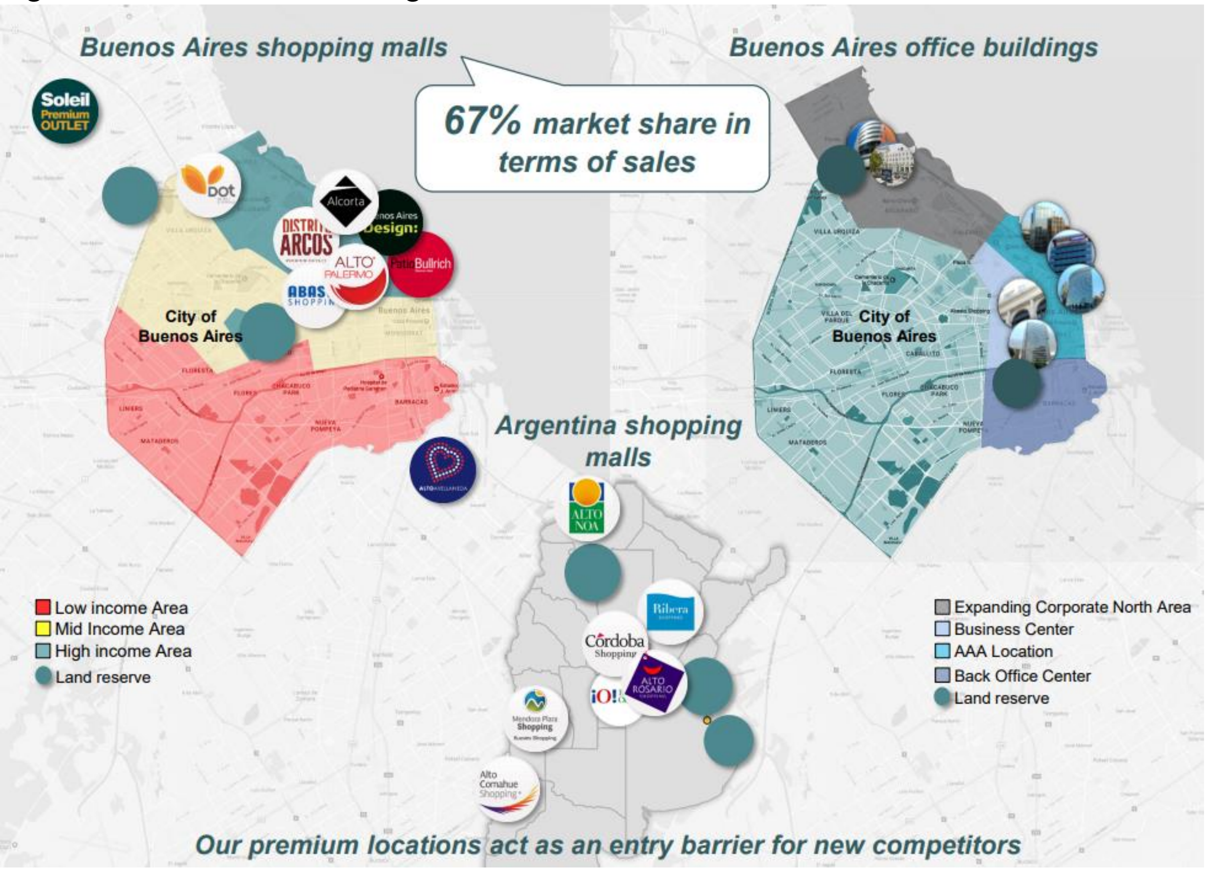
Figure 1 IRCP company overview



Source: [IRCP]

As with real estate it is always about location, location, location, IRCP is keen to show how its real estate is mostly in prime locations.

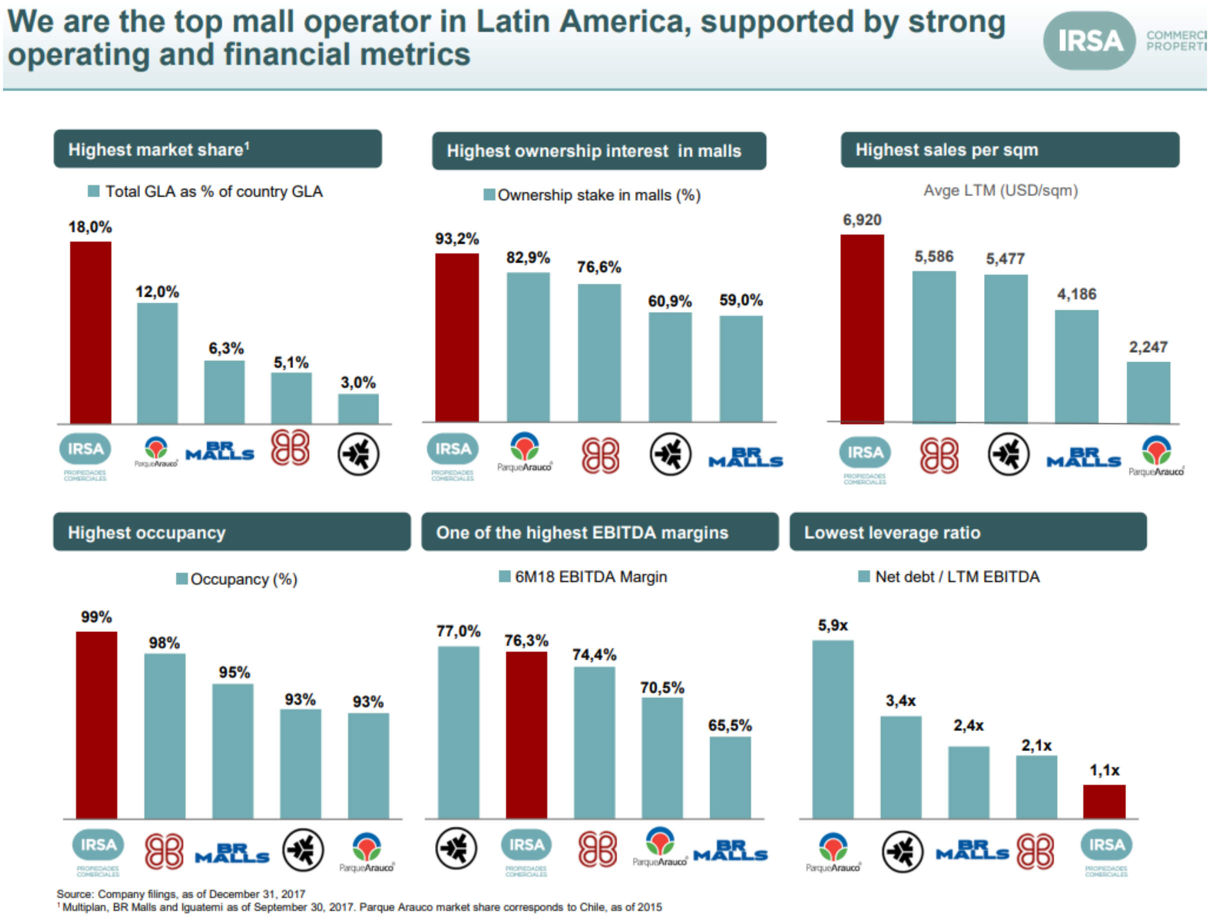
Figure 2 IRCP's assets are in high income locations



Source: [IRCP]

Good locations lead to great comparative numbers.

Figure 3 IRCP and the competition



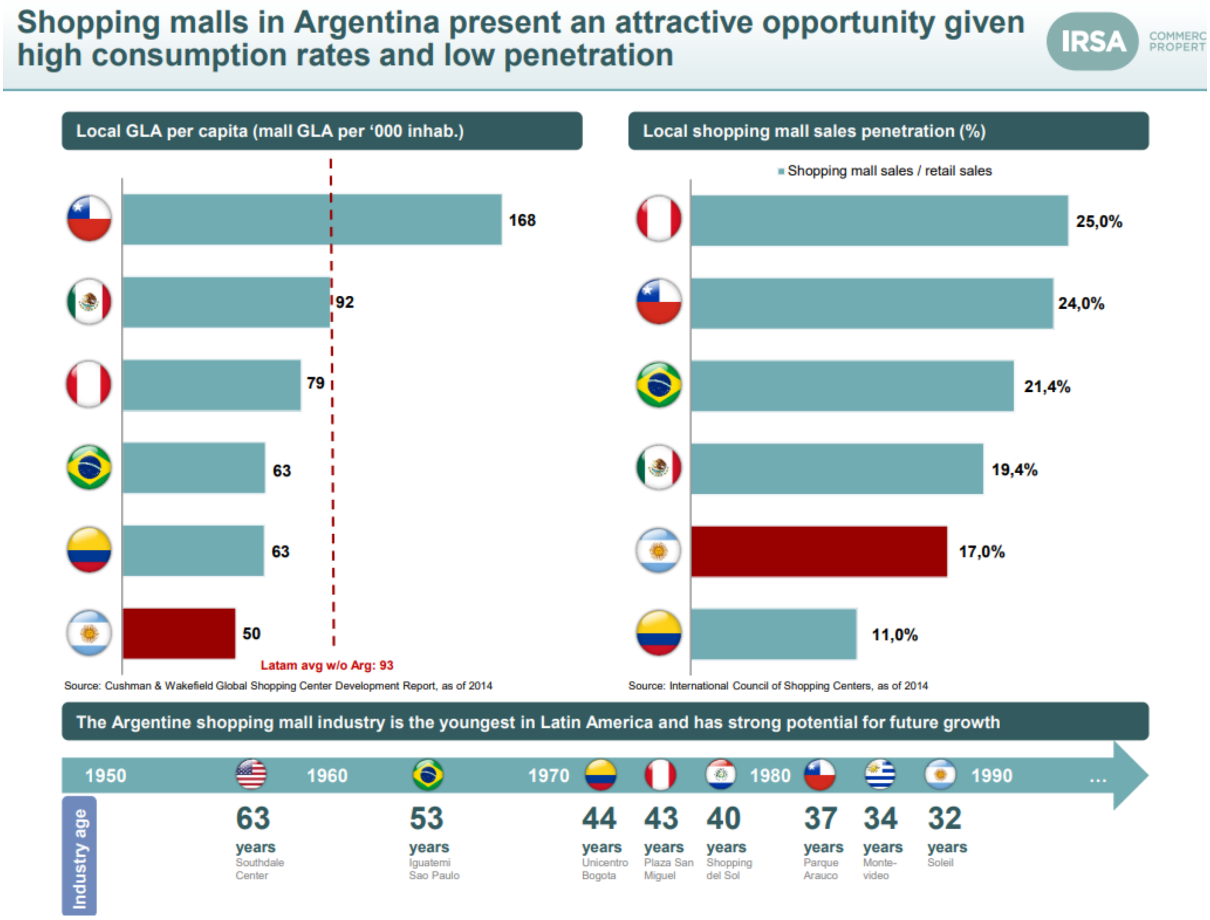
Source: [IRCP]

Highest sales, occupancy with the lowest leverage ratio make IRCP a good looking play. This is also why it has an AA local Fitch ratio and a B+ global ratio. I like the low leverage ratio but that is something to dig deeper into.

Growth strategy

According to IRCP, Argentina is underdeveloped when it comes to shopping malls and there is still a great opportunity for growth.

Figure 4 LATAM shopping mall situation

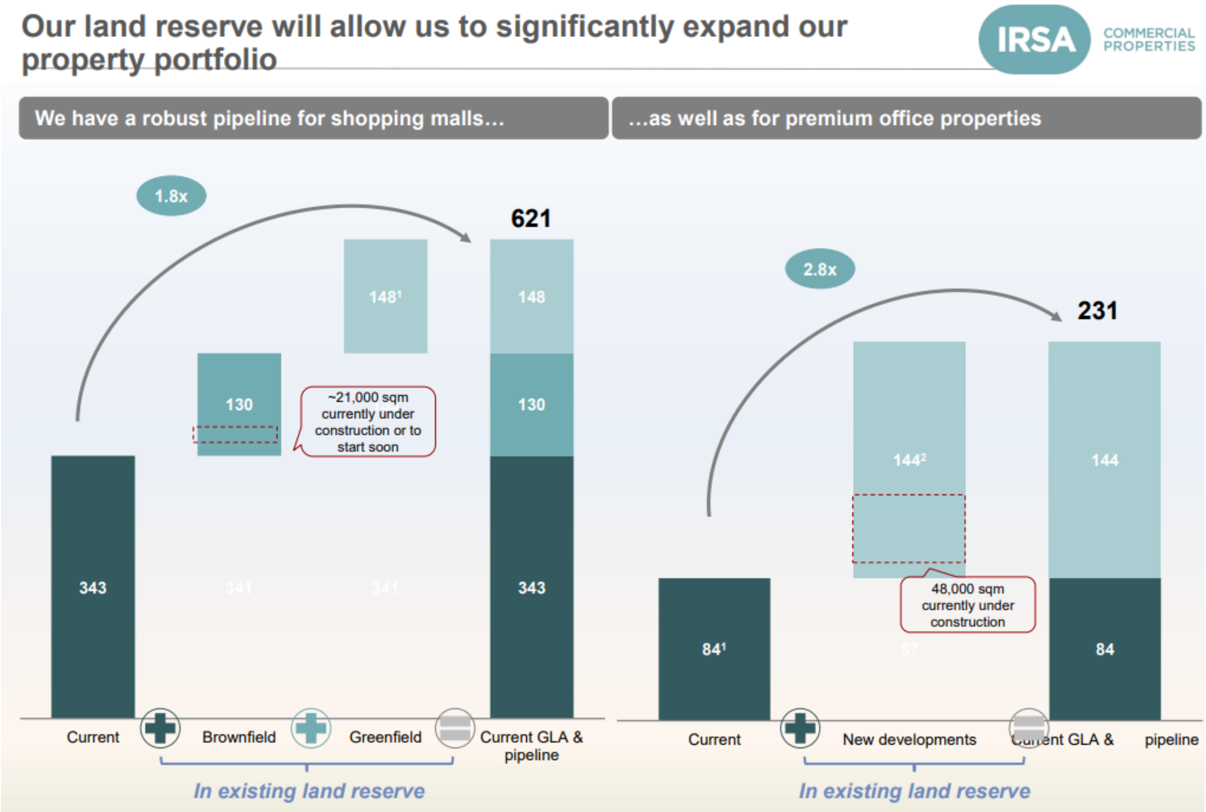


Source: [IRCP]

If I look at what is going on in the US, which is not that positive, Europe, where the east is still growing but is quickly becoming saturated, my idea is that there is still perhaps a decade of good growth for Argentina, especially if the economy picks up. This is why I also did an overview of [Mercadolibre (MELI)] which gave me insights into the online threat to malls. Fortunately for IRCP, online shopping is also lagging the US or Europe and it will take a while to get similar traction.

IRCP plans to cater to the above opportunity by developing more malls and offices on the land it already has in its reserve.

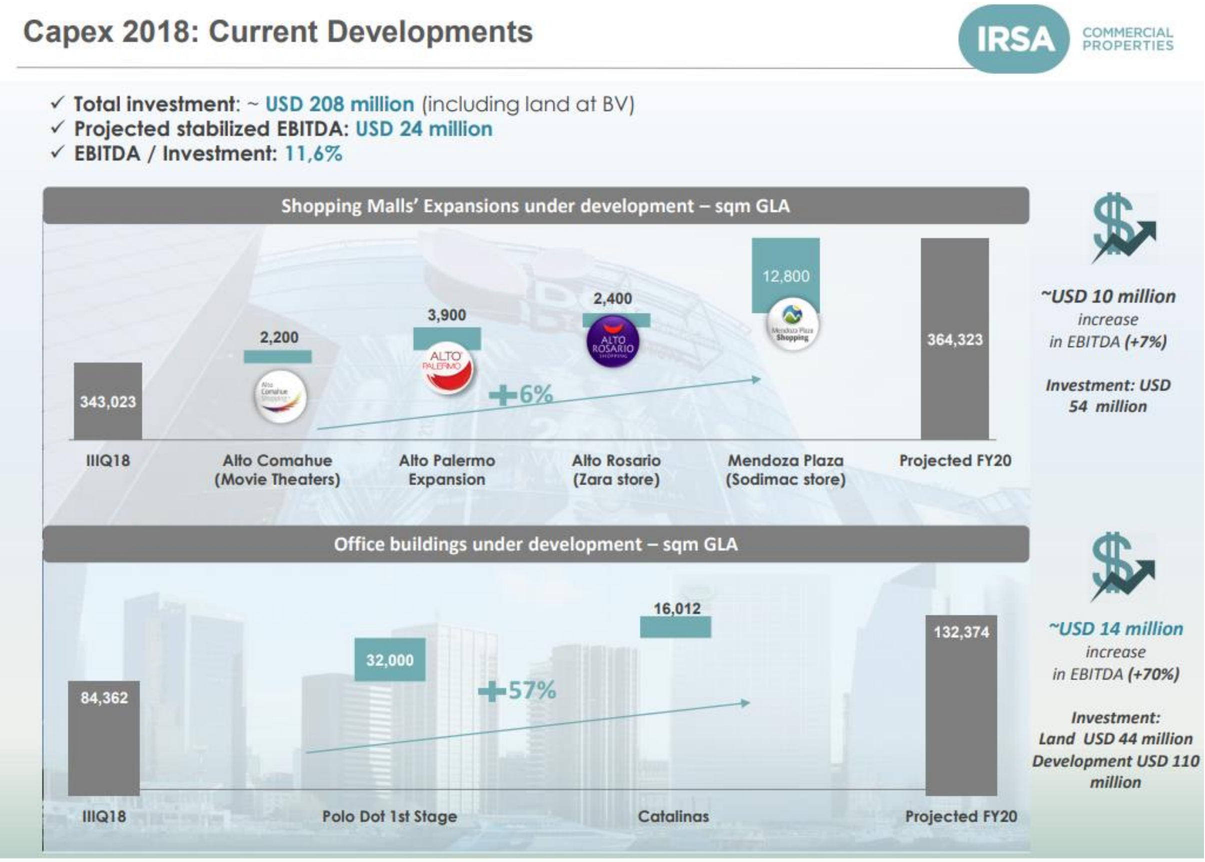
Figure 5 IRCP's growth plans and land



Source: [IRCP]

This should lead to a 6.2% in GLA for malls and 57% for offices by 2020 from investments that are already under development.

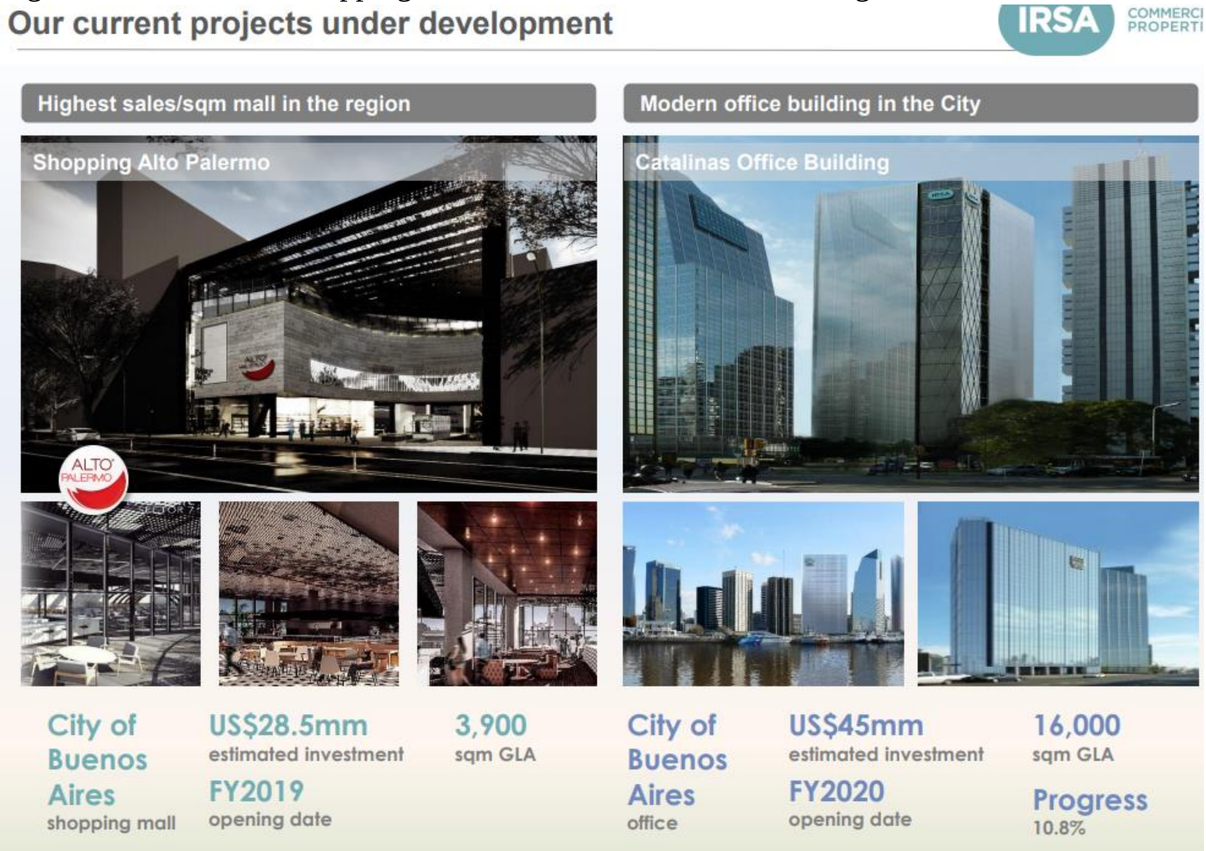
Figure 6 GLA growth from developments under development



Source: [IRCP]

Below is an example of what they are building.

Figure 7 Alto Palermo shopping mall and Catalianas office building

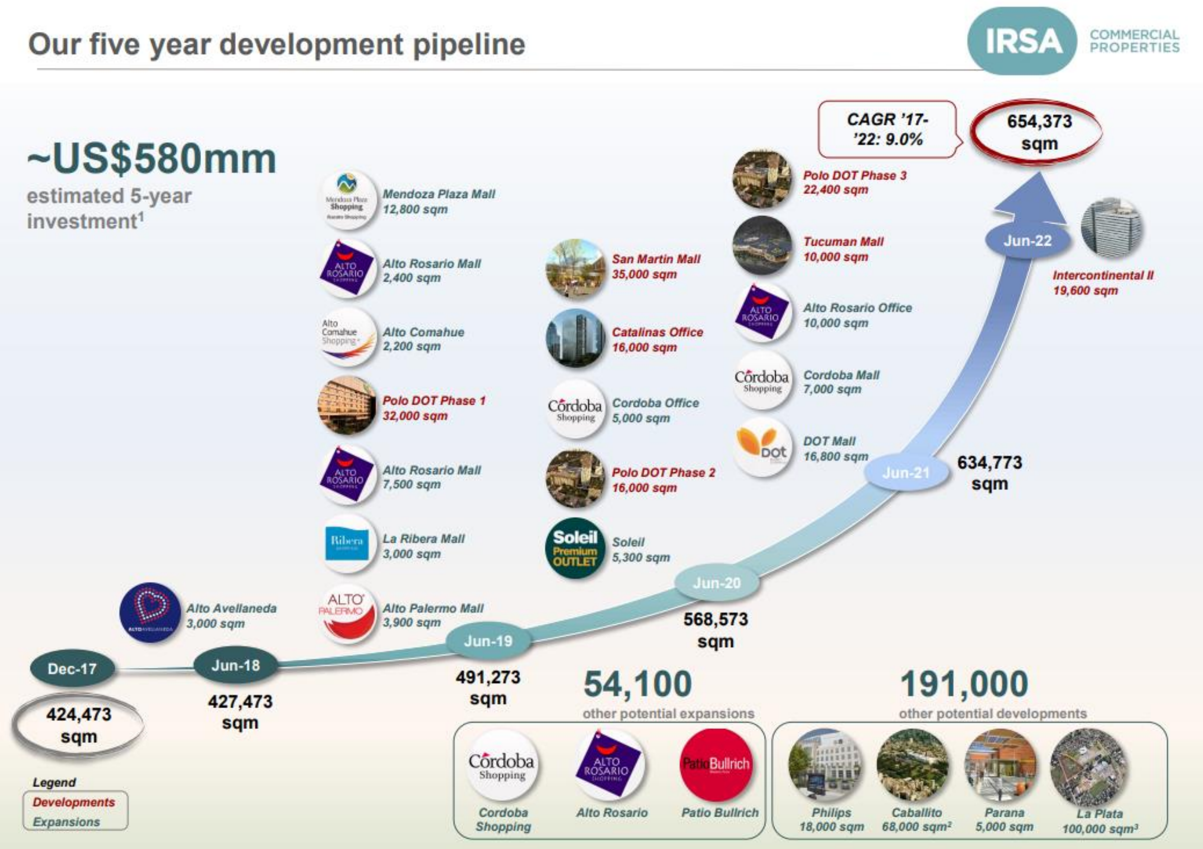


Source: IRCP

The EBITDA return on investment is 11.6% which is ok given that the cost of debt is 8.75% on the largest and most expensive note ant 5% on the two other notes but more about that in the debt and finances part.

All in all, IRCP has great plans that should expand the GLA by 54% in the next 5 years.

Figure 8 IRCP's growth plan



Source: [IRCP]

Additionally, there are another 245 thousand square meters in potential developments and expansions. Without the potential expansions the estimated investment is $580 million. Let's look at the finances and then discuss the risk reward.

Finances and debt

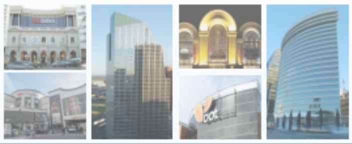
Office leases are in US$ while malls pay a base rent in pesos that is adjusted for inflation plus a percentage of sales. This allows the company to be protected from inflation and it was a strategy that worked well over the past years. This also gives IRCP a share in the risk the tenants carry so a leveraged play on the Argentinian economy.

AFFOs for the last reported 12 months were $116 million.

Figure 9 EBITDA and AFFOs

Consolidated Financial Results 9M FY 2018

IRSA COMMERCIAL PROPERTIES



	ARS million			USD million		
	LTM 18	LTM 17	Var %	LTM 18	LTM 17	Var %
Adjusted EBITDA	2,959	2,469	19.8%	168	164	2.8%
NOI	**3,397**	**2,773**	**22.5%**	**193**	**184**	**5.1%**
Adjusted FFO	2,039	1,392	46.4%	116	92	25.7%

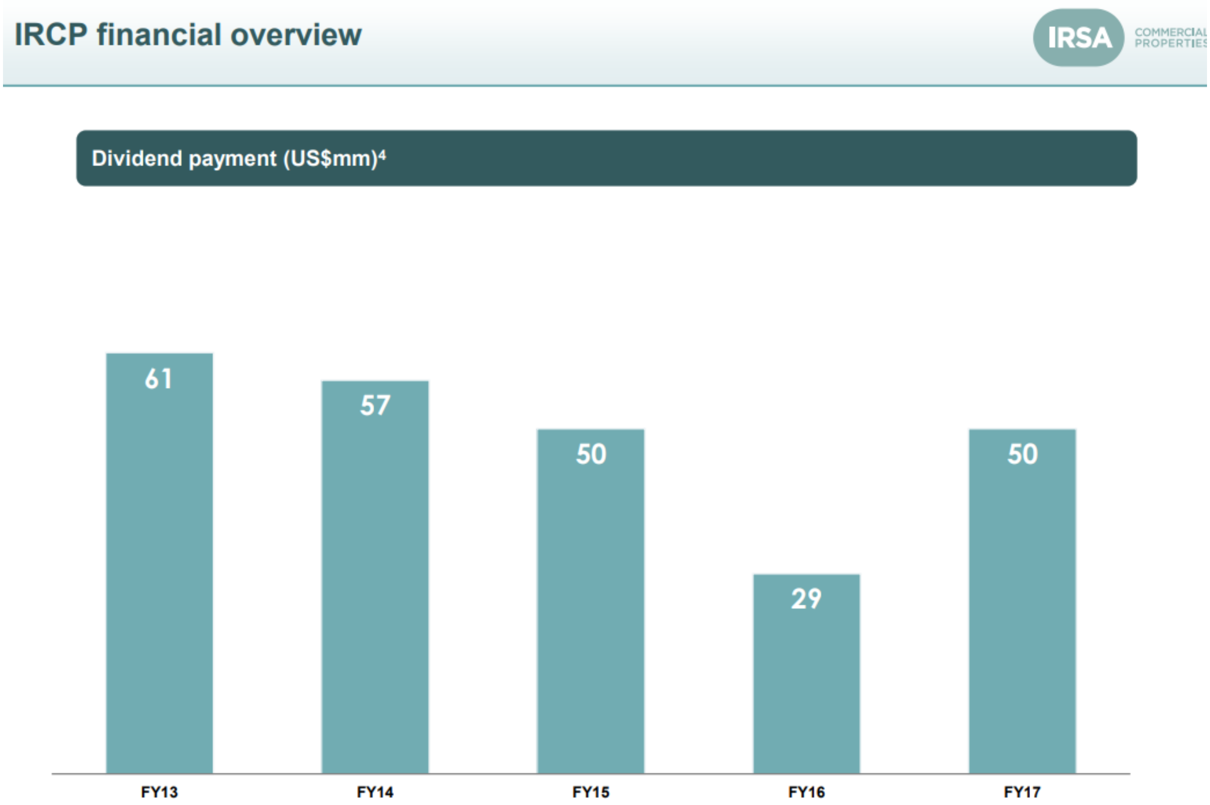
Valuation Metrics	Mar-31
Cap Rate	12.0%
EV/EBITDA	9.5x
P/FFO	12.1x
P/BV	0.85x

Source: IRCP

That gives us a $3.68 AFFO per share or an 11.8% potential cash yield. If the company delivers on its growth plans I would not be surprised to see the AFFO at $6 in 2022 which would lead to a 20% yield. The problem is that we don't know what will the management decide to do with that money: distribute it to shareholders or pursue more growth in the always unstable emerging markets and questionable brick and mortar retail environment.

The dividends were significant and constant over the past years with a dip during deepest part of the Argentinian crisis in 2016.

Figure 10 Dividends



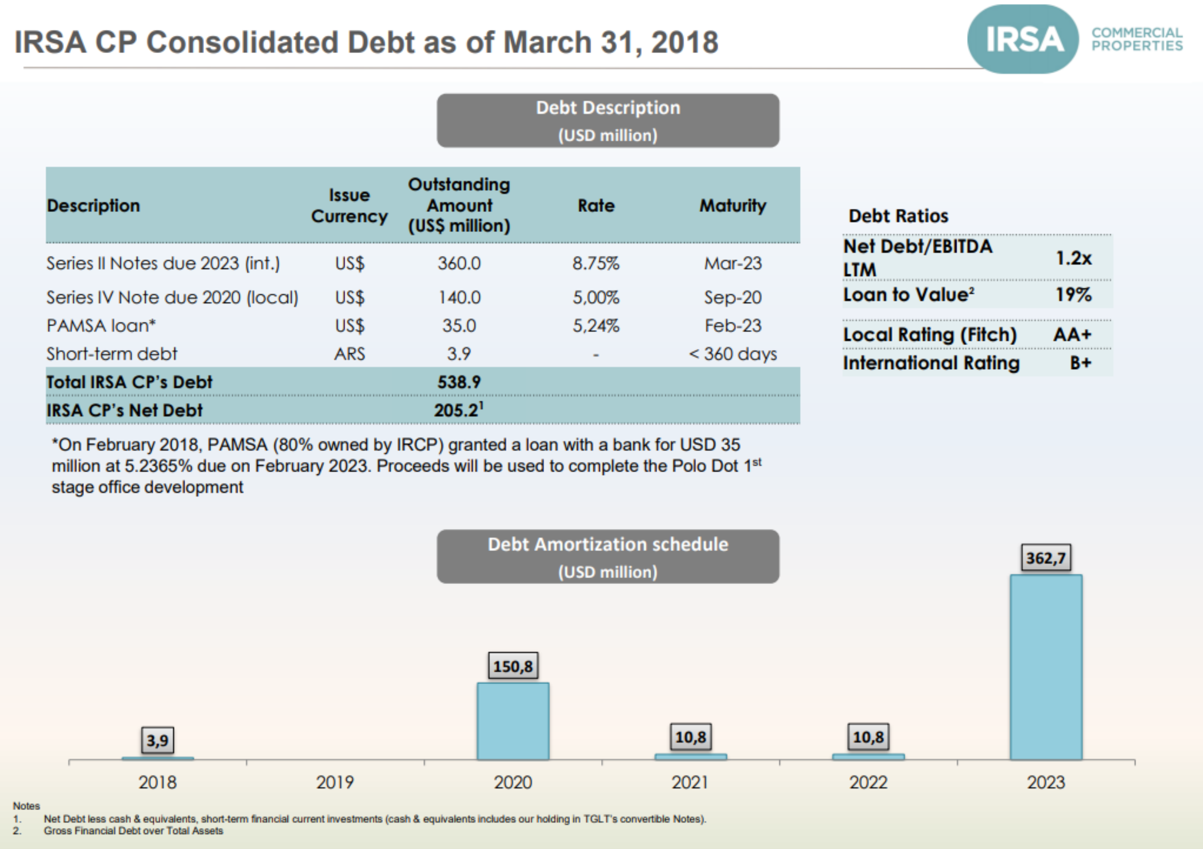
Source: [IRCP]

The last dividend was $50 million or $1.58 per share that gives a dividend yield of 5% which is not bad given the growth prospects.

The debt side is not that scary with one note due in 2020 and the other in 2023. However, they will probably issue much more debt to get to the $508 million necessary to finance their expansion plans. This should put a heavy burden on the company or delay the growth plans as the situation in Argentina is not that great with high costs of capital. But, a loan to value ratio of 19% is really low in the real estate business.

Also, by 2020 and 2023 the world's perspective on Argentina might completely change and who knows what can happen there.

Figure 11 IRCP's debt



Description	Issue Currency	Outstanding Amount (US$ million)	Rate	Maturity
Series II Notes due 2023 (int.)	US$	360.0	8.75%	Mar-23
Series IV Note due 2020 (local)	US$	140.0	5,00%	Sep-20
PAMSA loan*	US$	35.0	5,24%	Feb-23
Short-term debt	ARS	3.9	-	< 360 days
Total IRSA CP's Debt		**538.9**		
IRSA CP's Net Debt		**205.2[1]**		

*On February 2018, PAMSA (80% owned by IRCP) granted a loan with a bank for USD 35 million at 5.2365% due on February 2023. Proceeds will be used to complete the Polo Dot 1st stage office development

Debt Ratios	
Net Debt/EBITDA LTM	1.2x
Loan to Value[2]	19%
Local Rating (Fitch)	AA+
International Rating	B+

Notes
1. Net Debt less cash & equivalents, short-term financial current investments (cash & equivalents includes our holding in TGLT's convertible Notes).
2. Gross Financial Debt over Total Assets

Source: IRCP

Total assets, that are constantly revalued in relation to the depreciation of the peso and inflation are 54 billion ARS or $2.6 billion at the exchange rate of the last earnings report ($1 = ARS 20.65).

Total shareholders equity is ARS 33 billion or $1.6 billion that results in a book value per share of $50. As real estate keeps its value in Argentina and is always measured in dollars, we can take the $50 as a correct book value. However, book values and values in general, depend on the required return rate.

Risks and rewards

REIT's were the best performing asset class in the US over the past few decades. As Argentina is still emerging and developing, no matter what the economic situation might look like, there is a high chance that this will be a good investment especially if we see higher global food prices as Argentinian exports are mostly food related.

The risks are firstly related to the Argentinian economy. As we have seen in the dividend figure, lower economic activity leads to lower sales and lower cash flows.

In the past there have been difficulties for Argentinian companies to pay dividends to foreigners so that might also be a problem in the future. Currency issues, taxes, GDP growth, inflation, access to financial markets and who knows what might affect this company. Expect volatility.

The biggest risk is perhaps access to capital and the cost of it. To develop the pipeline and other potential growth projects, IRCP needs fresh capital. A higher cost of capital lowers the return on the investment, at least temporarily.

Conclusion

If I put the growth pipeline on hold, I can expect AFFOs of $4 per share. This should keep the dividend there and at a required return of 15%, a fair value for IRCP would be $26. Long term, if the Argentinian economy recovers, food prices increase, IRCP delivers on the growth, we could easily see AFFOs of $8 on a 7% valuation and you get yourself a stock of $114. That would be the upside.

On the downside, depending on sentiment, it might be volatile but we are closer to the bottom here. However, always be ready to the impossible with emerging markets. The stock is 50% below its peak but it was trading at $15 just a few years ago.

Figure 12 IRCP's stock price

Source: CNN Money

This stock traded below $4 in 2009 😊 when revenues were $160 million on 77 million shares or on 19 million ADR. The profits were negative in 2009 but not that much. A price to sales of 0.5 wasn't a big deal back then. However, the company grew both profits and revenues over time and now enjoys a great return over the long term which is what counts. If repeated we might see similar, perhaps a bit lower returns. A lower price would be great.

I'll put my fair value at $20 as a am looking for a 20% earnings return from Argentina. Given the growth, perhaps I can bring it to $26 as there will be growth from the projects already in development that are leased to Mercadolibre.

My market cap would be $819 million which means that the value IRSA owns of IRCP should be $700 million.