

GRAND CITY Properties S.A.

Luxembourg / Financial Services
 Frankfurt
 Bloomberg: GYC GR
 ISIN: LU0775917882

Q2 2016
 Results

RATING
BUY

PRICE TARGET
€26.00

Return Potential 29.4%
 Risk Rating Medium

ANOTHER STRONG QUARTER; DIVIDEND POLICY UPGRADED

Second quarter results increased substantially, spearheaded by rental income growth of 39% Y/Y to €108m (Q2/15: €78m). The results were slightly higher than our forecasts with the exception of net income, which benefited from an exceptionally strong fair value adjustment to the property portfolio. GCP reported a 32% Y/Y increase in Funds From Operations (FFO I) to €38.4m, while maintaining balance sheet discipline with a Loan-to-Value (LTV) of 39% at the end of Q2 (Q2/15: 39%). The Board also increased the dividend policy to 50% of FFO I (previously: 30%) in view of cash flow quality. We have adjusted our estimates to account for the strong valuation profits and now see fair value at €26/share (previously: €25). Our rating remains Buy.

Portfolio growth and operational performance drive strong rental income

GCP reported rental income of €108m for the three month period, which topped our estimate (FBe: €103m). The figure grew 39% Y/Y and 7% Q/Q. The increase in rental income can be traced to acquisitions and operational improvements in existing properties through rent and occupancy increases, as well as economies of scale. On a six month basis, rental income increased some 46% Y/Y to €209m. The portfolio contains 82k units as of August compared to 76k at the end of 2015. We note that the potential of the portfolio was not fully reflected in the Q2 figures. As of August 2016, the monthly annualised run rates for rental income and FFO I stood at €440m and €159m respectively (May 2016: €423m and €155m) continuing a positive trend (see overleaf).

Underlying indicators continue to improve Thanks to GCP's rigorous turnaround measures, the vacancy rate of rentable area was compressed further to 8.3% as of August compared to 10% in May 2016 and 12% in August 2015. The like-for-like occupancy KPI thus grew 3.2% Y/Y. At the same time, in-place rent increased to €5.30/m² corresponding to like-for-like in-place rent growth of 2.3% Y/Y. (p.t.o.)

FINANCIAL HISTORY & PROJECTIONS

	2013	2014	2015	2016E	2017E	2018E
Rental income (€m)	99.63	216.84	333.50	433.18	498.50	575.32
Y/Y growth	n.a.	117.6%	53.8%	29.9%	15.1%	15.4%
Adj. EBITDA (€m)	54.24	112.01	176.52	222.31	256.30	296.69
Net income (€m)	266.1	243.8	393.6	559.7	439.4	521.2
EPS (diluted) (€)	2.97	1.52	2.35	2.90	2.28	2.70
EPRA NAV (€m) ¹	861.92	1439.38	2544.35	3139.32	3595.95	4165.18
DPS (€)	0.00	0.21	0.20	0.50	0.58	0.68
FFO I (€m)	38.14	76.11	127.92	153.21	181.63	215.85
Net gearing	71.0%	103.9%	80.1%	63.5%	62.9%	61.3%
Liquid assets (€m)	166.80	272.30	388.93	665.03	582.81	570.70

¹ including hybrid notes

RISKS

Risks include, but are not limited to, unfavourable interest rate developments, which would affect unhedged financial debt, unfavourable macroeconomic development, and departure of key personnel.

COMPANY PROFILE

GRAND CITY Properties (GCP) is a real estate firm focusing on investing in and managing turnaround opportunities in the German real estate property market. GCP's portfolio is located in Germany's densely populated areas. GCP's primary strategy regarding its real estate investments is "buy-and-hold" long term, while "buy-and-sell" is an opportunistic component.

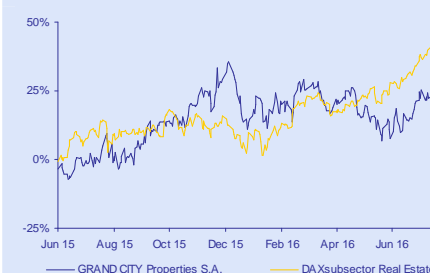
MARKET DATA

As of 19 Aug 2016

Closing Price	€ 20.09
Shares outstanding	153.79m
Market Capitalisation	€ 3089.64m
52-week Range	€ 15.34 / 21.50
Avg. Volume (12 Months)	244,668

Multiples	2015	2016E	2017E
P/FFO I	22.6	20.2	17.2
P/EPRA NAV	1.1	1.0	0.9
FFO I Yield	4.4%	5.0%	5.8%
Div. Yield	1.0%	2.5%	2.9%

STOCK OVERVIEW



COMPANY DATA

As of 30 Jun 2016

Liquid Assets	€ 511.70m
Current Assets	€ 813.70m
EPRA NAV ¹	€ 2,988.80m
Total Assets	€ 5,633.50m
Current Liabilities	€ 306.30m
Total Equity	€ 2667.60m

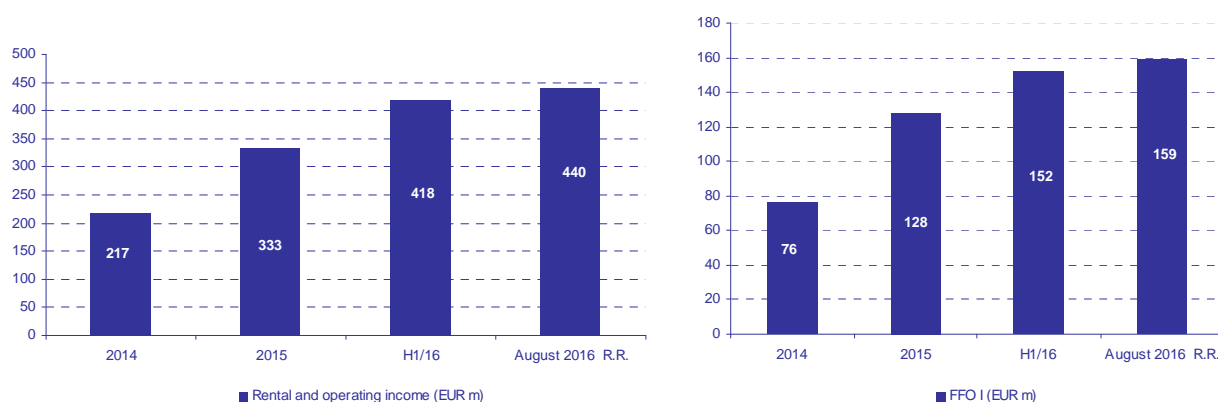
¹ including hybrid notes

SHAREHOLDERS

Edolaxia Ltd.	32.9%
FMR LLC	4.6%
Merrill Lynch Intl	2.6%
Odey Asset Mngt	2.3%
Free Float	57.7%



Figure 1: Rental income and FFO I developments



Source First Berlin Equity Research; Company

Core strategy and scalable platform contribute to strong bottom line The capital gains, property revaluations and other income line item spiked to €310m in the second quarter (Q2/15: €100m, FBe: €78m), nearly all of which was generated by changes in the fair value of investment properties. This was driven chiefly by successful increases in rent and occupancy metrics translating into increased property valuations conducted by external assessors. We believe the result underscores GCP's ability to acquire underperforming properties and unlock value over time.

Table 1: Q2 results vs estimates

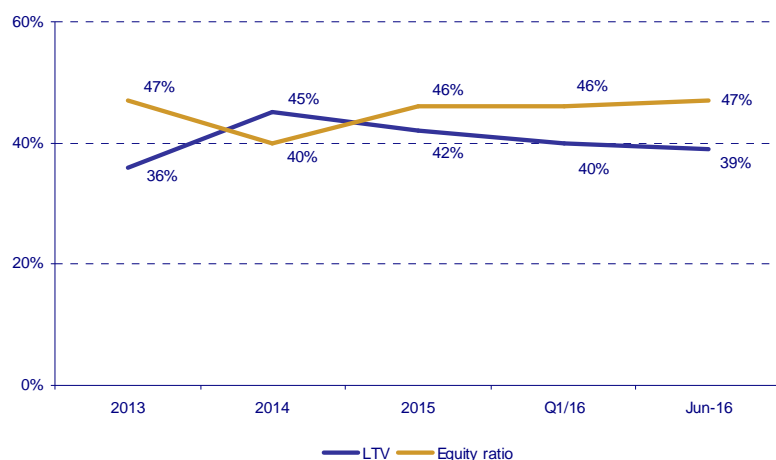
in € '000	Q2/16	Q2/16E	delta	Q2/15	delta	H1/16	H1/15	delta
Rental income	108,053	103,400	4.5%	77,822	38.8%	208,804	143,430	45.6%
Adjusted EBITDA*	53,261	52,734	1.0%	40,306	32.1%	107,268	74,550	43.9%
Adjusted margin	49.3%	51.0%	-	51.8%	-	51.4%	52.0%	-
FFO I	38,426	37,749	1.8%	29,134	31.9%	76,136	54,340	40.1%

*adjusted for capital gains, property revaluations, and other income

Source First Berlin Equity Research; Company

Property operating expenses increased 45% Y/Y to €52m in Q2, due chiefly to the increase in related purchased services, i.e. warm costs (water and heating) traced to rental income. At the operating level, administration and other expenses increased 29% Y/Y to €2.2m reflecting the overall growth of GCP. The lower growth in this KPI also underscores the scalability of the GCP platform, which delivered 37% Y/Y growth for the quarter. Adjusted EBITDA in Q2/16 climbed 32% Y/Y to €53m (Q2/15: €40m; FBe: €53m). Net income (NI) grew sharply by 163% Y/Y to €302m (Q2/15: €115m) fuelled by top line growth, the high level of revaluation profits, and economies of scale. On a six month basis, rental income, adjusted EBITDA and NI grew even stronger as highlighted in table 1.

FFO I increased strongly during Q2 to €38m compared to €29 in the prior year period, thanks to the strong adjusted EBITDA growth and improving financing conditions. The WACD stood at 1.6% at the end of Q2. On a six month basis, FFO I increased some 40% Y/Y to €76m equal to €0.44 per share.

**Figure 2: Balance sheet KPI developments**

Source First Berlin Equity Research; Company

Debt service metrics remain solid, liquidity boosted by new bond The debt structure featured an LTV of 39% at the end of Q2 compared to 40% at the end of Q1 and 42% at end 2015. This is well below the 45% internal limit set by the Management Board. GCP reported cash and liquid assets of €512m for the period compared to €389m at the end of 2015, while net debt remained steady at €1.8bn. Coverage ratios remained strong with a debt service coverage ratio (DSCR) and an interest coverage ratio (ICR) of 4.7x and 6.0x respectively at the end of Q2 (Q4/15: 4.7x and 6.1x respectively).

Table 2: Financial position highlights H1/16

in €'000	H1/16	2015	Delta
Cash & liquid assets	511,776	388,925	31.6%
Investment property ¹	4,535,610	3,859,511	17.5%
Total equity	2,667,584	2,172,295	22.8%
EPRA NAV inc. Hybrid notes	2,988,834	2,544,347	17.5%
EPRA NAV	2,510,721	2,066,201	21.5%
Interest bearing debt	829,966	846,900	-2.0%
Straight bonds	1,048,625	1,045,413	0.3%
Convertible bond (series C) ²	0	122,576	-100.0%
Convertible bond (series F) ³	426,385	0	-
Loan-to-Value (LTV)	39%	42%	-
Equity ratio	47%	46%	-

¹ including advanced payments and balance of inventories

² as of January 2016 Series C Bond has been fully converted

³ Series F issued in February 2016

Source First Berlin Equity Research; Company



Adjusting forecasts to account for valuation profits; GCP reported an excellent set of second quarter numbers demonstrating its ability to extract value from its portfolio with its repositioning measures. This led to a much higher than expected capital gains, property revaluations result in Q2, thus occasioning the increase to our KPI and net income forecast for this year. We have also slightly dialled back our external growth assumptions for 2017, given our view that GCP will remain selective with future acquisitions in the current market environment of climbing real estate prices. That said, we believe the company will continue to extract value from its existing portfolio as it sticks to its acquisition strategy.

Table 3: Changes to our forecasts

in €'000	2016E			2017E		
	Old	New	% change	Old	New	% change
Rental income	431,979	433,178	0.3%	521,835	498,498	-4.5%
Revaluations	247,845	484,977	95.7%	307,622	308,618	0.3%
Adjusted EBITDA*	221,698	222,313	0.3%	268,300	256,301	-4.5%
<i>margin</i>	51.3%	51.3%	-	51.4%	51.4%	-
Net income	322,083	494,201	53.4%	397,571	387,987	-2.4%
EPS € (diluted)	1.89	2.90	53.4%	2.33	2.28	-2.3%

*adjusted for capital gains, property revaluations, and other income

Source First Berlin Equity Research; Company

Value extraction momentum remains strong; increasing target price to €26 (previously: €25) GCP now ranks as the fourth largest listed German residential real estate company. The company's solid financial structure was also acknowledged by Standard and Poor's in June through an upgrade to a BBB rating (February 2013: BB-) with a positive outlook.

Management tightened the reins on balance sheet metrics by lowering the internal LTV ceiling to 45% (previously: 50%). Moreover, the quality of cash flow generation has allowed GCP to ratchet up its dividend policy to 50% of FFO I (previously: 30%), which pushes our projected 2016 dividend per share to €0.52 (previously: €0.36). The increased dividend policy combined with the upward revision to our valuation profits line item outweighs a slightly more conservative acquisition outlook. Our rating remains Buy with a €26 price target.



VALUATION MODEL

All figures in EUR '000	2016	2017	2018	2019
Shareholder's Equity	2,629,145	3,001,772	3,471,445	4,044,714
Consolidated NAV	2,816,180	3,223,959	3,735,327	4,359,381
NAV per share (€)	18.31	20.74	23.57	26.90
Deferred taxes	316,146	365,000	422,862	495,365
Derivative financial instruments	6,995	6,995	6,995	6,995
EPRA NAV	3,139,321	3,595,954	4,165,184	4,861,741
EPRA NAV per share (€)	20.41	23.13	26.29	30.00
FFO	153,212	181,626	215,846	251,942
Revaluation results	484,977	308,618	365,520	458,009
New Equity	-	-	-	-
Total return	638,189	490,245	581,366	709,951

Return on NAV	25.1%	15.6%	16.2%	17.0%
Cost of equity	5.0%	5.0%	5.0%	5.0%
Spread	20.1%	10.7%	11.2%	12.1%

	2016	2017	2018	2019
WACC	3.1%	3.1%	3.1%	3.1%
Value creation	631,965	383,482	467,135	587,925
NPV	625,238	368,170	435,207	531,528
Dividends paid	38,375	76,606	90,813	107,923
Present value of dividends paid	37,967	73,547	84,606	97,570

Fair value calculation	
PV of total value created	1,960,142
NAV (2015)	2,172,295
Adjustments	-
Equity value	4,132,437
PV of dividends	293,690
Fair value	4,426,127
Number of shares (fully diluted)	171,852
Fair value per share (€)	26.00



INCOME STATEMENT

All figures in EUR '000	2013A	2014A	2015A	2016E	2017E	2018E
Rental and operating income	99,630	216,837	333,497	433,178	498,498	575,322
Revenue from sale of buildings	70,000	14,675	0	0	0	0
Revenue	169,630	231,512	333,497	433,178	498,498	575,322
Capital gains, property revaluations & other	236,846	230,969	311,131	484,977	308,618	365,520
Result from equity-accounted investees	470	94	0	0	0	0
Property expenses	-42,711	-100,175	-151,552	-199,262	-229,309	-264,648
Cost of buildings sold	-54,914	-14,425	0	0	0	0
Administration expenses	-3,339	-5,650	-7,153	-13,335	-14,881	-16,286
Operating income (EBIT)	305,982	342,325	485,923	705,557	562,926	659,908
Finance expenses	-11,320	-22,040	-25,830	-37,978	-38,793	-39,307
Other financial results	7,778	-32,664	-73	0	0	0
Pre-tax income (EBT)	302,440	287,621	460,020	667,580	524,133	620,602
Tax and deferred tax expenses	-36,388	-43,787	-66,450	-107,896	-84,736	-99,398
Minority interests	-39,777	-38,259	-35,120	-44,775	-35,152	-41,696
Hybrid note investors	0	0	-14,517	-20,708	-16,258	-19,285
Net income	226,275	205,575	343,933	494,201	387,987	460,222
Basic EPS (in €)	2.97	1.73	2.71	3.21	2.50	2.90
Diluted EPS (in €)	2.97	1.52	2.35	2.90	2.28	2.70
Adjusted EBITDA	54,243	112,009	176,521	222,313	256,301	296,689
Ratios						
Adjusted EBITDA margin on rental income	54.4%	51.7%	52.9%	51.3%	51.4%	51.6%
Tax rate	14.0%	14.0%	-5.0%	14.0%	14.0%	14.0%
Expenses as % of revenues						
Property expenses	42.9%	46.2%	45.4%	46.0%	46.0%	46.0%
Administration expenses	3.4%	2.6%	2.1%	3.1%	3.0%	2.8%
Y-Y Growth						
Rental and operating income	n.a.	117.6%	53.8%	29.9%	15.1%	15.4%
Total revenues	n.a.	36.5%	44.1%	29.9%	15.1%	15.4%
Operating income	n.a.	11.9%	41.9%	45.2%	-20.2%	17.2%
Adjusted EBITDA	n.a.	106.5%	57.6%	25.9%	15.3%	15.8%
Net income/ loss	n.a.	-9.1%	67.3%	43.7%	-21.5%	18.6%
Funds from Operations (FFO)						
Operating profit	305,982	342,325	485,923	705,557	562,926	659,908
Depreciation and amortisation	193	903	1,729	1,733	1,994	2,301
EBITDA	306,175	343,228	487,652	707,290	564,920	662,210
Capital gains, property revaluations and other	-236,846	-230,969	-311,131	-484,977	-308,618	-365,520
Result from disposal of trading properties	-15,086	-250	0	0	0	0
Adjusted EBITDA	54,243	112,009	176,521	222,313	256,301	296,689
Financial expense	-11,320	-22,040	-25,830	-37,978	-38,793	-39,307
Tax	-4,780	-13,863	-22,776	-31,124	-35,882	-41,537
FFO I	38,143	76,106	127,915	153,212	181,626	215,846



BALANCE SHEET

All figures in EUR '000	2013A	2014A	2015A	2016E	2017E	2018E
Assets						
Current assets, total	248,592	401,815	627,204	913,303	868,521	900,446
Cash and cash equivalents	132,542	270,131	236,001	512,103	429,883	417,776
Traded securities at fair value though P&L	34,258	2,165	152,924	152,924	152,924	152,924
Trade and other receivables	61,843	123,705	226,402	237,358	273,149	315,245
Inventories - Trading property	19,949	5,814	11,877	10,918	12,565	14,501
Non-current assets, total	1,402,495	2,227,243	4,061,699	4,869,558	5,547,706	6,359,183
Equipment and intangible assets	4,383	7,516	9,493	10,442	11,487	12,635
Investment property	1,375,450	2,179,982	3,845,979	4,642,036	5,307,689	6,105,936
Equity accounted investees	7,354	0	0	0	0	0
Other LT assets	12,817	28,552	195,390	205,160	215,417	226,188
Deferred tax assets	2,491	11,193	10,837	11,921	13,113	14,424
Total assets	1,651,087	2,629,058	4,688,903	5,782,861	6,416,227	7,259,629
Shareholders' equity & debt						
Current liabilities, total	111,277	153,266	277,317	290,570	332,056	382,494
Short-term debt	10,563	5,792	54,676	16,467	20,037	26,095
Trade and other payables	92,357	128,837	190,358	240,206	276,427	319,028
Other current liabilities	8,357	18,637	32,283	33,897	35,592	37,372
Long-term liabilities, total	771,885	1,434,142	2,239,291	2,676,111	2,860,212	3,141,807
Long-term debt	461,753	537,217	792,224	823,332	1,001,850	1,304,758
Convertible and straight bonds	194,676	716,832	1,167,989	1,495,294	1,450,306	1,369,327
Deferred taxes	80,169	141,003	239,374	316,146	365,000	422,862
Other LT liabilities	35,287	39,090	39,704	41,339	43,057	44,860
Minority interests	63,001	90,736	142,260	187,035	222,186	263,883
Shareholders' equity	704,924	950,914	2,030,035	2,629,145	3,001,772	3,471,445
Total consolidated equity and debt	1,651,087	2,629,058	4,688,903	5,782,861	6,416,227	7,259,629
Ratios						
Current ratio (x)	2.23	2.62	2.26	3.14	2.62	2.35
Equity ratio	46.5%	39.6%	46.3%	48.7%	50.2%	51.5%
EPRA NAV ('000)	861,926	1,439,386	2,544,347	3,139,321	3,595,954	4,165,184
Net debt ('000)	500,192	987,545	1,625,964	1,670,066	1,889,385	2,129,481
Financial leverage	71.0%	103.9%	80.1%	63.5%	62.9%	61.3%
Loan-to-value	36.2%	45.1%	42.1%	35.9%	35.5%	34.8%
Return on equity (ROE)	34.6%	23.4%	18.1%	19.9%	13.6%	14.0%



CASH FLOW STATEMENT

All figures in EUR '000	2013A	2014A	2015A	2016E	2017E	2018E
Net income	266,052	243,834	393,570	559,684	439,396	521,203
Depreciation and amortisation	193	903	1,729	1,733	1,994	2,301
Profit from investments in equity accounted investee	-470	-94	0	0	0	0
Change in fair value of investment properties	-236,846	-230,968	-311,131	-484,977	-308,618	-365,520
Net finance expenses	3,542	54,704	25,903	37,978	38,793	39,307
Tax result	36,388	43,787	66,450	107,896	84,736	99,398
Others	0	171	753	0	0	0
Operating cash flow	68,859	112,337	177,274	222,313	256,301	296,689
Inventories - trading properties	0	14,134	-943	959	-1,646	-1,936
Trade & other receivables	-14,169	-39,030	-24,825	-10,956	-35,792	-42,095
Trade & other payables	7,463	31,359	20,234	49,848	36,221	42,600
Provisions for other liabilities	4,028	5,875	4,506	2,166	2,220	2,271
Tax paid	-4,780	-10,791	-18,798	-31,124	-35,882	-41,537
Net cash flow from operating activities	61,401	113,884	157,448	233,206	221,422	255,993
Investment in fixed/intangible assets	-975	-1,847	-3,680	-2,682	-3,038	-3,450
Investments and acquisitions of investment property	-309,468	-349,944	-406,475	-311,080	-357,035	-432,726
Acquisition of subsidiaries	-72,350	-38,561	-445,922	0	0	0
Proceeds from investments in financial assets	-28,070	62,449	-358,971	-9,770	-10,258	-10,771
Cash flow from investing	-410,863	-327,903	-1,215,048	-323,532	-370,331	-446,947
Debt financing, net	219,917	393,143	440,130	442,780	182,088	308,967
Equity financing, net	201,546	0	639,939	0	0	0
Other financing activities	-7,562	-11,648	-23,735	-38,375	-76,606	-90,813
Net paid financing expenses	-12,874	-29,887	-32,864	-37,978	-38,793	-39,307
Cash flow from financing	401,027	351,608	1,023,470	366,427	66,689	178,847
Net cash flows	51,565	137,589	-34,130	276,102	-82,220	-12,107
Cash, start of the year	80,977	132,542	270,131	236,001	512,103	429,883
Cash, end of the year	132,542	270,131	236,001	512,103	429,883	417,776
Adjusted EBITDA/share (in €)	0.71	0.94	1.27	1.45	1.65	1.87
FFO I	38,143	76,106	127,915	153,212	181,626	215,846
FFO/share (in €)	0.50	0.66	0.89	1.00	1.17	1.36
Y-Y Growth						
Operating cash flow	n.a.	85.5%	38.3%	48.1%	-5.1%	15.6%
Adjusted EBITDA/share	n.a.	32.6%	33.9%	14.3%	14.1%	13.6%
FFO I	n.a.	99.5%	68.1%	19.8%	18.5%	18.8%

FIRST BERLIN RECOMMENDATION & PRICE TARGET HISTORY

Report No.:	Date of publication	Previous day closing price	Recommendation	Price target
Initial Report	21 January 2013	€4.37	Buy	€14.30
2...12	↓	↓	↓	↓
13	1 December 2015	€19.50	Buy	€25.00
14	24 March 2016	€19.90	Buy	€25.00
15	18 May 2016	€19.92	Buy	€25.00
16	Today	€20.09	Buy	€26.00

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