

GRAND CITY Properties S.A.

Luxembourg / Financial Services

Frankfurt

Bloomberg: GYC GR

ISIN: LU0775917882

Update

RATING**PRICE TARGET**

Return Potential

Risk Rating

BUY**€25.00**

48.1%

Medium

CURRENT PORTFOLIO HARBOURS UPSIDE FOR VALUE CREATION

We believe Grand City Properties (GCP) is well positioned for a strong performance in 2017. The portfolio is well stocked with 84k units and features improving operational results with further embedded upside. GCP's financial profile is also very solid highlighted by conservative balance sheet metrics and good access to financing. Although we expect external portfolio growth to slow compared to the past two years, we see strong rental income and FFO I growth ahead this year driven by the existing portfolio and prudent acquisitions when opportunities appear. Given these prospects, we believe the current share price represents an excellent entry point after the sector correction in H2/16. We reiterate our Buy rating with a €25 price target.

Portfolio of 84,000 owned units harbours substantial upside As of its 9M/16 report, GCP boasted a portfolio valued at €4.7bn equating to a 22% expansion over the nine month period (YE/15: €3.8bn). The residential properties are well diversified throughout Germany across densely populated urban areas with strong economic fundamentals. The strategy to focus on metropolitan areas with vibrant economies helped GCP significantly reduce the vacancy rate by 440 basis points over a twelve month period to 8.1% as of October 2016. In-place rent also edged higher to €5.35/m² over this time frame (October 2015: €5.30/m²). We believe the current operational momentum will continue, given the low ratio of rents priced at market levels (figure 3 overleaf). In October, the company reported an annualised rental income run rate of €452m—a number that could potentially climb to €580m with ongoing repositioning activities, which will allow the company to further compress the vacancy rate and bring rents further in line with market levels. We also believe management is firmly committed to generating abundant cash flows (FFO I) from rental income while limiting asset disposal. This gives us a high degree of confidence in our rental income and FFO I forecasts for the next two years, even if external growth remains slow in the face of a tight supply environment. (p.t.o.)

FINANCIAL HISTORY & PROJECTIONS

	2013	2014	2015	2016E	2017E	2018E
Rental income (€m)	99.63	216.84	333.50	433.18	494.05	554.74
Y/Y growth	n.a.	117.6%	53.8%	29.9%	14.1%	12.3%
Adj. EBITDA (€m)	54.24	112.01	176.52	222.31	254.02	286.08
Net income (€m)	266.1	243.8	393.6	613.2	431.8	491.5
EPS (diluted) (€)	2.97	1.52	2.35	3.18	2.24	2.55
EPRA NAV (€m) ¹	861.92	1439.38	2544.35	3352.50	3800.23	4335.85
DPS (€)	0.00	0.21	0.20	0.50	0.58	0.66
FFO I (€m)	38.14	76.11	127.92	153.40	180.69	209.07
Net gearing	71.0%	103.9%	80.1%	53.9%	53.1%	50.0%
Liquid assets (€m)	166.80	272.30	388.93	810.72	752.07	769.10

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 specialist real estate firm focused on investing in and managing value-add opportunities in the German real estate property market. GCP's portfolio is primarily located in densely populated areas. The overarching strategy is to improve its properties through targeted modernisation and intensive tenant management, and thus create value by subsequently raising occupancy and rental levels.

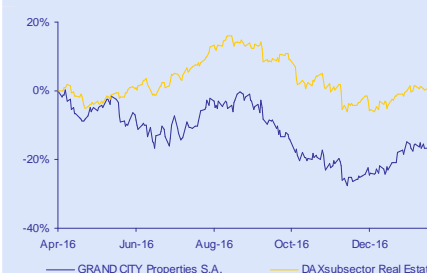
MARKET DATA

As of 23 Jan 2017

Closing Price	€ 16.88
Shares outstanding	153.79m
Market Capitalisation	€ 2595.98m
52-week Range	€ 14.73 / 20.50
Avg. Volume (12 Months)	227,116

Multiples	2015	2016E	2017E
P/FFO I	19.0	16.9	14.5
P/EPRA NAV	0.9	0.8	0.7
FFO I Yield	5.3%	5.9%	6.9%
Div. Yield	1.2%	3.0%	3.4%

STOCK OVERVIEW



COMPANY DATA

As of 30 Sep 2016

Liquid Assets	€ 643.50m
Current Assets	€ 1,050.50m
EPRA NAV ¹	€ 3,297.20m
Total Assets	€ 6,108.50m
Current Liabilities	€ 357.20m
Total Equity	€ 2,957.30m

¹ including hybrid notes

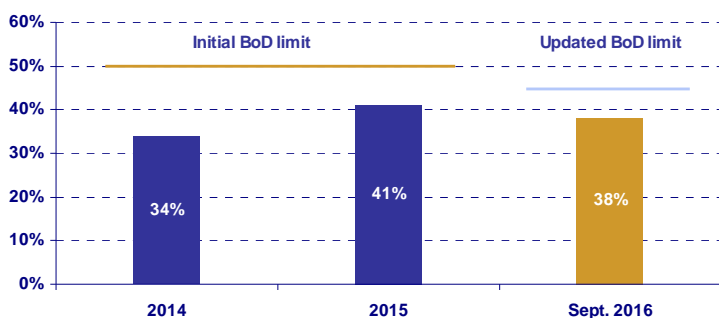
SHAREHOLDERS

Edolaxia Ltd.	35.6%
FMR LLC	4.5%
Merrill Lynch Intl	2.6%
Odey Asset Mngt	2.3%
Free Float	55.0%



Strong financial structure supports future growth In our view, management have done an excellent job in maintaining financial discipline alongside the exceptional growth of the past two years. The company’s conservative capital structure was recognised by Standard & Poor’s, which upgraded its long-term corporate credit rating of GCP to ‘BBB+’ from ‘BBB’ in November 2016. The key loan-to-value (LTV) metric dipped to 38% as of the September 2016 report, and management lowered the internal LTV limit to 45% from 50% and have their sights set on an ‘A -’ rating over the long term.

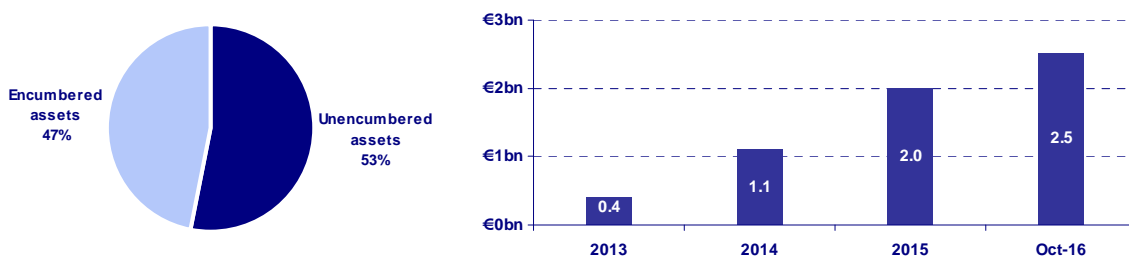
Figure 1: LTV development and internal limits set by the Board of Directors



Source: First Berlin Equity Research; Grand City Properties

As of October 2016, the unencumbered asset ratio was 53% of the portfolio value, while the overall value has more than doubled since YE/14. Moreover, the capital structure has allowed the company to report good financial coverage KPIs with an interest coverage ratio (ICR) of 6.2x and a debt to service coverage ratio (DSCR) of 4.6x as of the nine month report.

Figure 2: Unencumbered asset profile and corresponding value development

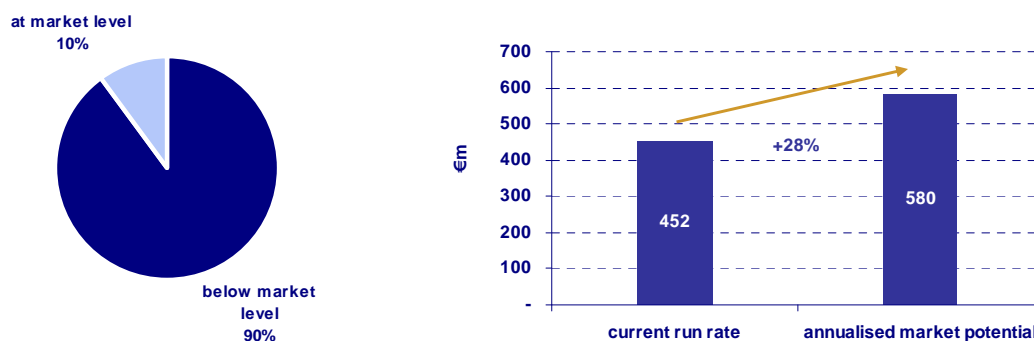


Source: First Berlin Equity Research; Grand City Properties

Grand City exited Q3/16 with liquid assets of some €644m, which should provide excellent flexibility to opportunistically grow, service its debt and cover CapEx needs over the next few years. We note the company has a weighted average debt maturity of seven years with the first sizable debts maturing in 2021 and 2022.

Current portfolio offers further upside; maintain Buy rating The monthly annualised rental income run rate was at €452m in October with an in-place rent of €5.35/m². This is well below the market rate of €6.50/m² for the corresponding regional footprint. Currently only 10% of the portfolio is priced at market levels leaving substantial upward scope for rent increases. Moreover, the EPRA vacancy rate of 8.1% likewise harbours room for improvement. Market observers believe the residential supply scarcity in Germany will persist in 2017, fuelled by rising pressure from economic and population growth. Property development is also unlikely to keep pace with tenant demand. In view of this environment, we believe the company will be able to further compress the vacancy rate some 100 basis p.a. to between 2% - 3% in the next five years. These factors should result in a rental income run rate of some €580m, which would then translate into additional FFO I of €70m - €80m. We also expect revaluation gains to range between €300m - €350m per annum over the next five years, which would help boost the EPRA NAV by some €1.5bn over this time frame.

Figure 3: Potential for rent increases to market levels and impact on rental income



Source: First Berlin Equity Research; Grand City Properties

If the tight supply environment persists and limits external growth opportunities, we believe management would increase its dividend payout policy to 60% - 70% of FFO I (presently: 50%). This would correspond to an attractive dividend yield north of 5% assuming a steady share price development towards our €25 price target.

We believe Grand City will be able to offset slower external growth with strong operational momentum. This should allow GCP to extract further embedded value from its sizable portfolio, which now totals 84k owned units. The company is well financed with a 1.6% cost of debt giving management the flexibility to make prudent acquisitions that follow disciplined investment criteria. The share currently trades at a 21% discount to the €3.3bn EPRA NAV (including perpetual notes). In our view, this is unwarranted and we maintain our Buy rating with a €25 price target.



EPRA NAV VALUATION MODEL

All figures in EUR '000	2016	2017	2018	2019
Shareholder's Equity	2,828,391	3,193,967	3,636,743	4,134,025
Consolidated NAV	3,019,708	3,419,830	3,901,923	4,443,088
NAV per share (€)	19.64	22.00	24.62	27.42
Deferred taxes	325,796	373,401	426,928	486,273
Derivative financial instruments	6,995	6,995	6,995	6,995
EPRA NAV	3,352,500	3,800,226	4,335,846	4,936,356
EPRA NAV per share (€)	21.80	24.45	27.36	30.46
FFO	153,402	180,690	209,068	235,444
Revaluation results	545,938	300,726	338,138	374,890
New Equity	-	-	-	-
Total return	699,340	481,416	547,205	610,333

EPRA NAV	3,352,500	3,800,226	4,335,846	4,936,356
Return on NAV	27.5%	14.4%	14.4%	14.1%
Cost of equity	5.0%	5.0%	5.0%	5.0%
Spread (percentage points)	22.5%	9.4%	9.4%	9.1%

	2016	2017	2018	2019
Value creation	755,454	357,522	409,620	450,416
NPV	755,454	347,625	386,491	412,404
Dividends paid	38,375	76,701	90,345	104,534
Present value of dividends paid	38,375	74,578	85,244	95,712

Fair value calculation	
PV of total value created	1,901,974
NAV (2015)	2,172,295
Adjustments	-
Equity value	4,074,269
PV of dividends	293,908
Fair value	4,368,178
Number of shares (fully diluted)	171,852
Fair value per share (€)	25.00



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	494,055	554,743
Revenue from sale of buildings	70,000	14,675	0	6,477	0	0
Revenue	169,630	231,512	333,497	439,655	494,055	554,743
Capital gains, property revaluations & other	236,846	230,969	311,131	545,938	300,726	338,138
Result from equity-accounted investees	470	94	0	0	0	0
Property expenses	-42,711	-100,175	-151,552	-199,262	-227,265	-255,182
Cost of buildings sold	-54,914	-14,425	0	-4,450	0	0
Administration expenses	-3,339	-5,650	-7,153	-13,335	-14,749	-15,703
Operating income (EBIT)	305,982	342,325	485,923	768,546	552,767	621,996
Finance expenses	-11,320	-22,040	-25,830	-37,788	-37,765	-36,959
Other financial results	7,778	-32,664	-73	0	0	0
Pre-tax income (EBT)	302,440	287,621	460,020	730,758	515,002	585,037
Tax and deferred tax expenses	-36,388	-43,787	-66,450	-117,546	-83,167	-93,578
Minority interests	-39,777	-38,259	-35,120	-49,057	-34,547	-39,317
Hybrid note investors	0	0	-14,517	-22,689	-15,978	-18,184
Net income	226,275	205,575	343,933	541,467	381,310	433,958
Basic EPS (in €)	2.97	1.73	2.71	3.52	2.45	2.74
Diluted EPS (in €)	2.97	1.52	2.35	3.18	2.24	2.55
Adjusted EBITDA	54,243	112,009	176,521	222,314	254,017	286,077
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%	14.1%	12.3%
Total revenues	n.a.	36.5%	44.1%	31.8%	12.4%	12.3%
Operating income	n.a.	11.9%	41.9%	58.2%	-28.1%	12.5%
Adjusted EBITDA	n.a.	106.5%	57.6%	25.9%	14.3%	12.6%
Net income/ loss	n.a.	-9.1%	67.3%	57.4%	-29.6%	13.8%
Funds from Operations (FFO)						
Operating profit	305,982	342,325	485,923	768,546	552,767	621,996
Depreciation and amortisation	193	903	1,729	1,733	1,976	2,219
EBITDA	306,175	343,228	487,652	770,279	554,743	624,215
Capital gains, property revaluations and other	-236,846	-230,969	-311,131	-545,938	-300,726	-338,138
Result from disposal of trading properties	-15,086	-250	0	-2,027	0	0
Adjusted EBITDA	54,243	112,009	176,521	222,314	254,017	286,077
Financial expense	-11,320	-22,040	-25,830	-37,788	-37,765	-36,959
Tax	-4,780	-13,863	-22,776	-31,124	-35,562	-40,051
FFO I	38,143	76,106	127,915	153,402	180,690	209,068



BALANCE SHEET

All figures in EUR '000	2013A	2014A	2015A	2016E	2017E	2018E
Assets						
Current assets, total	248,592	401,815	627,204	1,059,001	1,035,239	1,087,056
Cash and cash equivalents	132,542	270,131	236,001	657,800	599,147	616,180
Traded securities at fair value through 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	270,715	303,969
Inventories - Trading property	19,949	5,814	11,877	10,918	12,453	13,983
Non-current assets, total	1,402,495	2,227,243	4,061,699	4,937,780	5,558,040	6,219,519
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	4,710,257	5,318,024	5,966,272
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	5,996,781	6,593,279	7,306,575
Shareholders' equity & debt						
Current liabilities, total	111,277	153,266	277,317	290,584	329,107	368,881
Short-term debt	10,563	5,792	54,676	16,481	19,552	23,893
Trade and other payables	92,357	128,837	190,358	240,206	273,963	307,617
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	2,686,488	2,844,342	3,035,771
Long-term debt	461,753	537,217	792,224	824,058	977,578	1,194,655
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	325,796	373,401	426,928
Other LT liabilities	35,287	39,090	39,704	41,339	43,057	44,860
Minority interests	63,001	90,736	142,260	191,317	225,864	265,181
Shareholders' equity	704,924	950,914	2,030,035	2,828,391	3,193,967	3,636,743
Total consolidated equity and debt	1,651,087	2,629,058	4,688,903	5,996,781	6,593,279	7,306,575
Ratios						
Current ratio (x)	2.23	2.62	2.26	3.64	3.15	2.95
Equity ratio	46.5%	39.6%	46.3%	50.4%	51.9%	53.4%
EPRA NAV ('000)	861,926	1,439,386	2,544,347	3,352,500	3,800,226	4,335,846
Net debt ('000)	500,192	987,545	1,625,964	1,525,109	1,695,365	1,818,771
Financial leverage	71.0%	103.9%	80.1%	53.9%	53.1%	50.0%
Loan-to-value	36.2%	45.1%	42.1%	32.3%	31.8%	30.4%
Return on equity (ROE)	34.6%	23.4%	18.1%	20.3%	12.6%	12.6%



CASH FLOW STATEMENT

All figures in EUR '000	2013A	2014A	2015A	2016E	2017E	2018E
Net income	266,052	243,834	393,570	613,212	431,835	491,459
Depreciation and amortisation	193	903	1,729	1,733	1,976	2,219
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	-545,938	-300,726	-338,138
Net finance expenses	3,542	54,704	25,903	37,788	37,765	36,959
Tax result	36,388	43,787	66,450	117,546	83,167	93,578
Others	0	171	753	0	0	0
Operating cash flow	68,859	112,337	177,274	224,341	254,017	286,077
Inventories - trading properties	0	14,134	-943	959	-1,534	-1,530
Trade & other receivables	-14,169	-39,030	-24,825	-10,956	-33,357	-33,254
Trade & other payables	7,463	31,359	20,234	49,848	33,757	33,653
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	-35,562	-40,051
Net cash flow from operating activities	61,401	113,884	157,448	235,233	219,540	247,167
Investment in fixed/intangible assets	-975	-1,847	-3,680	-2,682	-3,020	-3,368
Investments and acquisitions of investment property	-309,468	-349,944	-406,475	-318,340	-307,040	-310,110
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	-330,792	-320,318	-324,249
Debt financing, net	219,917	393,143	440,130	443,520	156,590	221,419
Equity financing, net	201,546	0	639,939	150,000	0	0
Other financing activities	-7,562	-11,648	-23,735	-38,375	-76,701	-90,345
Net paid financing expenses	-12,874	-29,887	-32,864	-37,788	-37,765	-36,959
Cash flow from financing	401,027	351,608	1,023,470	517,357	42,125	94,115
Net cash flows	51,565	137,589	-34,130	421,799	-58,653	17,033
Cash, start of the year	80,977	132,542	270,131	236,001	657,800	599,147
Cash, end of the year	132,542	270,131	236,001	657,800	599,147	616,180
Adjusted EBITDA/share (in €)	0.71	0.94	1.27	1.45	1.63	1.81
FFO I	38,143	76,106	127,915	153,402	180,690	209,068
FFO/share (in €)	0.50	0.66	0.89	1.00	1.16	1.32
Y-Y Growth						
Operating cash flow	n.a.	85.5%	38.3%	49.4%	-6.7%	12.6%
Adjusted EBITDA/share	n.a.	32.6%	33.9%	14.3%	13.0%	10.5%
FFO I	n.a.	99.5%	68.1%	19.9%	17.8%	15.7%

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...14	↓	↓	↓	↓
15	18 May 2016	€19.92	Buy	€25.00
16	22 August 2016	€20.09	Buy	€26.00
17	18 November 2016	€15.17	Buy	€25.00
18	Today	€16.88	Buy	€25.00

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INFORMATION PURSUANT TO SECTION 34B OF THE GERMAN SECURITIES TRADING ACT [WPHG], TO REGULATION (EU) NO 596/2014 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL OF APRIL 16, 2014, ON MARKET ABUSE (MARKET ABUSE REGULATION) AND TO THE GERMAN ORDINANCE ON THE ANALYSIS OF FINANCIAL INSTRUMENTS [FINANV]

First Berlin Equity Research GmbH (hereinafter referred to as: "First Berlin") prepares financial analyses while taking the relevant regulatory provisions, in particular the German Securities Trading Act [WpHG], Regulation (EU) No 596/2014 of the European Parliament and of the Council of April 16, 2014, on market abuse (market abuse regulation) and the German Ordinance on the Analysis of Financial Instruments [FinAnV] into consideration. In the following First Berlin provides investors with information about the statutory provisions that are to be observed in the preparation of financial analyses.

CONFLICTS OF INTEREST

In accordance with Section 34b Paragraph 1 of the German Securities Trading Act [WpHG] and Regulation (EU) No 596/2014 of the European Parliament and of the Council of April 16, 2014, on market abuse (market abuse regulation) financial analyses may only be passed on or publicly distributed if circumstances or relations which may cause conflicts of interest among the authors, the legal entities responsible for such preparation or companies associated with them are disclosed along with the financial analysis.

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- The author, First Berlin, or a company associated with First Berlin provided investment banking or consulting services for the analysed company within the past twelve months for which remuneration was or was to be paid;
- The author, First Berlin, or a company associated with First Berlin reached an agreement with the analysed company for preparation of a financial analysis for which remuneration is owed;
- The author, First Berlin, or a company associated with First Berlin has other significant financial interests in the analysed company;

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PRICE TARGET DATES

Unless otherwise indicated, current prices refer to the closing prices of the previous trading day.

AGREEMENT WITH THE ANALYSED COMPANY AND MAINTENANCE OF OBJECTIVITY

The present financial analysis is based on the author's own knowledge and research. The author prepared this study without any direct or indirect influence exerted on the part of the analysed company. Parts of the financial analysis were possibly provided to the analysed company prior to publication in order to avoid inaccuracies in the representation of facts. However, no substantial changes were made at the request of the analysed company following any such provision.

ASSET VALUATION SYSTEM

First Berlin's system for asset valuation is divided into an asset recommendation and a risk assessment.

ASSET RECOMMENDATION

The recommendations determined in accordance with the share price trend anticipated by First Berlin in the respectively indicated investment period are as follows:

STRONG BUY: An expected favourable price trend of more than 50% combined with sizeable confidence in the quality and forecast security of management.

BUY: An expected favourable price trend of more than 25% percent.

ADD: An expected favourable price trend of between 0% and 25%.

REDUCE: An expected negative price trend of between 0% and -15%.

SELL: An expected negative price trend of more than -15%.

RISK ASSESSMENT

The First Berlin categories for risk assessment are low, average, high and speculative. They are determined by ten factors: Corporate governance, quality of earnings, management strength, balance sheet and financial risk, competitive position, standard of financial disclosure, regulatory and political uncertainty, strength of brandname, market capitalisation and free float. These risk factors are incorporated into the First Berlin valuation models and are thus included in the target prices. First Berlin customers may request the models.

INVESTMENT HORIZON

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UPDATES

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