

GRAND CITY Properties S.A.

Luxembourg / Real Estate
 Frankfurt
 Bloomberg: GYC GR
 ISIN: LU0775917882

2019
 Results

RATING
BUY

PRICE TARGET
€ 28.00

Return Potential 74.6%
 Risk Rating Medium

2019 RESULTS ARE REASON FOR OPTIMISM ONCE MARKETS CALM

Grand City reported annual results in line with FBe and full year guidance. Earnings outperformed topline growth, thanks to good operational scalability and a portfolio loaded with upside. Management discussed the impact of covid-19 and the Berlin rent cap on the conference call, and 2020 guidance is set. Headline results showed solid mid-single digit annualised growth, which the company expects to continue this year despite the current market turbulence. Operations should not be directly impacted by the coronavirus and Berlin's rent freeze will have only a marginal effect on performance, owing to portfolio diversity. We maintain our Buy rating and €28 price target.

Good fundamentals not enough for nervous investors GCP shares have fallen some 33% off mid-February highs as global bourses continue to be routed on recessionary fears traced to covid-19. Despite the poor market sentiment, Grand City looks well positioned to weather an economic downturn and operations should not be hindered by covid-related restrictions. The company will also be able to absorb the rent freeze in the German capital. Management guide for > 2% LFL rental growth in 2020. However, investors will likely continue to shrug at good fundamentals and widening NAV discounts until market volatility moderates and there is greater clarity on the economic downside once the spread of covid-19 flattens out. That said, we believe German residential will be among the quickest sectors to recover given its strong cashflow visibility and attractive dividend yield. Grand City's dividend yield now tops 5% after the retreat in the share price.

New guidance calls for FFOPS 1 growth of 3.1% to 6.3% 2019 results flourished on the back of strong operational upside combined with opportunistic external growth. The company recycled cash from the disposal. . . (p.t.o.)

FINANCIAL HISTORY & PROJECTIONS

	2016	2017	2018	2019	2020E	2021E
Rental income (€m)	435.67	494.89	544.98	560.30	592.96	624.12
Y/Y growth	30.6%	13.6%	10.1%	2.8%	5.8%	5.3%
Adj. EBITDA (€m)	224.73	247.98	275.53	297.66	309.82	326.10
Net income ² (€m)	542.5	534.6	488.6	406.9	407.5	416.6
EPS (diluted) (€)	3.25	3.06	2.76	2.29	2.28	2.33
EPRA NAV ¹ (€m)	2,402.09	3,208.45	3,993.06	4,783.07	5,172.02	5,531.35
DPS (€)	0.68	0.73	0.64	0.82	0.85	0.91
FFO 1 (€m)	160.12	178.01	197.85	211.97	220.05	235.04
FFOPS 1 (€)	1.05	1.12	1.19	1.27	1.31	1.40
Liquid assets (€m)	630.27	401.48	765.04	1069.46	895.24	571.60

¹ including perpetual notes ² after minority interests and hybrid investors

RISKS

Risks include, but are not limited to, unfavourable interest rate developments, unfavourable macroeconomic developments, and departure of key personnel.

COMPANY PROFILE

Grand City Properties is a specialist real estate company focused on investing in and managing value-add opportunities in the German real estate market. The overarching strategy is to improve the portfolio through targeted modernisation and intensive tenant management and thus create value by subsequently raising occupancy and rental levels.

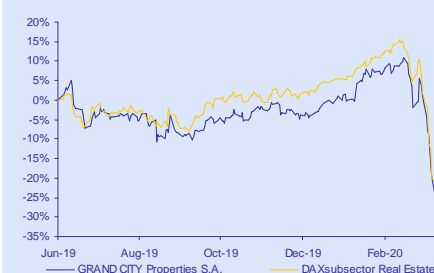
MARKET DATA

As of 19 Mar 2020

Closing Price	€ 16.04
Shares outstanding	167.92m
Market Capitalisation	€ 2693.44m
52-week Range	€ 14.28 / 23.94
Avg. Volume (12 Months)	252,150

Multiples	2019	2020E	2021E
P/FFO 1	12.7	12.2	11.5
P/EPRA NAV	0.5	0.5	0.5
FFO 1 Yield	7.9%	8.2%	8.7%
Div. Yield	5.1%	5.3%	5.7%

STOCK OVERVIEW



COMPANY DATA

As of 31 Dec 2019

Liquid Assets	€ 1,063.00m
Investment properties	€ 7,956.00m
EPRA NAV ¹	€ 5,150.00m
Total Assets	€ 9,851.00m
Current Liabilities	€ 454.00m
Total Equity	€ 4967.00m

¹ including perpetual notes

SHAREHOLDERS

Edolaxia Ltd.	39.0%
Free float	61.0%



. . . of mature and non-core properties to expand portfolios in London, Berlin, and Munich. Disposals totalled €0.5bn for the year against around €650m in acquisitions. Including revaluation gains, investment properties thus grew to €7.9bn (YE18: €7.2bn).

We expect operations to follow the same blueprint in 2020 with performance spurred by organic growth and value extraction, while GCP continues to filter its ~€300m pipeline with a 5.0% unlevered NOI (net operating income) as a hurdle rate for future acquisitions. Management expect FFO 1 to reach €220m – €226m this year, spurred by > 2.0% like-for-like (LFL) growth. This also factors in the Berlin rent cap and all related rent adjustment effects. We view this as highly achievable.

Quantifying the effects of the Berlin rent cap The law was passed on 30 January 2020 and implemented on 23 February. Thanks largely to GCP's portfolio diversification, the Berlin properties only constitute 14% of the YE19 portfolio's annualised rent. The downside from the now mandatory rent reduction to match the rent cap table will shave €3m off of rental income, which is less than 1% of overall top line. We have written about our views on the Berlin rent cap a number of times and maintain that the answer to the capital's acute housing shortage lies in addressing the sputtering supply of new build.

SCALABILITY DRIVES ANNUAL RESULTS

Both the top line and earnings showed solid performances led by a 8% Y/Y rise in adjusted EBITDA. This was spurred by continued strong like-for-like (LFL) performance. Last year, GCP realised total LFL net rental growth of 3.6% comprising 2.9% in-place rent and 0.7% occupancy increases.

Table 1: Full year results vs forecasts

in €m	Q4/19	Q4/19E	Variance	Q4/18	Variance	2019	2018	Variance
Rental income	142	142	0.4%	141	0.7%	560	545	2.8%
Net rent	98	98	0.2%	92	6.3%	383	364	5.2%
Adjusted EBITDA	78	77	1.4%	72	8.5%	298	276	8.0%
margin	55%	54%	-	51%	-	53%	51%	-
FFO 1	52	52	0.4%	48	8.3%	212	198	7.1%
FFOPS 1 (€)	0.31	0.31	0.0%	0.28	10.7%	1.27	1.19	6.7%

Source: First Berlin Equity Research; Grand City Properties

FFO 1, the key industry indicator for recurring cash flow, matched our estimate at €52m in Q4/19 and beat the prior year result by 8.0% equating to FFOPS 1 of €0.31. On a full year basis, FFO 1 rose 7.1% Y/Y to €212m or €1.27 per share (+6.7% Y/Y). The strong bottom line performance owes chiefly to the 3.6% LFL rental income growth. FFOPS 1 corresponds to a 7.3% yield and translates to a 7.0% CAGR for the period 2016 to 2019. Adjusted for perpetual note attribution, FFOPS 1 equalled €1.07 vs €1.01 in 2018.

As part of its capital recycling strategy, Grand City disposed of fully optimised and non-core properties in 2019 for proceeds of €500m—7% over net book value. This generated a €169m economic profit at a roughly 52% margin resulting in FFO 2 of €381m for the year (2018: €334m; +14%). AFFO (adjusted funds from operations), which strips out repositioning CapEx as a measure of recurring operational cash flows, increased to €136m vs €122m last year (+11%).



The 'property revaluations and capital gains' line item totalled €104m for the quarter (Q4/18: €123m). For the full year period, this KPI totalled €401m compared to €506m in 2018. Revaluations resulted chiefly (75%) from rental income growth and operational measures with the balance attributed to yield compression. The continued strong development relates to GCP's value-add business model: acquiring properties with strong value upside and repositioning the assets to unlock this potential. At year end, the average value per m² determined by external auditors climbed to €1,543 vs €1,257 YE18 (+23%) and corresponded to a net rental income yield of 4.9%. The net rent multiple equalled 20.4x vs 18.9x for YE18.

Adjusted EBITDA, which reflects recurring operational profit excluding capital gains and revaluation effects, rose 8.5% Y/Y to €78m in Q4 (Q4/18: €72m) and 7% Q/Q. The 2019 figure climbed 11% Y/Y to €298m (2018: €276m). The operational performance demonstrates the scalability of the business with earnings expanding quicker than net rent. We also note that growth was achieved despite the aforementioned capital recycling measures.

As of YE 2019, EPRA NAV totalled €4.1bn (€24.5 / share) compared to €3.8bn at year end 2018 (€22.2 / share, +9%). EPRA NAV growth owes predominantly to the strong net profit attributable to the owners of the company of €407m recorded for the year. Including the perpetual notes, which are classified as equity under IFRS, this KPI stood at €5.2bn or €30.6 / share (+7%).

The portfolio continues to feature strong clusters in Berlin (24%), North Rhine-Westphalia (27%), and Dresden / Leipzig / Halle (14%). The NRI yield topped 5.3% at YE vs 5.5% at the end of 2018.

Table 2: Portfolio overview as of YE19

	Investment properties (€m)	Rentable area ('000 m ²)	EPRA vacancy	Annualised net rent (€m)	In-place rent (€/m ²)	Number of units	Value (€/m ²)	Rental yield
NRW	1,883	1,649	7.9%	107	5.8	24,410	1,142	5.7%
Berlin	1,678	558	5.0%	53	8.3	7,580	3,008	3.2%
Dresden / Leipzig / Halle	1,018	925	9.0%	53	5.3	15,921	1,100	5.2%
Mannheim / KL / Frankfurt / Mainz	384	225	4.1%	20	7.5	3,788	1,705	5.1%
Nuremberg / Fürth / Munich	307	117	2.9%	13	9.4	1,802	2,632	4.3%
Hamburg / Bremen	375	297	4.4%	21	6.1	4,265	1,263	5.5%
London	907	109	4.0%	40	31.9	2,134	8,349	4.4%
Others	959	989	7.7%	61	5.9	16,746	969	6.4%
Development rights & new build	461	-	-	-	-	-	-	-
Total	7,972	4,869	6.7%	368	6.8	76,646	1,543	4.9%

Source: First Berlin Equity Research; Grand City Properties



Capital structure features strong debt metrics and cash position GCP exited 2019 with cash and liquid assets of €1.1bn compared to €760m at the end of last year, while net debt stood at €2.7bn vs €2.6bn at the end of 2018. The debt structure features an LTV of 33%, which remains well below the 45% internal limit set by the Management Board. Coverage ratios were solid with a debt service coverage ratio (DSCR) and an interest coverage ratio (ICR) of 5.5x and 6.6x respectively at the end of Q4. The debt portfolio carries an 8 year maturity with a 1.3% average cost of debt (YE18: 1.3%), while 93% of the capital structure is hedged. Management reiterated its desire to extend debt maturities as opportunities arise and confirmed financial firepower of some €1bn to go alongside the overall €300m pipeline, while keeping the LTV below 45%.

Table 3: Financial highlights

in €m	2019	2018	Variance
Cash & liquid assets	1,063	760	40%
Investment property ¹	7,972	7,244	10%
Total equity	4,967	4,667	6%
EPRA NAV incl. hybrid notes	5,150	4,783	8%
EPRA NAV	4,120	3,753	10%
Interest bearing debt	559	871	-36%
Straight bonds	2,920	2,177	34%
Convertible bond	275	272	1%
Loan-to-Value (LTV)	33%	34%	-
Equity ratio	50%	53%	-

¹ including inventories-trading property

Source: First Berlin Equity Research; Grand City Properties



LOOKING AHEAD

Table 3: Guidance for 2020 and FBe

	Unit	2020 Guidance	2020E
FFO 1	€m	220 - 226	220
FFOPS 1	€	1.31 - 1.35	1.31
DPS	€	0.85 - 0.87	0.85
LFL net rent growth	%	> 2.0	2.0
LTV	%	< 45	34

Source: First Berlin Equity Research; Grand City Properties

Organic growth still the driving story We have adopted the 2% LFL rental growth guidance for 2019 and believe this will normalise at ~2.5% over the mid-term as long as the Berlin rent cap remains in place. Based on the communicated €300m pipeline, we have modelled some €150m in net acquisitions this year. The company communicated post-reporting disposals of €250m, but we expect GCP to be a net buyer this year. Our NRI assumptions equate to a 4% CAGR for 2020 – 2021 and 5% FFO 1 CAGR for this time frame. Key changes to forecasts are shown below. The decline in NRI owes to the impact of the Berlin rent cap, while profitability remains more stable after adjusting for better than expected scale effects visible in 2019 reporting.

Table 4: Changes to forecasts

	old	new	revision	upside	dividend yield	total upside
Price target (€)	28.0	28.0	0.0%	74.6%	5.1%	79.7%
	2020E			2021E		
in €m	Old	New	Variance	Old	New	Variance
Net rent (NRI)	408	391	-4.1%	424	412	-2.8%
Adj. EBITDA	313	310	-1.0%	326	326	0.0%
margin (NRI)	77%	79%	-	77%	79%	-
FFO 1	224	220	-1.8%	236	235	-0.4%
Margin	55%	56%	-	56%	57%	-
FFOPS 1 (€)	1.34	1.31	-1.8%	1.41	1.40	-0.4%

Source: First Berlin Equity Research estimates



VALUATION MODEL

in €m	2020E	2021E	2022E	2023E	TV
EBITDA	310	326	345	363	367
(+) Revaluations	323	319	260	261	58
(+) Investment income	0	0	0	0	0
(-) Tax expense	95	97	91	94	64
NOPAT	538	548	514	531	361
Total assets	10,233	10,498	11,154	11,712	11,712
(-) Current liabilities	436	458	483	508	508
(+) Current financial debt	33	33	33	33	33
(-) Cash	740	416	494	482	482
(+) Deferred taxes	597	645	692	737	737
Capital employed (CE)	9,687	10,302	10,902	11,492	11,492
Average CE	9,377	9,995	10,602	11,197	11,492
ROCE	5.7%	5.5%	4.8%	4.7%	3.1%
WACC	3.1%	3.1%	3.1%	3.1%	3.1%
ROCE-WACC	2.6%	2.4%	1.8%	1.7%	0.1%
Economic Profit	248	240	187	185	6
NPV	243	227	172	165	279
Fair value calculation					
Total return	1,085				
(+) EPRA NAV (2019)	4,120				
(-) Dividend to be paid	138				
Equity value	5,068				
Diluted SO (m)	181				
Fair value per share (€)	28.00				
Valuation metrics					
Price target (€)	28.00	28.00	28.00	28.00	
Share price (€)	16.04	16.04	16.04	16.04	
Return potential	74.6%	74.6%	74.6%	74.6%	
Dividend yield	5.3%	5.7%	5.8%	5.9%	
Total return potential	79.9%	80.2%	80.4%	80.5%	
FFOPS 1 yield	8.2%	8.7%	9.0%	9.2%	
DPS (€)	0.85	0.91	0.90	0.96	



INCOME STATEMENT

All figures in EURm	2016	2017	2018	2019	2020E	2021E
Net rent	285	328	364	383	391	412
Rental and operating income	436	495	545	560	593	624
Revenue from sale of buildings	7	2	0	0	0	0
Revenue	443	497	545	560	593	624
Capital gains, property revaluations & other	598	616	507	401	323	319
Result from equity-accounted investees	1	6	1	0	0	0
Property expenses	-204	-239	-263	-256	-273	-287
Cost of buildings sold	-5	-1	0	0	0	0
Administration expenses	-10	-11	-11	-13	-13	-14
Operating income (EBIT)	823	868	780	693	629	642
Finance expenses	-36	-40	-46	-45	-50	-50
Other financial results	-11	-43	-36	-33	0	0
Pre-tax income (EBT)	775	786	698	615	579	592
Tax and deferred tax expenses	-122	-146	-115	-121	-87	-90
Minority interests	-88	-80	-64	-53	-52	-53
Hybrid note investors	-23	-24	-30	-33	-33	-33
Net income	542	535	489	407	408	417
Basic EPS (€)	3.56	3.35	2.95	2.43	2.43	2.48
Diluted EPS (€)	3.25	3.06	2.76	2.29	2.28	2.33
Adjusted EBITDA	225	248	276	298	310	326
Ratios						
Adjusted EBITDA margin	51.6%	50.1%	50.6%	53.1%	52.3%	52.3%
Tax rate	11.9%	-11.3%	-10.8%	-12.5%	11.5%	11.5%
Expenses as % of revenues						
Property expenses	46.8%	48.3%	48.2%	45.6%	46.0%	46.0%
Administration expenses	2.2%	2.2%	1.9%	2.3%	2.3%	2.3%
Y-Y Growth						
Rental and operating income	30.6%	13.6%	10.1%	2.8%	5.8%	5.3%
Total revenues	32.7%	12.2%	9.7%	2.8%	5.8%	5.3%
Operating income	69.3%	5.5%	-10.2%	-11.1%	-9.2%	1.9%
Adjusted EBITDA	26.8%	10.3%	11.1%	8.0%	4.1%	5.3%
Net income/ loss	57.7%	-1.5%	-8.6%	-16.7%	0.1%	2.2%
Funds from Operations (FFO)						
Operating profit	823	868	780	693	629	642
Depreciation and amortisation	2	2	3	4	3	3
EBITDA	825	871	782	697	632	645
Capital gains, property revaluations and other	-598	-616	-507	-401	-323	-319
Result from disposal of trading properties	-2	0	0	0	0	0
Others	0	-6	0	2	0	0
Adjusted EBITDA	225	248	276	298	310	326
Financial expense	-36	-40	-46	-45	-50	-50
Tax	-27	-28	-30	-37	-36	-38
Minorities	-1	-2	-2	-4	-4	-4
FFO 1	160	178	198	212	220	235
CapEx	-56	-67	-75	-76	-74	-79
AFFO	104	111	122	136	146	156



BALANCE SHEET

All figures in EURm	2016	2017	2018	2019	2020E	2021E
Assets						
Current assets, total	1,028	796	1,238	1,629	1,466	1,165
Cash and cash equivalents	449	312	603	914	740	416
Traded securities at fair value through P&L	181	89	162	155	155	155
Trade and other receivables	220	260	319	342	354	376
Inventories - Trading property	27	12	17	16	15	16
Assets held for sale	150	123	136	201	201	201
Non-current assets, total	5,126	6,712	7,623	8,223	8,767	9,334
Equipment and intangible assets	16	20	24	27	30	33
Investment property	4,823	6,414	7,282	7,981	8,509	9,059
Equity accounted investees	118	37	26	21	21	21
Other LT assets	155	214	254	151	160	170
Deferred tax assets	15	28	37	42	47	51
Total assets	6,154	7,508	8,861	9,851	10,233	10,498
Shareholders' equity & debt						
Current liabilities, total	338	371	306	454	436	458
Short-term debt	29	62	22	33	33	33
Trade and other payables	252	267	242	288	262	275
Other current liabilities	58	42	42	133	141	150
Long-term liabilities, total	2,750	3,288	3,887	4,431	4,476	4,361
Long-term debt	897	919	846	521	500	450
Convertible and straight bonds	1,478	1,810	2,450	3,195	3,205	3,081
Deferred taxes	326	500	523	592	644	696
Other LT liabilities	50	59	69	122	127	133
Minority interests	197	364	409	444	496	548
Shareholders' equity	2,868	3,485	4,258	4,523	4,825	5,131
Total consolidated equity and debt	6,154	7,508	8,861	9,851	10,233	10,498
Ratios						
Current ratio (x)	3.04	2.15	4.04	3.59	3.36	2.54
Equity ratio	50%	51%	53%	50%	52%	54%
EPRA NAV ¹ (€m)	3,208	3,993	4,783	5,150	5,487	5,846
Net debt (€m)	1,783	2,393	2,560	2,690	2,843	2,993
Net debt / equity	0.6	0.7	0.6	0.6	0.6	0.6
Net debt / EBITDA (x)	7.9	9.7	9.3	9.0	9.2	9.2
Interest cover (x)	6.2	6.2	6.0	6.6	6.1	6.6
Loan-to-value (LTV)	35%	36%	34%	33%	33%	32%
Return on equity (ROE)	21.3%	16.6%	12.5%	9.9%	9.2%	8.8%

¹ including perpetual notes



CASH FLOW STATEMENT

All figures in EURm	2016	2017	2018	2019	2020E	2021E
Net income	653	639	583	493	492	502
Depreciation and amortisation	2	2	3	4	3	3
Profit from equity accounted investees	-1	-6	-1	0	0	0
Change in fair value of investment properties	-598	-616	-507	-401	-323	-319
Net finance expenses	47	83	82	78	50	50
Tax result	122	146	115	121	87	90
Others	1	1	1	2	0	0
Operating cash flow	227	248	276	298	310	326
Change in working capital	-7	-24	-23	-20	-28	0
Tax paid	-19	-23	-28	-28	-36	-38
Net cash flow from operating activities	201	202	225	249	246	289
Investment in fixed/intangible assets	-3	-6	-6	-7	-6	-6
Net property investments / disposals	-476	-374	-501	-194	-206	-231
Acquisition of subsidiaries	-111	-324	-112	31	0	0
Proceeds from investments in financial assets	33	95	-100	117	-9	-10
Cash flow from investing	-557	-608	-718	-53	-220	-246
Debt financing, net	487	597	916	360	-12	-173
Equity financing, net	171	176	312	-33	0	0
Dividend paid	-38	-112	-79	-107	-138	-143
Other financing activities	-5	-345	-306	-55	0	0
Net paid financing expenses	-46	-47	-56	-50	-50	-50
Cash flow from financing	569	269	786	115	-200	-366
Net cash flows	213	-137	291	311	-174	-324
Cash, start of the year	236	449	312	603	914	740
Cash, end of the year	449	312	603	914	740	416
Adjusted EBITDA / share (€)	1.46	1.50	1.65	1.77	1.85	1.94
FFO I	160	178	198	212	220	235
FFOPS I (€)	1.05	1.12	1.19	1.27	1.31	1.40
Y-Y Growth						
Operating cash flow	27.8%	0.5%	11.0%	11.1%	-1.4%	17.4%
Adjusted EBITDA / share	15.0%	3.0%	9.8%	7.3%	4.1%	5.3%
FFO 1	25.1%	11.2%	11.1%	7.1%	3.8%	6.8%
FFOPS 1	3.9%	6.5%	7.1%	6.1%	3.5%	6.8%

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...33	↓	↓	↓	↓
34	20 August 2019	€20.46	Buy	€28.00
35	20 November 2019	€21.44	Buy	€28.00
36	10 March 2020	€20.66	Buy	€28.00
37	Today	€16.04	Buy	€28.00

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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:

Category		1	2
Current market capitalisation (in €)		0 - 2 billion	> 2 billion
Strong Buy ¹	An expected favourable price trend of:	> 50%	> 30%
Buy	An expected favourable price trend of:	> 25%	> 15%
Add	An expected favourable price trend of:	0% to 25%	0% to 15%
Reduce	An expected negative price trend of:	0% to -15%	0% to -10%
Sell	An expected negative price trend of:	< -15%	< -10%

¹ The expected price trend is in combination with sizable confidence in the quality and forecast security of management.

Our recommendation system places each company into one of two market capitalisation categories. Category 1 companies have a market capitalisation of €0 – €2 billion, and Category 2 companies have a market capitalisation of > €2 billion. The expected return thresholds underlying our recommendation system are lower for Category 2 companies than for Category 1 companies. This reflects the generally lower level of risk associated with higher market capitalisation companies.

RISK ASSESSMENT

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Legally required information regarding

- key sources of information in the preparation of this research report
- valuation methods and principles
- sensitivity of valuation parameters

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SUPERVISORY AUTHORITY: Bundesanstalt für Finanzdienstleistungsaufsicht (German Federal Financial Supervisory Authority) [BaFin], Graurheindorferstraße 108, 53117 Bonn and Lurgiallee 12, 60439 Frankfurt

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