GRAND CITY Properties S.A.

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

Q1 2020
results

RATING	**BUY**
PRICE TARGET	**€ 27.50**
Return Potential	39.0%
Risk Rating	Medium

STEADY Q1 PERFORMANCE IN UNSTABLE TIMES

First quarter reporting featured a steady operational performance, despite regulatory and pandemic headwinds. FFO 1 led headline figures with 5% annualised growth. The company will stick to its planned dividend payout, and management adjusted full year guidance to reflect the recent €0.6bn bond issuance and the decision to postpone further acquistions for now. FFOPS 1 is now expected at €1.27 to €1.31 (old: €1.31 - €1.35). With over €1.5bn in liquid assets and a well diversified portfolio, we continue to believe GCP is well structured to ride out the ripple effects of the pandemic world. Our price target moves to €27.5 (old: €28) after recalibrating our estimates. Our rating remains Buy.

Takeaways from today's call Aside from the earnings presentation, yesterday's call focused largely on the ripple effects of the pandemic on operations. Management stayed in the lane of cautious optimism, while addressing a range of scenarios. In April, GCP placed a €0.6bn bond to bolster liquidity. Although the 1.7% coupon raised some eyebrows, we regard this as a prudent insurance policy if the crisis re-escalates. Plus, the company can put the proceeds to work when acquistions resume or further optimise its capital structure. The €1.5bn in liquid assets should reassure investors in the event of a prolonged economic downturn and if financing options become more challenging. London continues to grow as a portfolio stronghold thanks to €100m in Q1 acquisitions. GCP bought 50 centrally located flats (Hackney, Greenwich) and continues to target 20% portfolio footprint in the British capital. However, further acquistions have been postponed for now until there is greater clarity on the pandemic. The company also discussed the growing sentiment for a legal reversal of the Berlin rent cap. Proceedings have been initiated at the federal court level increasing the likelihood of a swift decision that would essentially disarm Berlin in terms. . . (p.t.o.)

FINANCIAL HISTORY & PROJECTIONS

	2016	2017	2018	2019	2020E	2021E
Rental income (€m)	435.67	494.89	544.98	560.30	571.26	593.15
Y/Y growth	30.6%	13.6%	10.1%	2.8%	2.0%	3.8%
Adj. EBITDA (€m)	224.73	247.98	275.53	297.66	309.91	321.78
Net income² (€m)	542.5	534.6	488.6	406.9	387.0	397.3
EPS (diluted) (€)	3.25	3.06	2.76	2.29	2.16	2.22
EPRA NAV¹ (€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	0.82	0.86
FFO 1 (€m)	160.12	178.01	197.85	211.97	213.07	221.07
FFOPS 1 (€)	1.05	1.12	1.19	1.27	1.27	1.32
Liquid assets (€m)	630.27	401.48	765.04	1,069.46	1,711.97	1,382.21

[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

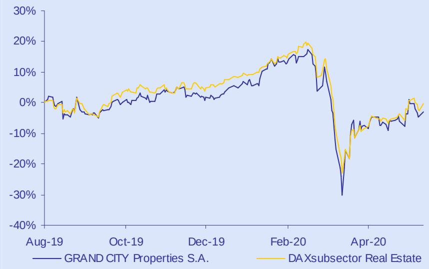
Grand City Properties is a specialist real estate company focused on investing in and managing value-add opportunities in the German real estate market. The overarching strategy is to improve the portfolio through targeted modernisation and intensive tenant management and thus create value by subsequently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

MARKET DATA

MARKET DATA	As of 18 May 2020
Closing Price	€ 19.78
Shares outstanding	167.92m
Market Capitalisation	€ 3321.46m
52-week Range	€ 14.28 / 23.94
Avg. Volume (12 Months)	271,270

Multiples	2019	2020E	2021E
P/FFO 1	15.4	15.4	14.9
P/EPRA NAV	0.6	0.6	0.6
FFO 1 Yield	6.5%	6.5%	6.7%
Div. Yield	4.1%	4.2%	4.3%

STOCK OVERVIEW



COMPANY DATA

COMPANY DATA	As of 31 Mar 2020
Liquid Assets	€ 948.00m
Investment properties	€ 7,844.00m
EPRA NAV¹	€ 5,141.00m
Total Assets	€ 9,941.00m
Current Liabilities	€ 414.00m
Total Equity	€ 4971.00m

[1] including perpetual notes

SHAREHOLDERS

Edolaxia Ltd.	39.0%
Free float	61.0%

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. . . of rent policy making. Operations have been largely unhampered thanks to a fluid transition to home working measures and technology deployed, such as video apartment showings, to orchestrate letting activities.

Revised outlook calls for FFOPS 1 growth of up to 3.1% The reduction in guidance owes chiefly to the issuance of the Series W straight bond and the associated higher interest costs plus postponed acquistions. Management now expect FFO 1 to reach €213m to €220m (old: €220m to €226m) in 2020, spurred by 1.5% to 2.0% like-for like (LFL) growth (old: >2%) This also factors in the Berlin rent cap and all related rent adjustment effects. We view this as achievable, assuming there is no major market dislocation.

Table 1: Changes to guidance

	Unit	New	Old	2020E
FFO 1	€m	213 - 220	220 - 226	213
FFOPS 1	€	1.27 - 1.31	1.31 - 1.35	1.27
DPS	€	0.82 - 0.85	0.85 - 0.87	0.82
LFL net rent growth	%	1.5 - 2.0	> 2.0	1.8
LTV	%	<45	< 45	31

Source: First Berlin Equity Research; Grand City Properties

Q1 RESULTS ENCOURAGING IN UNSTABLE TIMES

Net rent was stable Y/Y, while a 1.9% uptick in adjusted EBITDA helped propel a 4.7% rise in FFO 1. The performance was spurred by another good like-for-like (LFL) performance. As of Q1, GCP realised total LFL net rental growth of 3.4% comprising 0.6% occupancy increases and 2.8% in-place rent. The latter contains 1.2% indexation, and 1.6% re-letting increases with Dresden, Leipzig, and Halle driving the performance.

Table 2: First quarter results vs prior year and FBe

in €m	Q1/20	Q1/20E	*Variance*	Q1/19	*Variance*
Rental income	135	137	*-1.2%*	139	*-2.7%*
Net rent	95	90	*5.0%*	94	*0.3%*
Adjusted EBITDA	74	72	*2.8%*	73	*1.9%*
margin	*54.7%*	*52.6%*	-	*52.2%*	-
FFO 1	55	51	*8.2%*	53	*4.7%*
FFOPS 1 (€)	0.33	0.30	*8.2%*	0.32	*3.1%*

Source: First Berlin Equity Research; Grand City Properties

Operating effects boost profitability. . . Property operating expenses outperformed our assumptions. The cash recycling initiatives over the past quarters have culled the portfolio of lower quality properties and thus trimmed the line item to boost profitability.

. . . but property revaluations were much lower Revaluations retreated sharply on an annualised basis owing mainly to fewer property assessments during the pandemic lock down. The 'property revaluations and capital gains' line items totalled €69m (Q1/19: €120m) for the three month period. It remains difficult to predict when appraisals will pick up again this year.

Bottom line lower on non-recurring 'other financial results' The net financial result included some €-60m (Q1/19: €-17m) in non-recurring adjustments in the market value of financial assets and derivatives. Net profit thus declined to €56m compared to €125m in the prior year period. This was also occasioned by the noted decline in revaluations.

But bottom line cash flows show good growth FFO 1, the key industry indicator for recurring cash flow, beat our estimate (FBe: €51m) at €55m and the prior year result by 4.7% and equated to FFOPS 1 of €0.33. The KPI also edged 5.7% higher sequentially in Q1.

As part of its capital recycling strategy, Grand City disposed of fully optimised and non-core properties in Q1 for proceeds of €270m at a multiple of 16x rental income. This generated a €89m economic profit at a roughly 47% margin resulting in FFO 2 of €144m in Q1. AFFO (adjusted funds from operations), which strips out repositioning CapEx as a measure of recurring operational cash flows, increased to €39m vs €34m in Q1/19 (+13%). Disposals were offset by the aforementioned €100m in London acquisitions.

As of Q1, EPRA NAV totalled €4.1bn (€24.5 / share) compared to €4.1bn at year end 2019 (€24.5 / share, +0%). Profits generated during the period were offset by changes in the fair value of derivative financial instruments. Including the perpetual notes, which are classified as equity under IFRS, this KPI stood at €5.1bn or €30.6 / share.

Table 3: Financial highlights

in €m	Q1/20	2019	*Variance*
Cash & liquid assets	948	1,063	*-11%*
Investment property[1]	7,844	7,972	*-2%*
Total equity	4,971	4,967	*0%*
EPRA NAV incl. hybrid notes	5,141	5,150	*0%*
EPRA NAV	4,127	4,120	*0%*
Interest bearing debt	664	559	*19%*
Straight bonds	2,934	2,920	*0%*
Convertible bond	276	275	*0%*
Loan-to-Value (LTV)	36%	33%	-
Equity ratio	50%	50%	-
[1] including inventories-trading property			

Source: First Berlin Equity Research; Grand City Properties

Existing portfolio takes over the growth reins Grand City exited Q1 with cash and liquid assets of €948m and net debt of €2.9bn. The company issued a €0.6bn straight bond in April to bolster liquidity (>€1.5bn) and has suspended acquistions for the time being. Although management hinted at financial firepower of over €1bn, the company will husband cash until the market environment stabilises. A 36% LTV gives the company ample headroom, once the environment stabilises.

We have recalibrated forecasts to reflect: (1) higher financing costs traced to the new bond; (2) lower external growth in 2020 (FBe: €200m vs old: €400m); (3) more conservative revaluations gains; and (4) an improved operating expense structure. Key changes to forecasts are shown overleaf.

With external growth largely idling, the company will continue to generate organic growth through portfolio optimisation. We also note that as a show of solidarity with its tenants, management have suspended rent increases until the end of the year.

Table 4: Changes to forecasts and price target

	old	new	revision	upside	dividend yield	total upside
Price target (€)	28.0	27.5	-1.8%	39.0%	4.1%	43.2%

	2020E			2021E		
in €m	**Old**	**New**	***Variance***	**Old**	**New**	***Variance***
Net rent (NRI)	391	386	*-1.4%*	412	400	*-2.8%*
Adj. EBITDA	310	310	*0.0%*	326	322	*-1.3%*
margin (NRI)	*79%*	*80%*	-	*79%*	*80%*	-
FFO 1	220	213	*-3.1%*	235	221	*-5.9%*
Margin	*56%*	*55%*	-	*57%*	*55%*	-
FFOPS 1 (€)	1.31	1.27	*-3.1%*	1.40	1.32	*-5.9%*

Source: First Berlin Equity Research; Grand City Properties

VALUATION MODEL

in €m	2020E	2021E	2022E	2023E	TV
EBITDA	310	322	340	359	362
(+) Revaluations	303	309	260	261	49
(+) Investment income	0	0	0	0	0
(-) Tax expense	92	95	90	93	62
NOPAT	**521**	**537**	**510**	**527**	**350**
Total assets	**10,786**	**11,029**	**11,669**	**12,213**	**12,213**
(-) Current liabilities	416	433	457	481	481
(+) Current financial debt	33	33	33	33	33
(-) Cash	1,557	1,227	1,301	1,286	1,286
(+) Deferred taxes	594	641	686	730	730
Capital employed (CE)	**9,441**	**10,043**	**10,630**	**11,209**	**11,209**
Average CE	9,254	9,742	10,336	10,920	11,209
ROCE	5.6%	5.5%	4.9%	4.8%	3.1%
WACC	3.1%	3.1%	3.1%	3.1%	3.1%
ROCE-WACC	2.5%	2.4%	1.9%	1.7%	0.0%
Economic Profit	236	236	191	190	4
NPV	**232**	**225**	**177**	**170**	**177**
Fair value calculation					
Total return	**980**				
(+) EPRA NAV (2019)	4,120				
(-) Dividend to be paid	138				
Equity value	**4,963**				
Diluted SO (m)	181				
Fair value per share (€)	**27.50**				

Valuation metrics	2020E	2021E	2022E	2023E
Price target (€)	27.50	27.50	27.50	27.50
Share price (€)	19.78	19.78	19.78	19.78
Return potential	39.0%	39.0%	39.0%	39.0%
Dividend yield	4.2%	4.3%	4.5%	4.5%
Total return potential	**43.2%**	**43.4%**	**43.5%**	**43.5%**
FFOPS 1 yield	6.4%	6.7%	6.9%	7.0%
DPS (€)	0.82	0.86	0.85	0.90

INCOME STATEMENT

All figures in EURm	2016	2017	2018	2019	2020E	2021E
Net rent	**285**	**328**	**364**	**383**	**386**	**400**
Rental and operating income	**436**	**495**	**545**	**560**	**571**	**593**
Revenue from sale of buildings	7	2	0	0	0	0
Revenue	**443**	**497**	**545**	**560**	**571**	**593**
Property revaluations & capital gains	598	616	507	401	303	309
Result from equity-accounted investees	1	6	1	0	0	0
Property expenses	-204	-239	-263	-256	-251	-261
Cost of buildings sold	-5	-1	0	0	0	0
Administration expenses	-10	-11	-11	-13	-13	-13
Operating income (EBIT)	**823**	**868**	**780**	**693**	**611**	**628**
Finance expenses	-36	-40	-46	-45	-57	-60
Other financial results	-11	-43	-36	-33	0	0
Pre-tax income (EBT)	**775**	**786**	**698**	**615**	**553**	**568**
Tax and deferred tax expenses	-122	-146	-115	-121	-84	-88
Minority interests	-88	-80	-64	-53	-49	-50
Hybrid note investors	-23	-24	-30	-33	-33	-33
Net income	**542**	**535**	**489**	**407**	**387**	**397**
Basic EPS (€)	3.56	3.35	2.95	2.43	2.30	2.37
Diluted EPS (€)	3.25	3.06	2.76	2.29	2.16	2.22
Adjusted EBITDA	**225**	**248**	**276**	**298**	**310**	**322**
Ratios						
Adjusted EBITDA margin	51.6%	50.1%	50.6%	53.1%	54.3%	54.3%
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%	44.0%	44.0%
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%	2.0%	3.8%
Total revenues	32.7%	12.2%	9.7%	2.8%	2.0%	3.8%
Operating income	69.3%	5.5%	-10.2%	-11.1%	-11.9%	2.9%
Adjusted EBITDA	26.8%	10.3%	11.1%	8.0%	4.1%	3.8%
Net income/ loss	57.7%	-1.5%	-8.6%	-16.7%	-4.9%	2.7%
Funds from Operations (FFO)						
Operating profit	**823**	**868**	**780**	**693**	**611**	**628**
Depreciation and amortisation	2	2	3	4	3	3
EBITDA	**825**	**871**	**782**	**697**	**613**	**631**
Capital gains, property revaluations and other	-598	-616	-507	-401	-303	-309
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**	**322**
Financial expense	-36	-40	-46	-45	-57	-60
Tax	-27	-28	-30	-37	-36	-37
Minorities	-1	-2	-2	-4	-4	-4
FFO 1	**160**	**178**	**198**	**212**	**213**	**221**
CapEx	-56	-67	-75	-76	-73	-77
AFFO	**104**	**111**	**122**	**136**	**140**	**145**

BALANCE SHEET

All figures in EURm	2016	2017	2018	2019	2020E	2021E
Assets						
Current assets, total	**1,028**	**796**	**1,238**	**1,629**	**2,268**	**1,955**
Cash and cash equivalents	449	312	603	914	1,557	1,227
Traded securities at fair value though P&L	181	89	162	155	155	155
Trade and other receivables	220	260	319	342	341	358
Inventories - Trading property	27	12	17	16	14	14
Assets held for sale	150	123	136	201	201	201
Non-current assets, total	**5,126**	**6,712**	**7,623**	**8,223**	**8,518**	**9,073**
Equipment and intangible assets	16	20	24	27	30	33
Investment property	4,823	6,414	7,282	7,981	8,260	8,799
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**	**10,786**	**11,029**
Shareholders' equity & debt						
Current liabilities, total	**338**	**371**	**306**	**454**	**416**	**433**
Short-term debt	29	62	22	33	33	33
Trade and other payables	252	267	242	288	241	250
Other current liabilities	58	42	42	133	141	150
Long-term liabilities, total	**2,750**	**3,288**	**3,887**	**4,431**	**5,073**	**4,956**
Long-term debt	897	919	846	521	500	450
Convertible and straight bonds	1,478	1,810	2,450	3,195	3,805	3,681
Deferred taxes	326	500	523	592	641	692
Other LT liabilities	50	59	69	122	127	133
Minority interests	197	364	409	444	493	544
Shareholders' equity	**2,868**	**3,485**	**4,258**	**4,523**	**4,805**	**5,096**
Total consolidated equity and debt	**6,154**	**7,508**	**8,861**	**9,851**	**10,786**	**11,029**
Ratios						
Current ratio (x)	3.04	2.15	4.04	3.59	5.46	4.51
Equity ratio	50%	51%	53%	50%	49%	51%
EPRA NAV[1] (€m)	3,208	3,993	4,783	5,150	5,464	5,806
Net debt (€m)	1,783	2,393	2,560	2,690	2,626	2,782
Net debt / equity	0.6	0.7	0.6	0.6	0.5	0.5
Net debt / EBITDA (x)	7.9	9.7	9.3	9.0	8.5	8.6
Interest cover (x)	6.2	6.2	6.0	6.6	5.4	5.4
Loan-to-value (LTV)	35%	36%	34%	33%	31%	31%
Return on equity (ROE)	21.3%	16.6%	12.5%	9.9%	8.9%	8.5%

[1] including perpetual notes

CASH FLOW STATEMENT

All figures in EURm	2016	2017	2018	2019	2020E	2021E
Net income	**653**	**639**	**583**	**493**	**469**	**480**
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	-303	-309
Net finance expenses	47	83	82	78	57	60
Tax result	122	146	115	121	84	88
Others	1	1	1	2	0	0
Operating cash flow	**227**	**248**	**276**	**298**	**310**	**322**
Change in working capital	-7	-24	-23	-20	-35	2
Tax paid	-19	-23	-28	-28	-36	-37
Net cash flow from operating activities	**201**	**202**	**225**	**249**	**240**	**286**
Investment in fixed/intangible assets	-3	-6	-6	-7	-6	-6
Net property investments / disposals	-476	-374	-501	-194	24	-229
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**	**10**	**-245**
Debt financing, net	487	597	916	360	588	-173
Equity financing, net	171	176	312	-33	0	0
Dividend paid	-38	-112	-79	-107	-138	-138
Other financing activities	-5	-345	-306	-55	0	0
Net paid financing expenses	-46	-47	-56	-50	-57	-60
Cash flow from financing	**569**	**269**	**786**	**115**	**393**	**-372**
Net cash flows	**213**	**-137**	**291**	**311**	**643**	**-330**
Cash, start of the year	236	449	312	603	914	1,557
Cash, end of the year	**449**	**312**	**603**	**914**	**1,557**	**1,227**
Adjusted EBITDA / share (€)	**1.46**	**1.50**	**1.65**	**1.77**	**1.85**	**1.92**
FFO I	**160**	**178**	**198**	**212**	**213**	**221**
FFOPS I (€)	**1.05**	**1.12**	**1.19**	**1.27**	**1.27**	**1.32**
Y-Y Growth						
Operating cash flow	27.8%	0.5%	11.0%	11.1%	-4.0%	19.5%
Adjusted EBITDA / share	15.0%	3.0%	9.8%	7.3%	4.1%	3.8%
FFO 1	25.1%	11.2%	11.1%	7.1%	0.5%	3.8%
FFOPS 1	3.9%	6.5%	7.1%	6.1%	0.2%	3.7%

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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:

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

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.

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...30	↓	↓	↓	↓
31	7 May 2019	€21.22	Buy	€28.00
32	21 May 2019	€22.64	Buy	€28.00
33	6 June 2019	€23.44	Buy	€28.00
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	20 March 2020	€16.04	Buy	€28.00
38	Today	€19.78	Buy	€27.50

INVESTMENT HORIZON

Unless otherwise stated in the financial analysis, the ratings refer to an investment period of twelve months.

UPDATES

At the time of publication of this financial analysis it is not certain whether, when and on what occasion an update will be provided. In general First Berlin strives to review the financial analysis for its topicality and, if required, to update it in a very timely manner in connection with the reporting obligations of the analysed company or on the occasion of ad hoc notifications.

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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**

can be accessed through the following internet link: https://firstberlin.com/disclaimer-english-link/

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