

Grand City Properties S.A.

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

Update

RATING
BUY

PRICE TARGET
€ 19.00

Return Potential 104.6%
 Risk Rating Medium

SECTOR REELING FROM HIGHER RATES

We are reducing mid- and long-term forecasts to account for the impact of the rising interest environment on FFOPS 1 and DPS. Sector sentiment is poor with investors worried about leverage levels and potential asset value declines, although prices for German residential properties are still quite stable according to assessors. We see good value in the GCP stock after sharp declines (-59% YTD), but there are few clear catalysts for a rebound on the horizon beyond a stabilisation of the macro environment. Adjustments to our discounted dividend model (DDM) result in a €19 target price (old: €24). Our rating remains Buy.

Sector sentiment is bad right now Global markets are going through their most painful adjustment since the global financial crisis. The primary cause of the market chaos is the Federal Reserve's battle with inflation. After losing the first three rounds since prices began to surge in 2021, the Fed is now swinging harder with jumbo rate hikes, and the central bank expects to raise the federal funds rate to nearly 4.5% by the end of the year and perhaps higher in 2023. Until there is some sign that monetary tightening is coming to an end, we expect sector sentiment to remain poor and keep investors side-lined.

Risks to asset values have risen but expectations look overblown While we acknowledge the increased risk to asset values in the wake of rising discount rates, we don't see these as wobbly as the market currently expects, and YTD reporting / feedback from residential bellwethers support this view. Transaction volumes have slowed, but no one is dumping properties below BV, and the wide demand / supply gap may be the fundamental force that keeps asset values stable. Germany has suffered from an acute shortage of flats during the recent boom. Now with refugees arriving from Ukrainian battle zones, the country is expected to absorb >1m net immigrants this year and put further strain on limited supply. (p.t.o.)

FINANCIAL HISTORY & PROJECTIONS

	2018	2019	2020	2021	2022E	2023E
Rental income (€m)	544.98	560.30	535.42	524.63	540.43	565.55
Y/Y growth	10.1%	2.8%	-4.4%	-2.0%	3.0%	4.6%
Adj. EBITDA (€m)	275.53	297.66	299.78	298.59	302.72	318.14
Net income (€m)	488.6	406.9	362.2	523.5	408.0	461.3
EPRA NTA (€m)	0.00	4,357.72	4,566.43	5,020.19	5,446.91	5,840.62
EPRA NTAPS (€)	0.00	25.93	26.55	30.40	31.60	33.89
DPS (€)	0.77	0.82	0.82	0.83	0.86	0.89
FFO 1* (€m)	167.59	178.97	182.21	186.33	193.63	204.88
FFOPS 1* (€)	1.01	1.07	1.07	1.11	1.15	1.19
Liquid assets (€m)	765.04	1,069.46	1,697.91	1,113.53	556.89	856.24

* after perpetual adjustment

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.

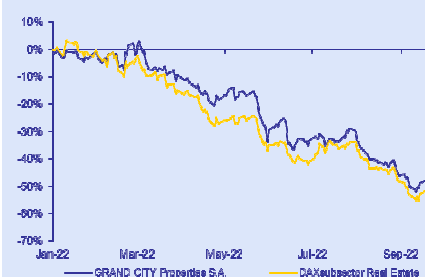
MARKET DATA

As of 11 Oct 2022

Closing Price € 9.29
 Shares outstanding 176.18m
 Market Capitalisation € 1635.83m
 52-week Range € 9.28 / 22.68
 Avg. Volume (12 Months) 340,115

Multiples	2021	2022E	2023E
P/FFO 1	8.3	8.1	7.8
P/NTA	0.3	0.3	0.3
FFO 1 Yield	12.0%	12.4%	12.8%
Div. Yield	9.0%	9.3%	9.6%

STOCK OVERVIEW



COMPANY DATA

As of 30 Jun 2022

Liquid Assets € 453.20m
 Investment properties € 9,800.60m
 EPRA NTA € 5,234.00m
 Total Assets € 11,305.80m
 Current Liabilities € 447.30m
 Total Equity € 5,984.90m

SHAREHOLDERS

Edolaxia Ltd. 58.0%
 Treasury 2.0%
 Free float 40.0%



Excess demand may be the force that ensures price stability The government has attempted to shore up construction activity with more funding, but residential construction has largely come to a halt due to surging financing costs and shortages in both material and manpower. We think ever-increasing replacement costs should provide downside protection to property values.

While the era of soaring valuation is likely at an end, we see asset values remaining stable vs scenarios projecting them to fall off a cliff. But investors are unconvinced by the stability offered by German residential sector or, in Grand City's case, by the landlord's operational quality, and are clearly waiting for key catalysts: (1) convincing evidence that asset values won't sharply decline; or (2) signs that macro headwinds, particularly inflation, are abating.

Subdued transaction activity A pick-up in German residential transaction volumes might allay worries about asset values. However, CBRE, a property market-watcher, recently reported that Q2/22 transactions were 50% lower Y/Y to €1.5bn. Plus, Savills, another market researcher, noted that a mere €2.7bn of German commercial and residential properties changed hands in August 2022 with only five transactions accounting for ~45% of the volume. This compares to an average monthly transaction volume of roughly €7.4bn over the last five years. Vonovia also recently highlighted this market restraint at its Capital Market Day. The landlord wants deleverage through asset disposals but said that is not under time pressure and will prioritise "best price" over the fastest outcome.

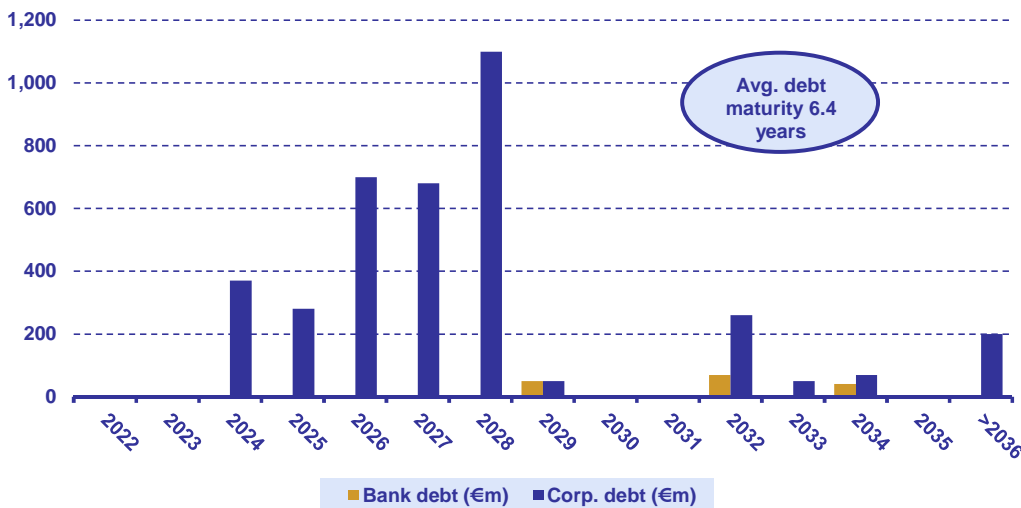
Energy cost headwinds Tenants will have stump up for their higher heating bills this winter, putting household budgets under pressure next year. This will likely gate near-term rental growth opportunities and *could* also lead to unpaid rents in some cases. We broadly expect tenants to find a way to avoid eviction scenarios, especially given the difficulty in finding a new flat in a market with an acute supply shortage. Government support and ample savings should also buffer against wide spread rent delinquency. It is impossible to predict how this all may affect landlords. We thus do not factor anything explicitly into our model and continue to look for 2% LFL rent growth helped by inflation.



REVISED OUTLOOK

Ample flexibility to manage financing needs. . . Grand City has cash and liquid assets of around €450m—enough to cover debt maturities into mid-2025. Plus, the company said it has access to another €300m in secured debt financing.

Figure 1: Debt maturity schedule



Source: First Berlin Equity Research; Grand City Properties

. . . but much has changed this year In January, inflation was transitory according to central bankers. Russia hadn't invaded Ukraine, the energy markets were calm and world economies were still expanding. Now markets are gripped by fears of stubborn inflation, war, and a looming recession.

The Fed is determined to break the back of inflation with jumbo rate hikes. We have thus again bumped up our interest expense assumptions for Grand City starting in 2024 when the first batch of debt will need to be refinanced. The largest quanta (> €600m) start maturing in 2026, which may be far enough out for rates to settle down—although we do not expect them to return to January levels—and allow GCP to refinance at more favourable terms than available today.

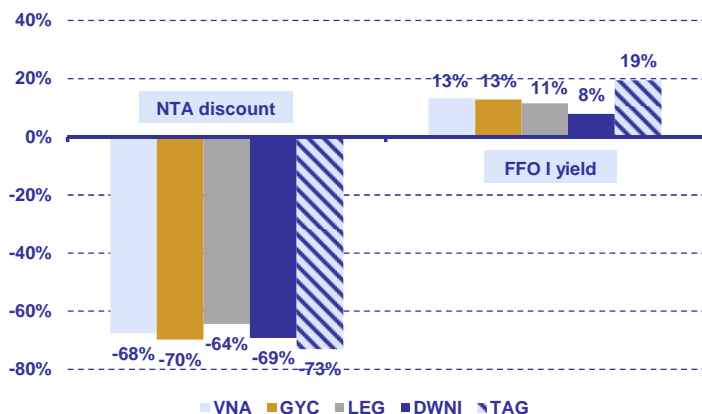
After nudging up our mid- and long-term cost of debt (CoD) assumptions to 1.5% earlier this year during this initial surge in bond yields, we are upping them another 150 bps to 3.0%. These adjustments point to new a target price of €19 (old: €24) in our DDM model (overleaf).



VALUATION MODEL

In the midst of the interest rate-shock, Germany's property bellwethers (Vonovia, Deutsche Wohnen, Aroundtown, Grand City, LEG, TAG) have shed some €45bn in market cap YTD and are trading well below their respective NAVs (figure 2).

Figure 2: Sector at deep NTA (net tangible assets) discount despite good FFO 1 yields



Source: First Berlin Equity Research; Grand City Properties

We see good value in GYC shares after nearly 59% of its market capitalisation vanished in the sector rout, but investors need to be patient with no clear catalysts on the horizon beyond evolution of the macro environment. Our rating remains Buy.

Figure 3: Discounted dividend model

	Unit	2022E	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E	TV	
FFOPS 1	€	1.15	1.19	1.25	1.30	1.15	1.12	1.09	1.06	1.12	1.13	
Payout ratio	%	7.5	7.5	7.5	7.5	7.5	7.5	7.5	7.5	7.5	7.5	
Dividend (DPS)	€	0.86	0.89	0.94	0.98	0.86	0.84	0.82	0.80	0.84	0.85	
Y/Y	%		0.03	0.05	0.04	-0.12	-0.03	-0.02	-0.03	0.05	n.a.	
NPV	€	0.85	0.84	0.84	0.83	0.69	0.64	0.59	0.55	0.55	12.8	
CAGR (2022 to 2026)	%	0.7										
Terminal growth rate	%	1.0										
Discount rate	%	5.4										
NPV of dividends	€	6.4										
NPV of TV	€	12.8										
Fair value per share	€	19.0										

		Terminal growth						
		-0.5%	0.0%	0.5%	1.0%	1.5%	2.0%	2.5%
Discount rate	4.8%	17.0	19.0	20.0	22.0	25.0	28.0	33.0
	5.0%	17.0	18.0	19.0	21.0	23.0	26.0	30.0
	5.2%	16.0	17.0	18.0	20.0	22.0	25.0	28.0
	5.4%	16.0	17.0	18.0	19.0	21.0	23.0	26.0
	5.6%	15.0	16.0	17.0	18.0	20.0	22.0	25.0
	5.8%	15.0	15.0	16.0	18.0	19.0	21.0	23.0
	6.0%	14.0	15.0	16.0	17.0	18.0	20.0	22.0
		Cost of debt						
		2.25%	2.50%	2.75%	3.00%	3.25%	3.50%	3.75%
Discount rate	4.8%	25.0	24.0	23.0	22.0	21.0	20.0	19.0
	5.0%	24.0	23.0	22.0	21.0	20.0	19.0	18.0
	5.2%	23.0	22.0	21.0	20.0	19.0	18.0	17.0
	5.4%	22.0	21.0	20.0	19.0	18.0	17.0	16.0
	5.6%	21.0	20.0	19.0	18.0	17.0	16.0	15.0
	5.8%	20.0	19.0	18.0	17.0	16.0	15.0	14.0
	6.0%	19.0	19.0	18.0	17.0	16.0	15.0	14.0



INCOME STATEMENT

All figures in EURm	2018	2019	2020	2021	2022E	2023E
Net rent	364	383	372	375	387	405
Rental and operating income	545	560	535	525	540	566
Property revaluations & capital gains	507	401	343	695	369	376
Result from equity-accounted investees	1	0	4	4	0	0
Property expenses	-261	-253	-226	-218	-225	-234
Cost of buildings sold	0	0	0	0	0	0
Administration expenses	-10	-11	-11	-11	-12	-12
Depreciation & amortisation	-3	-4	-5	-8	-6	-7
Operating income (EBIT)	780	693	640	986	666	688
Finance expenses	-46	-45	-53	-46	-43	-45
Other financial results	-36	-33	-46	-149	-42	0
Pre-tax income (EBT)	698	615	542	791	581	644
Tax and deferred tax expenses	-115	-121	-93	-174	-100	-103
Minority interests	-64	-53	-54	-69	-48	-54
Hybrid note investors	-30	-33	-33	-25	-25	-25
Net income	489	407	362	524	408	462
Basic EPS (€)	2.95	2.43	2.13	3.12	2.42	2.68
AEBITDA	276	298	300	299	303	318
Ratios						
AEBITDA margin (% of net rent)	75.6%	77.8%	80.5%	79.7%	78.1%	78.5%
Tax rate	-10.8%	-12.5%	-10.5%	-13.1%	13.0%	13.0%
Expenses (% of net rent)						
Property expenses	71.7%	66.2%	60.8%	58.2%	58.0%	57.7%
Administration expenses	2.6%	3.0%	2.9%	3.0%	3.1%	3.0%
Y-Y Growth						
Rental and operating income	10.1%	2.8%	-4.4%	-2.0%	3.0%	4.6%
Total revenues	9.7%	2.8%	-4.4%	-2.0%	3.0%	4.6%
Operating income	-10.2%	-11.1%	-7.6%	54.0%	-32.5%	3.4%
Adjusted EBITDA	11.1%	8.0%	0.7%	-0.4%	1.4%	5.1%
Net income/ loss	-8.6%	-16.7%	-11.0%	44.5%	-22.0%	13.1%
Funds from Operations (FFO)						
Operating profit	780	693	640	986	666	688
Depreciation and amortisation	3	4	5	8	6	7
EBITDA	782	697	645	994	672	695
Property revaluations & capital gains	-507	-401	-343	-695	-369	-376
Others	0	2	-2	-1	-1	-1
Adjusted EBITDA	276	298	300	299	303	318
Financial expense	-46	-45	-53	-46	-43	-45
Tax	-30	-37	-31	-39	-39	-41
Minorities	-2	-4	-1	-2	-2	-2
FFO 1 (before perpetuals)	198	212	215	211	219	230
Perpetual note adjustment	-30	-33	-33	-25	-25	-25
FFO 1	168	179	182	186	194	205
CapEx	-75	-76	-62	-63	-74	-71
AFFO	92	103	120	123	120	134



BALANCE SHEET

All figures in EURm	2018	2019	2020	2021	2022E	2023E
Current assets, total	1,238	1,629	2,264	1,679	1,034	1,355
Cash and cash equivalents	603	914	1,412	895	404	704
Traded securities at fair value through P&L	162	155	286	218	153	153
Trade and other receivables	319	342	395	452	466	488
Inventories - Trading property	17	16	16	0	0	0
Assets held for sale	136	201	155	114	11	11
Non-current assets, total	7,623	8,223	8,602	9,883	10,521	11,175
Equipment and intangible assets	24	27	27	70	77	85
Investment property	7,282	7,981	8,043	9,364	10,030	10,656
Equity accounted investees	26	21	108	0	0	0
Other LT assets	254	151	373	397	358	372
Deferred tax assets	37	42	51	51	57	62
Total assets	8,861	9,851	10,866	11,562	11,556	12,530
Current liabilities, total	306	454	427	773	336	351
Short-term debt	22	33	147	455	5	5
Trade and other payables	242	288	209	216	222	231
Other current liabilities	42	133	71	103	109	115
Long-term liabilities, total	3,887	4,431	4,884	4,986	5,017	5,609
Long-term debt	846	521	427	353	300	800
Convertible and straight bonds	2,450	3,195	3,639	3,642	3,657	3,679
Deferred taxes	523	592	634	760	821	883
Other LT liabilities	69	122	183	231	238	246
Minority interests	409	444	535	615	663	717
Shareholders' equity	4,258	4,523	5,020	5,188	5,540	5,853
Total consolidated equity and debt	8,861	9,851	10,866	11,562	11,556	12,530
Ratios						
EPRA NTA (€m)	n.a.	4,358	4,566	5,020	5,447	5,841
EPRA NTAPS (€)	n.a.	25.9	26.5	30.4	31.6	33.9
Net debt (€m)	2,560	2,690	2,521	3,342	3,405	3,628
Net debt / equity (x)	0.6	0.6	0.5	0.6	0.6	0.6
Net debt / EBITDA (x)	9.3	9.0	8.4	11.2	11.2	11.4
Interest cover (x)	6.0	6.6	5.7	6.4	7.1	7.1
Loan-to-value (LTV)	34%	33%	31%	36%	34%	34%
Equity ratio	53%	50%	51%	50%	54%	52%
Return on equity (ROE)	12.5%	9.9%	8.1%	10.6%	7.8%	8.2%



CASH FLOW STATEMENT

All figures in EURm	2018	2019	2020	2021	2022E	2023E
Net income	583	493	449	617	481	540
Depreciation and amortisation	3	4	5	8	6	7
Profit from equity accounted investees	-1	0	-4	-4	0	0
Change in fair value of investment properties	-507	-401	-343	-695	-369	-376
Net finance expenses	82	78	98	195	85	45
Tax result	115	121	93	174	100	103
Others	1	2	2	3	0	0
Operating cash flow	276	298	300	299	304	319
Change in working capital	-23	-20	-29	-45	0	-4
Tax paid	-28	-28	-28	-37	-39	-41
Net cash flow from operating activities	225	249	242	217	265	274
Investment in fixed/intangible assets	-6	-7	-7	-8	-14	-15
Net property investments / disposals	-501	-194	-492	-465	-195	-250
Acquisition of subsidiaries	-112	31	547	333	0	0
Proceeds from investments in financial assets	-100	117	-439	-58	105	-14
Cash flow from investing	-718	-53	-392	-198	-103	-279
Debt financing, net	916	360	559	-71	-488	522
Equity financing, net	312	-33	207	-91	-25	-25
Share buyback	0	0	0	-272	0	0
Dividend paid	-79	-107	-71	-54	-55	-149
Other financing activities	-306	-55	7	0	-42	0
Net paid financing expenses	-56	-50	-51	-50	-43	-45
Cash flow from financing	785	115	651	-537	-653	304
Fx effects	-1	0	-3	2	0	0
Net cash flows	291	311	498	-517	-491	299
Cash, start of the year	312	603	914	1,412	895	404
Cash, end of the year	603	914	1,412	895	404	704
AEBITDA / share (€)	1.65	1.77	1.74	1.69	1.65	1.73
FFO 1*	168	179	182	186	194	205
FFOPS 1* (€)	1.01	1.07	1.07	1.11	1.15	1.19
Y-Y Growth						
Operating cash flow	11.0%	11.1%	-2.9%	-10.4%	22.0%	3.6%
Adjusted EBITDA / share	9.8%	7.3%	-1.6%	-2.8%	-2.7%	5.1%
FFO 1	9.0%	6.8%	1.8%	2.3%	4.1%	5.8%
FFOPS 1	5.0%	5.8%	0.3%	3.6%	3.5%	3.4%

* adjusted for perpetual notes

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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...42	↓	↓	↓	↓
43	17 March 2021	€21.58	Buy	€27.50
44	15 April 2021	€22.26	Buy	€27.50
45	19 May 2021	€21.88	Buy	€27.50
46	17 August 2021	€23.40	Buy	€27.50
47	16 November 2021	€22.28	Buy	€28.00
48	18 March 2022	€19.92	Buy	€28.00
49	18 May 2022	€16.43	Buy	€24.50
50	16 August 2022	€13.86	Buy	€24.00
51	Today	€9.29	Buy	€19.00

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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