

GRAND CITY Properties S.A.

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

Q3
 Results

RATING
BUY

PRICE TARGET
€ 28.00

Return Potential 30.6%
 Risk Rating Medium

SOLID Q3 RESULTS; GAUGING BERLIN RENT CONTROL IMPACT

Third quarter reporting continued the good operational trajectory of the past quarters. Net rent climbed 6.6% Y/Y, thanks to the reversionary potential of the portfolio, which resulted in 3.6% like-for-like (LFL) total net rent growth. But the conference call centred around the German capital's rent freeze set for the start of 2020, which Berlin lawmakers agreed to in October. Management provided guidance on the LFL impact. Thanks to strong portfolio diversification, only ~15% of portfolio rent is exposed to the Berlin rent freeze and LFL net rent growth should remain above 2% in 2020 and climb to 2.5% the following year. The estimated €3m decline in net rent equals <1% of the portfolio total and does not materially impact our forecasts. We stick to our Buy rating and €28 pricetarget.

Expect housing shortage to worsen Although city lawmakers want to halt soaring housing costs, we think their plan could ultimately backfire. It will not ease Berlin's acute housing shortage, and it will certainly spook potential property investors looking to build in the capital. We thus expect this to further ratchet up the pressure on the already tight housing market. In our view, the freeze will only have a marginal impact on Grand City's earnings (see overleaf), given its manageable portfolio exposure to the German capital.

Key points of rent cap now set The rent freeze will fix rents to the price levels of 8 June 2019. This applies to existing renters as well as new leases. The legislation (see overleaf) also includes a clause allowing for rent reductions after September 2020. The plan will be sent to the Berlin parliament by YE for approval and go into effect 1 January 2020. GCP's well diversified portfolio—Berlin accounts for 9% of total units and <15% of rental income—means that overall LFL performance has <1% exposure to the Berlin rent freeze. Assuming other German metropolises don't follow suit, the Berlin cap should not disrupt good operational momentum. (p.t.o.)

FINANCIAL HISTORY & PROJECTIONS

	2015	2016	2017	2018	2019E	2020E
Rental income (€m)	333.50	435.67	494.89	544.98	591.36	627.82
Y/Y growth	53.8%	30.6%	13.6%	10.1%	8.5%	6.2%
Adj. EBITDA (€m)	177.27	224.73	247.98	275.53	296.57	312.97
Net income ² (€m)	343.9	542.5	534.6	488.6	395.0	412.9
EPS (diluted) (€)	2.35	3.25	3.06	2.76	2.22	2.31
EPRA NAV ¹ (€m)	2,402.09	3,208.45	3,993.06	4,783.07	5,172.02	5,531.35
DPS (€)	0.25	0.68	0.73	0.64	0.82	0.87
FFO 1 (€m)	128.04	160.12	178.01	197.85	211.80	224.24
FFOPS 1 (€)	1.01	1.05	1.12	1.19	1.27	1.34
Liquid assets (€m)	388.93	630.27	401.48	765.04	1,014.78	912.92

¹ including perpetual notes ²after 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.

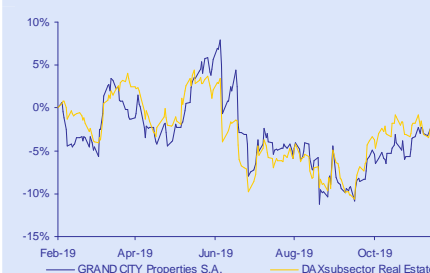
MARKET DATA

As of 19 Nov 2019

Closing Price	€ 21.44
Shares outstanding	167.89m
Market Capitalisation	€ 3599.56m
52-week Range	€ 18.62 / 23.44
Avg. Volume (12 Months)	237,127

Multiples	2018	2019E	2020E
P/FFO 1	17.9	16.9	16.0
P/EPRA NAV	0.7	0.7	0.6
FFO 1 Yield	5.6	5.9	6.3
Div. Yield	3.0%	3.8%	4.1%

STOCK OVERVIEW



COMPANY DATA

As of 30 Sep 2019

Liquid Assets	€ 898.00m
Current Assets	€ 1,883.60m
EPRA NAV ¹	€ 5,012.00m
Total Assets	€ 9,774.40m
Current Liabilities	€ 542.70m
Total Equity	€ 4,858.10m

¹ including perpetual notes

SHAREHOLDERS

Edolaxia Ltd.	39.0%
Edge Point	5.0%
Free Float	56.0%



CENTRAL POINTS ON THE RENT CAP

- 18 June 2019 is now the reference day to fix rents for five years. This also applies to new tenants in the event of a changeover;
- If rents are above 120% of the rent cap (including modernization & location based adjustments), tenants may apply for a rent reduction. This applies nine months after the law comes into force;
- The rent cap can be increased by €1 / m², if three of five criteria are fulfilled (elevator, fitted kitchen, energy consumption less than 120kWh / m² per annum, high-quality flooring & sanitary equipment);
- Modernization allocation limit set at €1 / m² for specific measures that only require the landlord to notify local authorities of the planned investments.

Impact of Grand City performance Management confirmed they will follow the framework of the rent cap and outlined the impact on GCP's operational performance on today's call: (1) an overall decrease in LFL rental growth of 1.4% to 1.8%; (2) ~2.0% LFL growth in 2020; (3) 2.5% in the following years; (4) a €3m decrease in rental income (<1% of total portfolio rent); (5) a one-time decline in Berlin LFL of 5% to 7% assuming all tenants apply for potential rent reductions (not a certainty in our view); and (6) annualised rental income market potential of €425m (+20%) that considers frozen Berlin rents. Given the minor impact on rental income, we leave our estimates unchanged and will wait for the dust to settle to review our forecasts once the rent cap becomes law in early 2020.

History shows that rent controls exacerbate housing shortages Rent control is a textbook example of a well-intended policy that often fails. Rent control causes good-quality housing stock to shrink. Existing properties become run down, since landlords have no incentive to invest in upkeep or upgrades. Renters stay put in their decaying flats. This in turn widens the disparity between market and paid rents. And a static renters market can even hurt local economic productivity, since housing becomes mismatched with favoured tenants as opposed with those who can make best use of a flat.

Although Berlin renters are celebrating the benefits of the capped rents, outsiders, or current tenants, who want to move, will suffer from lower housing stock and fewer opportunities. Drove of urbanites queuing up in hopes of finding tenancy have become a common spectacle around the German capital in the past years. This will undoubtedly worsen.

Meanwhile, sputtering new construction remains endlessly gated by slow permitting and burdensome regulations. We have written a number of times that the housing shortage can only be resolved with more construction to fill the supply / demand gap. Now a return to socialist policy making will certainly unnerve property builders at a time when the city needs more shovels in the dirt. Permitting is already down Y/Y. We thus fail to see how a rent cap will provide housing for the 300k population influx that city planners are expecting over the next ten years.

Headed for a legal showdown Since Bundestag lawyers have already declared the rent freeze unconstitutional, we expect the federal government to challenge the new legislation, which will likely lead to a prolonged regulatory duel between city-state and federal lawmakers. Management hinted that the showdown could take up to two years, and we share the view that the rent cap will probably not survive the constitutional review. However, Berlin's mayor, Michael Müller, is confident the new legislation can withstand legal challenges. If not, Berlin renters could be liable for lost rent during an 'unlawful' freeze.



THIRD QUARTER RESULTS

Despite regulatory volatility, operations continue to deliver good results. Both the top line and earnings showed solid performances led by a 7.8% Y/Y rise in adjusted EBITDA and 6.7% increase in FFO 1. This was spurred by a good like-for-like (LFL) performance. As of 9M, GCP realised total LFL net rental growth of 3.6% comprising 0.6% occupancy increases and 3.0% in-place rent. The latter contains 0.9% indexation, 1.9% re-letting and 0.2% modernisation increases.

Table 1: Third quarter results vs forecasts

in €m	Q3/19	Q3/19E	Variance	Q3/18	Variance	9M/19	9M/18	Variance
Rental income	140	138	1.3%	136	3.2%	418	404	3.5%
Net rent	96	94	1.8%	90	6.6%	285	272	4.9%
Adjusted EBITDA	74	73	0.8%	67	9.4%	220	204	7.8%
margin	53%	53%	-	50%	-	53%	50%	-
FFO 1	54	53	1.9%	51	5.9%	160	150	6.7%
FFOPS 1 (€)	0.32	0.31	1.9%	0.31	3.2%	0.96	0.91	5.5%

Source: First Berlin Equity Research estimates

FFO 1 was close to our estimate and climbed 6% Y/Y to €54m in Q3/19 equating to FFOPS 1 of €0.32 (+3.2%). The capital gains, property revaluations and other income line item totalled €86m for the quarter (Q3/18: €134m) but lagged behind the strong pace set last year. Operating performance spurred around two thirds of the revaluation gains with the balance owing to yield compression. Roughly 3/4 of the portfolio was evaluated in 9M. Adjusted EBITDA, which reflects recurring operational profit excluding capital gains and revaluation effects, rose 9.4% Y/Y to €74m.

The company is thus tracking well towards guidance and our full year targets (table 3 overleaf). FFO 2 amounted to €256m in 9M (9M/18: €265m). GCP disposed of €500m in non-core and mature assets during the first nine months as part of its cash recycling strategy.

Table 2: Financial highlights

in €m	9M/19	2018	Variance
Cash & liquid assets	899	760	18%
Investment property ¹	7,599	7,244	5%
Total equity	4,858	4,667	4%
EPRA NAV incl. hybrid notes	5,012	4,783	5%
EPRA NAV	3,982	3,753	6%
Interest bearing debt	532	871	-39%
Straight bonds	2,923	2,177	34%
Convertible bond	274	272	1%
Loan-to-Value (LTV)	33%	34%	-
Equity ratio	50%	53%	-

¹ including inventories-trading property

Source: First Berlin Equity Research estimates

As of 30 September, EPRA NAV totalled €4.0bn (€23.7 / share) compared to €3.8bn at year end 2018 (€22.5 / share, +5.3%). NAV growth owes predominantly to the strong net profit of €365m recorded for the six month period. Including the perpetual notes, which are classified as equity under IFRS, this KPI stood at €5.0bn or €298 / share (+3.8%).

**Table 3: Full year guidance confirmed and in line with forecasts**

	Unit	9M annualised	2019 Guidance	2019E
FFO 1	€m	213	211 - 213	212
FFOPS 1	€	1.28	1.26 - 1.27	1.27
DPS	€	0.83	0.82 - 0.83	0.82
LFL net rent growth	%	3.6	> 3.5	3.5
LTV	%	34	< 45	34

Source: First Berlin Equity Research, Grand City Properties

VALUATION

Sticking to Buy rating and €28 price target Third quarter results matched our expectations. Operational performance continues to deliver upper single digit annualised growth as management corrals embedded portfolio reversionary upside. Although we cannot fully rule out that other cities which are federal states (Bremen, Hamburg) will follow the Berlin rent control pilot, we think this highly unlikely, given the decidedly socialist government structure in Berlin. We therefore look for operations to continue their current positive trajectory as the company balances external growth with disposal of mature and non-core assets. The GCP share is trading ~9% off its yearly highs and looks attractive considering the scenario outlined by management.

in €m	2019E	2020E	2021E	2022E	TV
EBITDA	297	313	330	347	351
(+) Revaluations	342	322	312	260	54
(+) Investment income	2	2	2	2	2
(-) Tax expense	96	95	97	91	61
NOPAT	544	541	547	518	346
Total assets	9,747	10,196	10,455	11,097	11,097
(-) Current liabilities	307	327	339	355	355
(+) Current financial debt	22	22	22	22	22
(-) Cash	853	751	478	606	606
(+) Deferred taxes	541	588	635	681	681
Capital employed (CE)	9,150	9,729	10,294	10,838	10,838
Average CE	8,805	9,439	10,011	10,566	10,838
ROCE	6.2%	5.7%	5.5%	4.9%	3.2%
WACC	3.1%	3.1%	3.1%	3.1%	3.1%
ROCE-WACC	3.1%	2.6%	2.4%	1.8%	0.1%
Economic Profit	273	250	239	192	11
NPV	273	241	224	174	496
Fair value calculation					
Total return	1,408				
(+) EPRA NAV (2018)	3,753				
(-) Dividend to be paid	107				
Equity value	5,054				
Diluted SO ('000)	181				
Fair value per share (€)	28.00				



INCOME STATEMENT

All figures in EURm	2015	2016	2017	2018	2019E	2020E
Net rent	220	285	328	364	384	408
Rental and operating income	333	436	495	545	591	628
Revenue from sale of buildings	0	7	2	0	0	0
Revenue	333	443	497	545	591	628
Capital gains, property revaluations & other	311	598	616	507	342	322
Result from equity-accounted investees	0	1	6	1	2	2
Property expenses	-152	-204	-239	-263	-284	-303
Cost of buildings sold	0	-5	-1	0	0	0
Administration expenses	-7	-10	-11	-11	-13	-14
Operating income (EBIT)	486	823	868	780	638	634
Finance expenses	-26	-36	-40	-46	-49	-51
Other financial results	0	-11	-43	-36	-21	0
Pre-tax income (EBT)	460	775	786	698	569	584
Tax and deferred tax expenses	-66	-122	-146	-115	-91	-86
Minority interests	-35	-88	-80	-64	-50	-52
Hybrid note investors	-15	-23	-24	-30	-33	-33
Net income	344	542	535	489	395	413
Basic EPS (€)	2.71	3.56	3.35	2.95	2.36	2.46
Diluted EPS (€)	2.35	3.25	3.06	2.76	2.22	2.31
Adjusted EBITDA	177	225	248	276	297	313
Ratios						
Adjusted EBITDA margin	53.2%	51.6%	50.1%	50.6%	50.2%	49.9%
Tax rate	12.8%	11.9%	-11.3%	-10.8%	11.0%	11.0%
Expenses as % of revenues						
Property expenses	45.4%	46.8%	48.3%	48.2%	48.0%	48.2%
Administration expenses	2.1%	2.2%	2.2%	1.9%	2.3%	2.3%
Y-Y Growth						
Rental and operating income	53.8%	30.6%	13.6%	10.1%	8.5%	6.2%
Total revenues	44.1%	32.7%	12.2%	9.7%	8.5%	6.2%
Operating income	41.9%	69.3%	5.5%	-10.2%	-18.2%	-0.6%
Adjusted EBITDA	58.3%	26.8%	10.3%	11.1%	7.6%	5.5%
Net income/ loss	67.3%	57.7%	-1.5%	-8.6%	-19.2%	4.5%
Funds from Operations (FFO)						
Operating profit	486	823	868	780	638	634
Depreciation and amortisation	2	2	2	3	2	2
EBITDA	488	825	871	782	640	636
Capital gains, property revaluations and other	-311	-598	-616	-507	-342	-322
Result from disposal of trading properties	0	-2	0	0	0	0
Others	1	0	-6	0	-2	-2
Adjusted EBITDA	177	225	248	276	297	313
Financial expense	-26	-36	-40	-46	-49	-51
Tax	-23	-27	-28	-30	-33	-34
Minorities	-1	-1	-2	-2	-4	-4
FFO 1	128	160	178	198	212	224
CapEx	-34	-56	-67	-75	-83	-89
AFFO	94	104	111	122	129	136



BALANCE SHEET

All figures in EURm	2015	2016	2017	2018	2019E	2020E
Assets						
Current assets, total	627	1,028	796	1,238	1,523	1,444
Cash and cash equivalents	236	449	312	603	853	751
Traded securities at fair value though P&L	153	181	89	162	162	162
Trade and other receivables	226	220	260	319	356	378
Inventories - Trading property	12	27	12	17	16	17
Assets held for sale	0	150	123	136	136	136
Non-current assets, total	4,062	5,126	6,712	7,623	8,224	8,752
Equipment and intangible assets	9	16	20	24	26	29
Investment property	3,846	4,823	6,414	7,282	7,861	8,364
Equity accounted investees	0	118	37	26	28	29
Other LT assets	195	155	214	254	269	285
Deferred tax assets	11	15	28	37	40	44
Total assets	4,689	6,154	7,508	8,861	9,747	10,196
Shareholders' equity & debt						
Current liabilities, total	277	338	371	306	338	359
Short-term debt	55	29	62	22	22	22
Trade and other payables	190	252	267	242	272	290
Other current liabilities	32	58	42	42	45	47
Long-term liabilities, total	2,239	2,750	3,288	3,887	4,371	4,440
Long-term debt	792	897	919	846	530	530
Convertible and straight bonds	1,168	1,478	1,810	2,450	3,188	3,202
Deferred taxes	239	326	500	523	581	633
Other LT liabilities	40	50	59	69	72	75
Minority interests	142	197	364	409	460	512
Shareholders' equity	2,030	2,868	3,485	4,258	4,578	4,886
Total consolidated equity and debt	4,689	6,154	7,508	8,861	9,747	10,196
Ratios						
Current ratio (x)	2.26	3.04	2.15	4.04	4.50	4.02
Equity ratio	46.3%	49.8%	51.3%	52.7%	51.7%	52.9%
EPRA NAV ¹ (€m)	2,402	3,208	3,993	4,783	5,172	5,531
Net debt (€m)	1,626	1,783	2,393	2,560	2,725	2,841
Net debt / equity	0.8	0.6	0.7	0.6	0.6	0.6
Net debt / EBITDA (x)	9.2	7.9	9.7	9.3	9.2	9.1
Interest cover (x)	6.9	6.2	6.2	6.0	6.1	6.2
Loan-to-value (LTV)	41.9%	34.9%	36.4%	34.3%	34.0%	33.3%
Return on equity (ROE)	18.1%	21.3%	16.6%	12.5%	9.5%	9.2%

¹ including perpetual notes



CASH FLOW STATEMENT

All figures in EURm	2015	2016	2017	2018	2019E	2020E
Net income	394	653	639	583	478	498
Depreciation and amortisation	2	2	2	3	2	2
Profit from equity accounted investees	0	-1	-6	-1	-2	-2
Change in fair value of investment properties	-311	-598	-616	-507	-342	-322
Net finance expenses	26	47	83	82	69	51
Tax result	66	122	146	115	91	86
Others	1	1	1	1	0	0
Operating cash flow	177	227	248	276	297	313
Inventories - trading properties	-1	2	-6	-6	1	-1
Trade & other receivables	-25	-6	-39	-38	-37	-22
Trade & other payables	20	3	19	18	30	18
Provisions for other liabilities	5	-6	3	3	2	2
Tax paid	-19	-19	-23	-28	-33	-34
Net cash flow from operating activities	157	201	202	225	260	275
Investment in fixed/intangible assets	-4	-3	-6	-6	-5	-5
Investments & acquisitions of investment property	-406	-476	-374	-501	-236	-182
Acquisition of subsidiaries	-446	-111	-324	-112	0	0
Proceeds from investments in financial assets	-359	33	95	-100	-15	-16
Cash flow from investing	-1,215	-557	-608	-718	-256	-202
Debt financing, net	440	487	597	916	423	14
Equity financing, net	640	171	176	312	0	0
Other financing activities	-24	-44	-457	-385	-128	-138
Net paid financing expenses	-33	-46	-47	-56	-49	-51
Cash flow from financing	1,023	569	269	786	246	-175
Net cash flows	-34	213	-137	291	250	-102
Cash, start of the year	270	236	449	312	603	853
Cash, end of the year	236	449	312	603	853	751
Adjusted EBITDA / share (€)	1.27	1.46	1.50	1.65	1.77	1.86
FFO I	128	160	178	198	212	224
FFOPS I (€)	1.01	1.05	1.12	1.19	1.27	1.34
Y-Y Growth						
Operating cash flow	38.3%	27.8%	0.5%	11.0%	15.6%	6.0%
Adjusted EBITDA / share	34.5%	15.0%	3.0%	9.8%	6.9%	5.5%
FFO I	68.2%	25.1%	11.2%	11.1%	7.0%	5.9%
FFOPS I	52.8%	3.9%	6.5%	7.1%	6.0%	5.5%

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...31	↓	↓	↓	↓
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	Today	€21.44	Buy	€28.00

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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.

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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.

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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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