WOOD FLASH NOTE

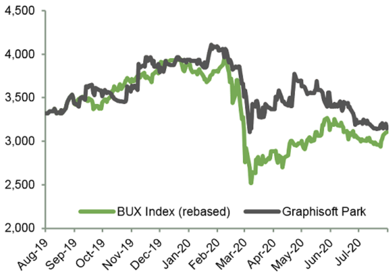
WOOD & COMPANY

14 August 2020

Graphisoft Park — HOLD

Graphisoft Park: 2Q20 results - impact on valuations limited (so far); 12% FFO yield attractive

BBG Ticker	GSPARK HB
Market Cap (USD mil)	110
Price	3,180
Price target	5,285
Upside	66.2%



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Graphisoft Park reported its 2Q20 results yesterday evening. Following the payment of the special dividend, the net LTV increased to 33%, compared to 23% at the end of 1Q20. The stock is down 22% ytd, in total return terms, and is currently trading at a 45% discount to NAV, and at an FFO yield of nearly 12%, on the annualised 2Q20 FFO. Operationally, Graphisoft Park has benefitted from strong leasing demand in the Budapest office market during the past three-to-four years. As vacancies across Budapest were declining and the average rents started to trend up, the buildings in the Park are no longer rented at a premium to the market.

While we expect to see further revaluation losses booked in the next 6-18 months, we believe Graphisoft Park is likely to retain most of its tenants. As long as we are right, and the rates remain low, we believe the drop in values should not exceed 5-15% of the portfolio value. We believe that Graphisoft Park is currently trading at attractive levels. Further developments and, potentially, a takeover by a larger peer, could be the key triggers for a rerating, we believe.

Graphisoft Park: 2Q20 review

EUR m	2Q19	3Q19	4Q19	1Q20	2Q20	qoq	yoy	WOOD	vs. W
Rental income	3.5	3.6	3.6	3.8	3.6	-3%	3%	3.5	4%
Service charge income	1.3	1.2	1.5	1.4	1.1	-21%	-17%	1.2	-7%
Service charge expense	-1.2	-1.1	-1.3	-1.3	-1.0	-24%	-20%	-1.2	-20%
Direct property related expenses	0.0	0.0	0.0	0.0	-0.5	15.6x	18.2x	0.0	29.1x
Net rental income	**3.6**	**3.7**	**3.8**	**3.9**	**3.3**	-15%	-9%	**3.4**	-5%
Operating expenses	-0.4	-0.3	-0.4	-0.3	-0.5	46%	7%	-0.3	58%
Other income (expense)	0.0	0.0	0.0	0.4	0.0	-96%	-1.9x	0.0	n/a
EBITDA	**3.2**	**3.4**	**3.4**	**4.0**	**2.8**	-29%	-11%	**3.1**	-10%
D&A and revaluation gains	0.0	0.0	1.1	-2.0	-0.4	-80%	7.2x	-5.0	-92%
Operating profit	**3.1**	**3.4**	**4.5**	**1.9**	**2.4**	26%	-22%	**-1.9**	-2.3x
Interest income	0.0	0.0	0.0	0.0	0.0	n/a	n/a	0.0	n/a
Interest expense	-0.3	-0.3	-0.3	-0.5	0.5	-2.0x	-2.7x	-0.3	-2.7x
FX differences - realized	-0.1	0.0	0.0	-0.1	-0.7	3.9x	12.5x	0.0	n/a
FX differences - not realized	0.0	0.0	0.1	0.0	-0.1	-30.0x	-2.9x	-0.2	-55%
PBT	**2.8**	**3.0**	**4.3**	**1.3**	**2.2**	73%	-23%	**-2.4**	-1.9x
Current income tax	0.0	0.0	0.0	0.0	0.0	0%	67%	0.0	-38%
Deferred income tax	0.0	0.0	0.0	0.0	0.0	n/a	n/a	0.0	n/a
Profit for the period	**2.8**	**3.0**	**4.3**	**1.2**	**2.2**	73%	-23%	**-2.4**	-1.9x
FFO reconciliation	**2Q19**	**3Q19**	**4Q19**	**1Q20**	**2Q20**	**qoq**	**yoy**	**WOOD**	**vs. W**
Net rental income	3.6	3.7	3.8	3.9	3.3	-15%	-9%	3.4	-5%
Operating expenses	-0.4	-0.3	-0.4	-0.3	-0.5	46%	7%	-0.3	58%
Other income / expense	0.0	0.0	0.0	0.4	0.0	-96%	-1.9x	0.0	n/a
Net interest expense	-0.3	-0.3	-0.3	-0.5	0.5	-2.0x	-2.7x	-0.3	-2.7x
Realized FX differences	-0.1	0.0	0.0	-0.1	-0.7	3.9x	12.5x	0.0	n/a
FFO I - pre-tax	**2.8**	**3.1**	**3.1**	**3.3**	**2.7**	-19%	-5%	**2.8**	-6%
Current income tax	0.0	0.0	0.0	0.0	0.0	0%	67%	0.0	-38%
FFO I	**2.8**	**3.1**	**3.1**	**3.3**	**2.7**	-19%	-5%	**2.8**	-6%
# of shares (ex.treasury and employee)	10.1	10.1	10.1	10.1	10.1	0%	0%	10.1	0%
FFO I / sh	**0.28**	**0.30**	**0.31**	**0.33**	**0.26**	-19%	-5%	**0.28**	-6%
Annualized FFO yield*	12.4%	13.5%	13.7%	14.5%	11.7%				
NAV	189.5	190.9	195.3	194.8	165.6	-15%	-13%		
NAV/sh	18.8	18.9	19.4	19.3	16.4	-15%	-13%		
P/NAV*	0.48x	0.48x	0.46x	0.47x	0.55x				

*Source: Company data, WOOD Research; *on current share price*

The revaluation result was almost flat, as Graphisoft Park booked negative EUR 0.4m during 2Q20, the following EUR 2.0m write-down recorded during 1Q20. According to management, there has been a certain amount of yield expansion recorded during 2Q, but this has been partly offset by higher rental fees, driven by the renewal of rental contracts and indexation. Furthermore, temporary vacancies were lower than either the management or the appraisers expected during the initial phases of the pandemic. We have been pencilling in that the company would book a slightly higher write-down, of around EUR 5m, following our conversations with S Immo and other companies under our coverage, which pointed out that appraisers in Budapest had a conservative view on the impact of the pandemic and the economic downturn on valuations. Transaction evidence remains weak, for the time being. We believe we may need to wait for the autumn and winter periods to have better clarity on the impact that the pandemic outbreak may have had on the valuation of commercial properties in Budapest.

The majority of Graphisoft Park's tenants are financially stable companies, operating in IT or biotech. Based on the initial feedback from its tenants, management expects the impact on leasing demand for premium office space to be limited. The updated management guidance, which is slightly more optimistic than the projections made at the end of 1Q20, implies that the FFO should reach EUR 11.2m in 2020E and EUR 11.4m in 2021E. This would translate into an FFO yield of 12-13%.

Occupancy stood at 97% at the end of 2Q20. In the remainder of the year, management expects occupancy to decrease by around 2-3ppt. Reportedly, this is partly due to the impact of coronavirus on the tenants, and partly due to isolated tenant requests. In the future, management expects occupancy to increase again. According to its conversations with tenants, while home office became a general practice during the lockdown, the employers still expects the employees to be physically present in the office, going forward.

Management reiterated its intention to maintain its existing dividend policy and to continue distributing 90% of the pro-forma profit.

There is a room to develop c.20k sqm in the Southern Development Area. While we believe there are no immediate plans to start building, management highlighted, in the report, that the company could launch construction within the following 18 months, if it saw demand for the space. Upon clean-up, the Northern Area could accommodate an additional 42k sqm. If all this space is developed (42+20), the total GLA would increase by c.75% relative to current levels. The Northern Area of the Park is still blocked for development, as it needs to be decontaminated first. The polluter - the Capital City Gas Works - does not appear to be co-operative and it is unclear whether the rehabilitation works will commence in the foreseeable future.

The company noted that, on 30 April, the Pest County Government Office notified Graphisoft Park about the repeated prolongation of the completion deadline for rehabilitation of the Northern Development Area. It would be possible to appeal against the decision, but taking into account all the circumstances of the case including the new deadlines of 31 May 31 2021E and 30 September 2022E, as well as the expected duration of such legal proceedings, Graphisoft Park decided not to appeal against the new resolution.

Year	BV (EUR m)	BVPS (EUR)	Net LTV	Equity ratio	FFO (EUR m)	FFOPS (EUR)	FFO ROE	P/BV	FFO yield	DPS (EUR)	Div. Yield
2016	24	2.3	65%	30%	7.2	0.71	31.1%	3.4x	9.0%	0.25	3.2%
2017	26	2.6	69%	25%	8.5	0.84	34.3%	4.3x	7.5%	0.30	2.6%
2018	168	16.6	28%	67%	9.9	0.98	10.2%	0.7x	9.0%	0.64	5.9%
2019E	175	17.4	38%	59%	12.0	1.19	7.0%	0.52x	13.2%	2.77	30.8%
2020E	181	18.0	37%	59%	11.1	1.10	6.2%	0.50x	12.2%	0.71	7.9%
2021E	187	18.6	35%	60%	11.0	1.09	6.0%	0.5x	12.1%	0.71	7.9%

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Date		Date	PT
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03/12/2019	HOLD	03/12/2019	HUF 5,285

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