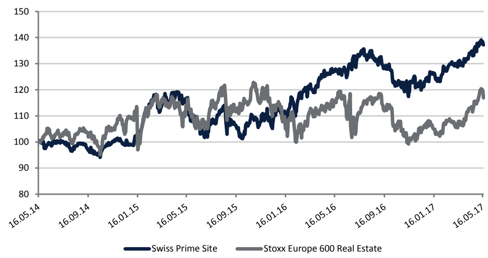
Swiss Prime Site

Market profile

Country	Switzerland
Sector	Real Estate
Industry	Real Estate
Price (CHF)	88.45
52-week high	90.65
52-week low	78.45
Market Cap	6’300
Avg. daily volume	149’300
Beta	0.68
ISIN	CH0008038389



Key metrics

	2016	2017e	2018e		2016	2017e	2018e
FFOps	4.04	4.20	4.50	P/FFO	21.9	21.1	19.7
YoY Growth	-3.8 %	4.0 %	3.7%	P/NAV	1.18	1.22	1.19.
Dividend yield	4.4%	4.2%	4.2 %	FFO Margin	39%	41%	43%

Executive Summary

Swiss Prime Site (SPS), which owns and manages a property portfolio worth more than CHF 10 billion, is one of the leading real estate companies in Switzerland. It is a specialist of the office and retail markets, accounting for 40% and 33% of total rental incomes. The company is also a provider of real estate and assisted-living services through two independent entities: Wincasa and Tertianum. These two businesses are not pure real estate activities, but they are related to the industry, where SPS has an expertise and wish to expand as it sees interesting perspective of growth.

The firm is only active in Switzerland. Its main markets are Zurich and Geneva, which represent 42% and 21% of the total portfolio value. The rest of the properties are located in the Swiss German part of the country (Bern, Basel and St. Gallen).

Since its listing on the stock exchange market in 2000, Swiss Prime Site has been following a growth strategy, which is evidenced by the evolution of its portfolio and its revenues.

Indeed, since its incorporation SPS has been able to grow its portfolio value from CHF 0.8 billion to more than CHF 10 billion and its operating income from CHF 30 million to CHF 400 million, which corresponds to a 16.4% compounded annual growth rate.

The growth story of SPS seems well on track to pursue its course as the company has a development pipeline of around CHF 1.5 billion to be completed within the next five years and ambition to increase the operating profits of its real estate-related activities by +50%.

Swiss Prime Site

Vitangelo Pagliarulo, Junior Financial Analyst **May 2017**

Business description

Swiss Prime Site (SPS), which has a market value of around CHF 6 billion, is the leading real estate company in Switzerland. The firm manages a portfolio of 184 assets worth CHF10.1 billion and also invests in real estate-related business fields. In terms of size, SPS is even one of the largest real estate player in Continental Europe as only six companies own a portfolio worth more than CHF 10 billion.

Swiss Prime Site is structured as a group composed of five brands, each active in different businesses related to the real estate industry.

Swiss Prime Site Immobilien is the core company of the group and the largest contributor to the total annual revenues. It is a pure real estate business whose activity consists in acquiring and managing properties. The focus is made on high quality assets located in the city centers of the most dynamic cities of Switzerland. The company targets the commercial segment as it mainly owns offices and retail properties. They account respectively for 40% and 33% of total net rental income. Development and transformation of sites is also an important part of the activity, which is the main driver of growth for the company.

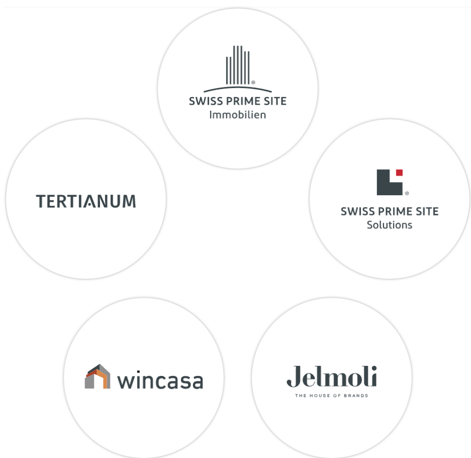
Wincasa is the biggest provider of real estate services in Switzerland. According to the last figures published, Wincasa has CHF 64 billion of assets under management. The company offers a wide range of services such as property management, leasing advisory or facility management. It also invests a lot in digitalization in order to improve its profitability and develop a competitive advantage.

Jelmoli – The House of Brands is a premium department store located in Zurich. It is a retail activity for the group. The store is operated according to two models. One half of the shop is self-managed by Jelmoli like a traditional retail shop while the other half generates revenue following the shop-in-shop model, which consists in renting a part of the retail space to different independent brands. Jelmoli will soon expand its activity as a new store will open at the airport of Zürich in 2019.

Tertianum is a provider of assisted-living services, one of the largest of the country. It is structured as a group comprised of five brands (Tertianum, Perlavita, Vitadomo, SENIOcare, BOAS), each targeting different type of needs. The group has an exposure on different segments of this business in order to diversify its income base. For instance, under the Tertianum brand, the group manages special accommodations that allow residents to be autonomous while having care and support services. Perlavita is a geriatric care facilities operator. Vitadomo is specialized in senior centres.

The presence of SPS in this business is a play on the ageing population, where demand for specialized facilities is increasing. This market is highly regulated and hard to penetrate. Acting as a leader might be an enormous advantage in the long term as it will allow the company to develop a real know-how and to be in a good position to seize growth opportunities.

Fig. 1: Swiss Prime Site Group Structure
Source: Company Data

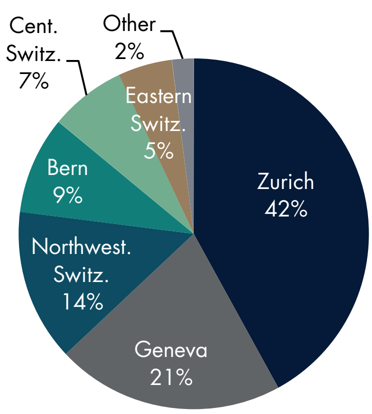


Swiss Prime Site Solutions is an asset manager dedicated to the real estate business offering specific services for third-parties. The objective of this activity is to generate revenue with a low level of risk. Indeed, SPS simply perceives a fee for its role of manager and doesn't invest any money. It is a good way to use its expertise to generate additional income *(Fig. 1)*.

Geographic exposure

Swiss Prime Site is only active in Switzerland. Its main markets are Zurich and Geneva, which account for 42% and 21% of the total portfolio value. The rest of the properties are located in the Swiss German part of the country (Bern, Basel and St-Gallen).

Fig. 2 : Portfolio value by region
Source: Company Data

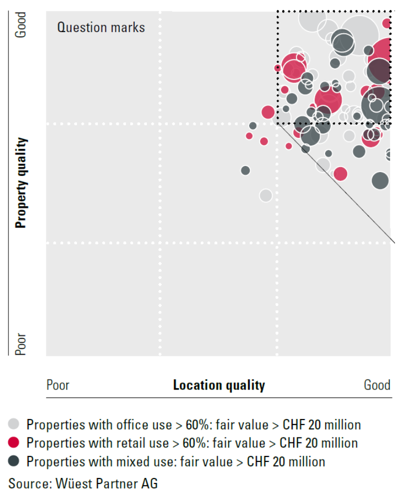


Strategy

Since its listing on the stock exchange market in 2000, Swiss Prime Site has been following a growth strategy, which is evidenced by the evolution of its portfolio and its revenues. Indeed, since its incorporation SPS has been able to grow its portfolio value from CHF 0.8 billion to more than CHF10 billion and its revenues from CHF 30 million to CHF 400 million, which represents a 16.4% compounded annual growth rate. The business model of SPS has evolved a lot over the years as initially the group was a traditional real estate firm whose activity simply consisted in acquiring, developing and operating properties. In fact, in 2009 SPS operated a shift in its business model and started to invest in other activities, but with the condition it had to be related to the real estate business. A move initiated with the acquisition of Jelmoli and that has intensified over years. As we have seen, today SPS also offers real estate and assisted-living services through its subsidiaries Wincasa and Tertianum.

Although its business model has progressed, SPS's strategy and core value has never changed. The group invests in activities where it sees interesting opportunities of growth and with the aim to acquire a dominant position in order to ensure a competitive advantage.
As a matter of fact, Swiss Prime Site is the leading real estate company in Switzerland and owns top-class assets in terms of quality or location. This is a key element in the company's strategy as these properties tend to be more resilient in bad market competition. Around 80% of its properties are in the top segment of the market matrix produced by the independent appraiser Wüest Partner *(Fig 3)*.

Fig. 3: Market matrix (portfolio quality)
Source: Company Data



Wincasa, acquired in 2012, has experienced an impressive growth and has become, with a market share of 20%, the largest player of the industry. Over the last five years, it has increased its number of rental properties under management from 175'000 to 231'000 units.

The assisted-living activity has also well-developed since SPS penetrated this business field in 2013. The company has made several acquisitions that have allowed the company to triple its operating income and to become the market leader.

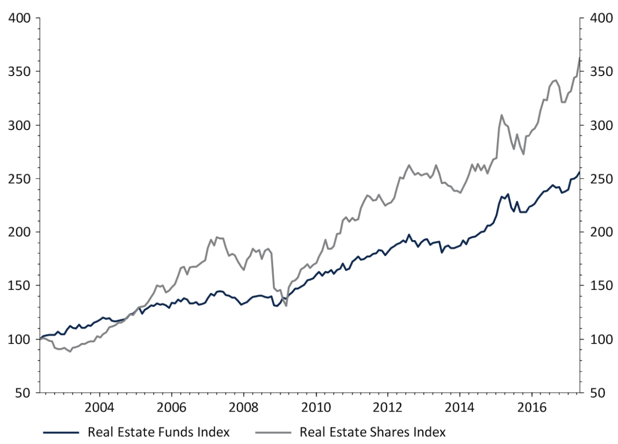
Industry overview & Competitive positioning

The listed real estate market is worth around CHF 60 billion (total market value) in Switzerland and is comprised of two types of investments: funds and shares. SPS is positioned on the share segment.

Real estate funds are more constraint investments than real estate companies. For instance, funds can only own and manage real estate assets while companies can diversify their activities either in real estate or in other businesses. Moreover, funds are limited in their leverage (max. 30%).

In fact, funds are investments designed for institutional investors such as pension funds and insurances, which seek defensive investments offering stable income. Thus, in order to protect investors, this market is subject to more regulations. As a result, funds offer less potential of growth than companies, but they are also less riskier investments *(Fig. 4)*.

Fig 4: Real estate shares index vs real estate funds index
Source: Datastream



The share segment, which is worth almost CHF 20 billion (total market value), is composed of around 15 companies. It is mainly dominated by 6 firms, accounting for 80% of the total market value. Swiss Prime Site is the dominant player, followed by PSP.

SPS is active on the commercial market, with a strong focus on offices and retail properties. Its closest competitor within the industry is PSP as 80% of its portfolio is comprised of commercial properties, even though its focus is more on offices. Moreover, PSP is also focused on prime properties. The other competitors are more diversified with a portfolio of lower quality *(Fig. 5)*.

As we have seen, SPS is positioned in top locations with mostly prime properties, which are the most profitable assets available on the market. For instance, according to the last statistics available (source: AMI International), rents in the city center of Geneva for office properties varies between 400 and 810 (CHF/m2/year) against a range between 200 and 450 (CHF/m2/year) outside the center. Besides, in the case of departures, these assets tend to be released faster.

Financial analysis

Growth

SPS has been very successful in growing its revenues over time. As we can see, they have been multiplied by more than five times over the last ten years; more precisely they have grown at an impressive compounded annual growth rate of 17.6% *(Fig. 6)*.

Such a growth is mainly due to two elements: a good ability to continuously renew the development pipeline for its portfolio and the development of new activities (acquisition of Jelmoli, Wincasa and Tertianum).

EBITDA (ex-property sales and revaluations)

Though, if we look at the EBITDA evolution, we notice a much weaker rate of growth (CAGR of 10.5% over 10 years) and a worsening margin. As a matter of fact, Jelmoly, the real estate service business and the assisted-living activity, which have grown rapidly since 2010, are activities generating high revenues but with low margins. For instance, the real estate activity generates a gross margin of around 75% against only 15% for Wincasa and 4.5% for Tertianum.

Fig. 5: Revenue by asset class
Source: Company Data

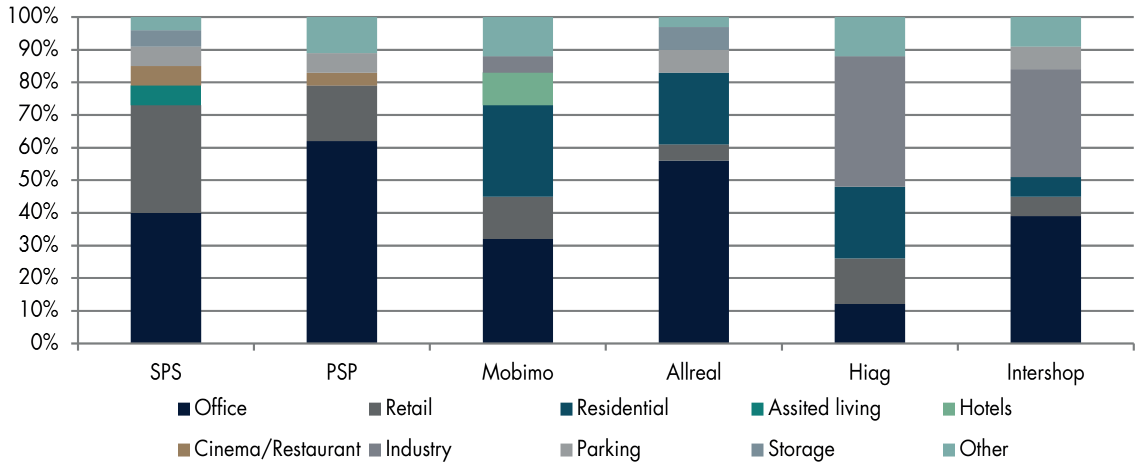


Fig. 6: Revenue evolution (CHF mn)
Source: Company Data

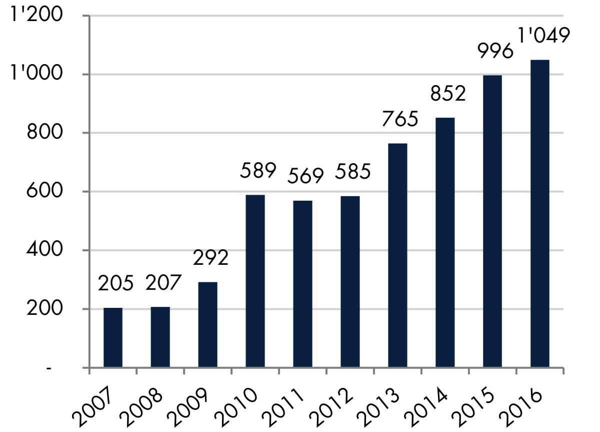
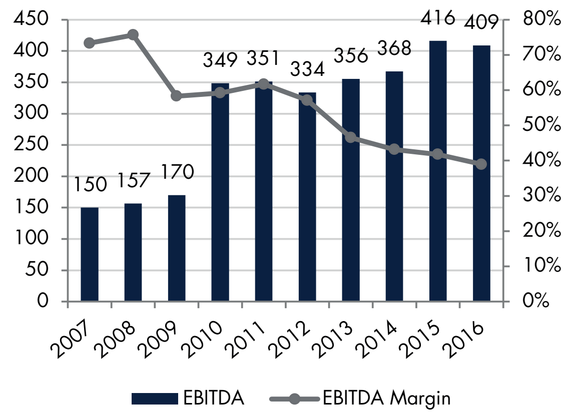


Fig 7: EBITDA (CHF mn) & margin
Source: Company Data



However, SPS has demonstrated a good ability to improve its efficiency as the gross margin of Wincasa has increased from less than 10% to 15% since the acquisition. According to the management, it will be hard to exceed this level in the future, but the company has plenty of room to increase its market share as it is a highly fragmented sector and Wincasa has a dominant position. This is rather encouraging for the assisted-living activity, which has begun only a few years ago. The retail business has been suffering as the whole industry is under pressure since the SNB unpegged the Swiss franc. The EBITDA margin reduction could thus have reached a bottom in 2016 and profitability could increase in the next years.

Dividend

In real estate, dividend is a figure of major importance for investors. In fact, as the business model to operate in this industry is quite basic, it consists simply in leasing assets and collecting rents, shareholders principally look for predictable returns (dividends). Analyzing the dividend evolution of SPS, we can notice that it has been regularly increased over time.

Although it remained stable during several periods, it has never decreased, which is a positive sign as it demonstrates a conservative policy and a high predictability (Fig. 8).

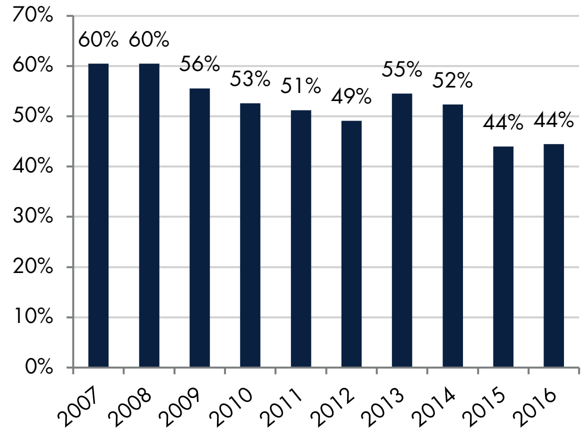
The payout ratio has ranged between 78% and 110% of the earning per share (ex-revaluations) during this period. SPS tends to increase its dividend in anticipation of the delivery of its developments. As a result, the payout exceeds sometimes the incomes available, but the compensation is always made right after. It is not impossible to see a new increase in the dividend in 2017 as the payout has stabilized these last three years.

Balance sheet

In order to assess the level of indebtedness of a real estate company, investors commonly use the loan-to-value ratio (LTV). It consists in dividing the total amount of borrowings by the market value of the properties. A high ratio means an important leverage and vice versa (Fig. 9).

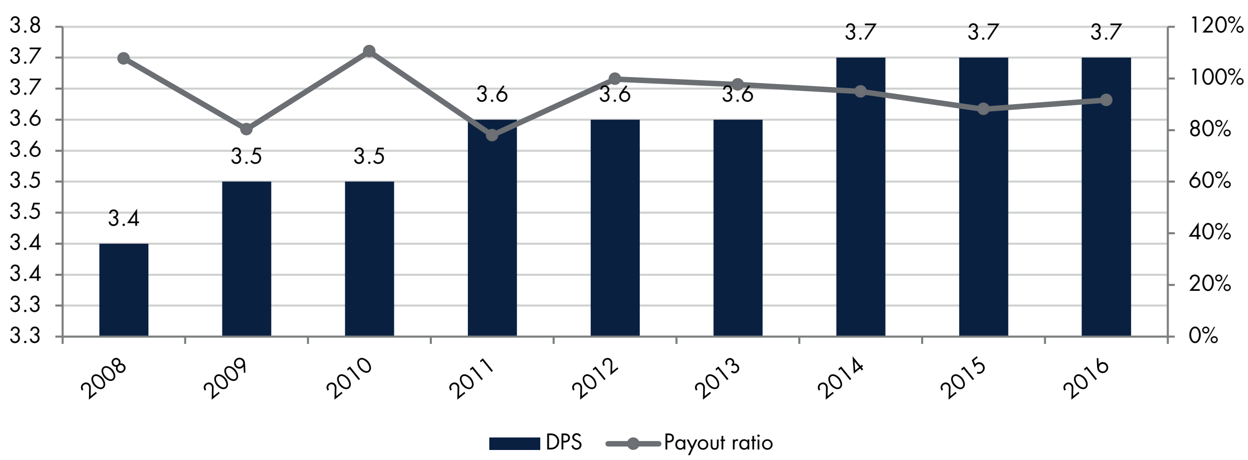
Swiss Prime Site's LTV ratio has significantly decreased over the last ten years, from 60% in 2007 to 44% in 2016. Its main competitor, PSP, has a more conservative approach as its LTV ratio is only 31%. In the actual environment of low interest rates, having a higher level of debt makes sense as debt is really cheap. For instance, in April, SPS took out a loan of CHF 250 million on10 years bearing an interest rate of only 0.825%.

Fig : 9: Loan-To-Value
Source: Company Data



Though, even if having more debt is interesting, it still includes a risk as in bad market conditions, assets could depreciate and consequently push up the LTV ratio. Knowing that loans often have covenants, in such a scenario a company could be forced to sell some assets or make capital increases, which would dilute income available for shareholders. In our case, we can assume that current level of indebtedness is acceptable; the average LTV ratio in Switzerland is around 40%.

Fig 8: Dividend per share & payout ratio
Source: Company Data



Investment Case

The commercial real estate market is currently facing some challenges in Switzerland. In fact, as we've been in a low interest rates environment since several years, investors have flowed lots of capital into real estate projects in order to find attractive returns. As a consequence, supply has increased and put pressure on rent prices, which have been in a downtrend since 2013. This phenomenon has been principally observed on the office segment. As a matter of fact, the retail real estate market has been impacted by other specific elements: a strong currency, which has encouraged consumption outside the country, and the e-commerce boom.

According to GfK, share of online trade in retailing, which has been continuously increasing since 2008, represents around 6% of the total retail sales against a share of only 3% in 2008.

Though, despite a challenging environment, we can be confident on Swiss Prime Site's perspective of growth. First, the company mainly owns prime assets in top locations, which are properties more immune to market fluctuations. For example, although the vacancy rate of SPS has deteriorated over last years, from 4.8% in 2012 to 6.5% in 2016, it is still a comfortable level. Besides, the company guides a decrease in the vacancy for 2017.

Second, SPS has an impressive pipeline of around CHF1.5 billion on the medium term, which should bring growth for several years.

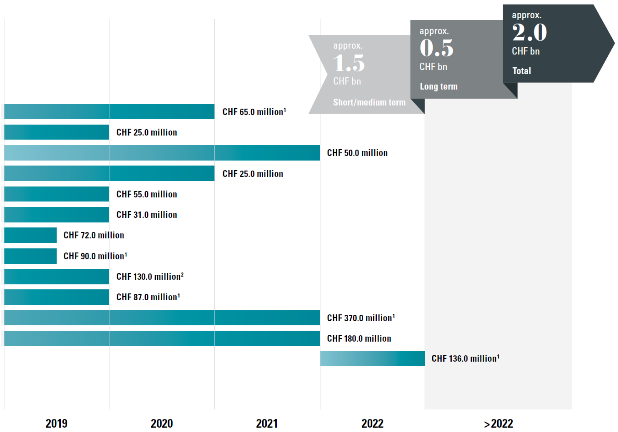
Finally, SPS is working hard to improve the profitability of Wincasa and Tertianum. In fact, while these two activities generated together an operating profit of around CHF 42 million in 2016, the company targets a figure of CHF 65 million for 2020, which represents an increase of +50% in less than 5 years. The growth story of SPS seems to be well on track to pursue its course at least another four years.

Valuation

If we look at the premium/discount to NAV, the company looks quite expensive as the actual level (19%) is above its long-term average (14%).

However, this premium seems justified as SPS has a very large pipeline and growth coming from its other activities. Furthermore, bonds' yields are currently in negative territory while SPS pays a dividend, entirely covered by its revenues, yielding above 4%. Thus, valuation doesn't appear to be too demanding, even if growth is already priced in.

Fig. 10 :Pipeline
Source: Company Data



Risks

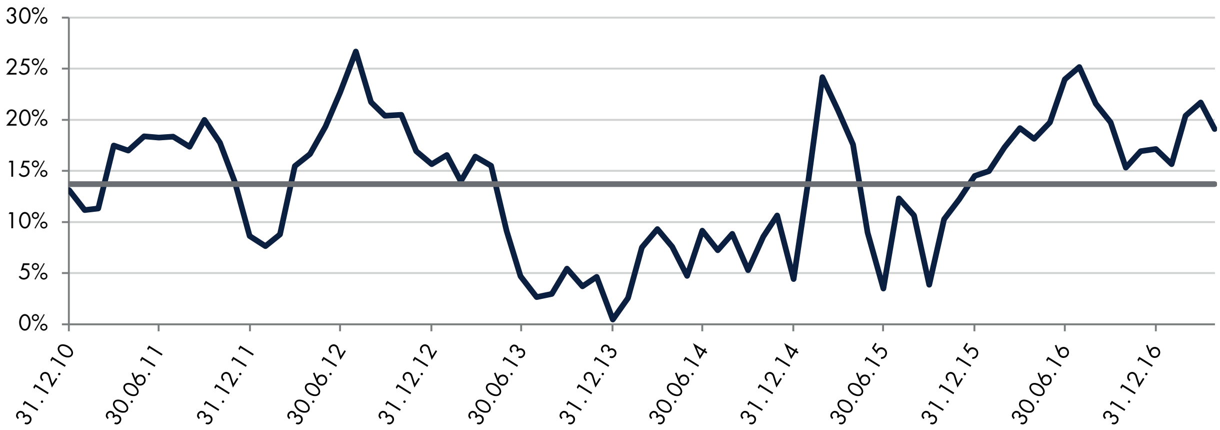
Every investment is subject to various risks. For instance, the whole economy could deteriorate and negatively impact companies' profits or firms could take inappropriate strategic decisions which would result in significant loss for investors.

Though, SPS is currently facing another risk that is worth analyzing deeper, the revision of the Lex Koller. As a matter of fact, the revision of this law could shake up the whole listed Swiss real estate market.

Lex Koller

The Lex Koller is a federal law established in 1997 whose aim was to settle rules for foreign property ownership. This law is currently under revision by the

Fig. 11: Premium/Discount to NAV
Source: Company Data



Federal Council who wants to reinforce it and add new limitations for foreign investors *(Fig. 11)*.

As a result, two important issues have arisen from the draft law revision for the listed real estate industry:

- Foreign investors would not be allowed any more to purchase shares of Swiss real estate listed companies.
- Ownership of commercial properties by foreigners would not be permitted any more unless permission is granted. However, actual owners would not have to sell their properties.

However, we are only at the beginning of the process as we are presently only in the consultation process, which could easily last several years. Thus, no risks should materialize in the short term. Moreover, those are only propositions. Indeed, the Association of Real Estate Investors believes that the Federal Council can be convinced that these suggestions could be removed from the draft revision.

Nevertheless, if this revision law should be accepted in the future, Swiss Prime Site could be heavily impacted as around 30% of the capital is owned by foreign investors.