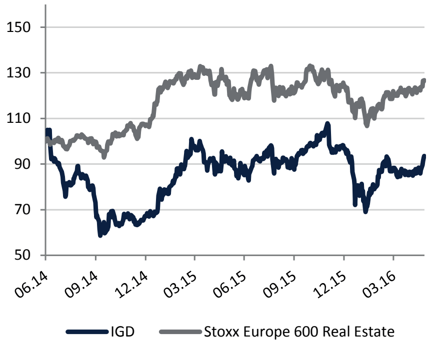
IAM
Independent Asset Management

August 2017

Immobiliare Grande Distribuzione

Market profile

Country	Italy
Sector	Real Estate
Price (CHF)	0.85
52-week high	0.88
52-week low	0.62
Capitalisation (EURm)	671
Avg. daily volume	1'442'500
Beta	0.85
ISIN	IT0003745889



Key metrics

	2016	2017e	2018e		2016	2017e	2018e
FFOps	0.063	0.076	0.083	**P/FFO**	11.6	11.2	10.2
YoY Growth	18%	20%	10%	**P/NAV**	0.54	0.60	0.59
Dividend Yield	6.1%	6.3%	6.9	**FFO Margin**	38%	40%	43%

Executive Summary

Immobiliare Grande Distribuzione (IGD), which is worth 670 million euros, is an Italian company active in the retail real estate industry. The firm owns and manages an important property portfolio comprised essentially of medium-sized shopping malls and hypermarkets.

IGD's primary market is Italy, where the company owns 56 properties. The portfolio is well-diversified across the country, but with a stronger focus on the north region, which is the most dynamic. To a lesser extent, IGD is also present on the Romanian market, where it owns a shopping centers chain called Winmarkt comprised of 15 properties. This is a small activity for the group as Romania accounts only for 8% of the total portfolio value.

In 2016, the Italian GDP has grown by 0.9% and is expected to grow by another 1% in 2017 according to the OECD forecast. Although it is still below the Eurozone average (2017e: +1.8%), it is improving and signals a positive development of the Italian economy. As a result, the retail real estate market has gained appeal and investments have boosted in 2016, increasing by 89% compared to 2015 to reach 2.6 billion euros. IGD has recently launched a business plan that should allow it to significantly improve its revenues. As a matter of fact, the company is guiding an increase of its FFO per share of +20% in 2017.

Furthermore, since 2008, IGD has been operating under the SIIQ regime, which is the equivalent of the REIT status in Italy. This specific structure applies only to real estate companies and has for main feature to relax corporations active in this industry from paying taxes.

Immobiliare Grande Distribuzione

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

Business description

Immobiliare Grande Distribuzione (IGD), which is worth 670 million euros, is an Italian company active in the retail real estate industry. The firm owns and manages an important property portfolio comprised essentially of medium-sized shopping malls and hypermarkets. It also makes developments for its own portfolio with few projects currently under construction.

Fig. 1: IGD Logo
Source: Company Data

IGD's describes its operations as following:

Property management and leasing. This is the main activity and core business of IGD. It consists in managing the property portfolio in terms of maintenance and communication as well as in asset rotation. In one hand, the company works to ensure sound flow traffic in its shopping centers to maintain a high level of occupancy. As a result, IGD is able to maximize its assets' return as retailers' revenues are directly linked to flow traffic. On the other hand, the aim is to optimize the entire portfolio structure to improve the total yield generated by its properties. IGD actively monitors the market to seize opportunities of acquisitions offering growth and also to sell mature assets with low potential. Furthermore, the company offers property management services to third parties, which generates additional revenues to the group.

Services. IGD offers different types of services such as security, cleaning and routine maintenance, which also contribute positively to the revenues.

Contract management. This activity is attributed to a specific team, which is responsible for negotiating lease/release contracts. In fact, IGD is engaged with a wide range of retailers, more than 600, and each year there are a large number of contracts expiring as well as departures. For instance, in 2016, IGD had to treat around 200 leases over a total of 1'192, which represents almost 20% of all contracts. As a consequence, the company puts a strong emphasis on this activity. Moreover, it allows IGD to strictly monitor the risk profile of its tenants and its structure. Indeed, the concentration of retailers is limited; in 2016 the ten largest tenants generated only 20% of total revenues.

Marketing. The marketing division, although it doesn't generate any revenues, is also core to IGD. It has been recently restructured in order to improve the support to all its shopping centers. The division is now following a new methodology, using a more developed analytical approach. It also uses social medias to launch special events, which drives footfalls and increases shopping centers' appeal.

Besides, since 2008, IGD has been operating under the SIIQ regime, which is the equivalent of the REIT status in Italy. This specific structure applies only to real estate companies. Its main feature is to relax corporations active in this industry from paying taxes. Though, in order to achieve this status, SIIQs have to respect several conditions, such has respecting a strict set of rules to avoid conflicts of interest and distributing at least 70% of the taxable net income to shareholders. In fact, as the business model to operate in real estate is quite basic, it simply consists in leasing assets and collecting rents as investors principally look for return (dividends). Thus, under such a regime, as almost all the revenue must be distributed, it is taxed only once, at the investor level when the dividend is paid.

History of the company

IGD's creation took place in 1977. The company was originally called ESP, Dettaglianti Associati and was specialized in the management of non-food retail properties. In 1983 the hypermarket chain Coop Romagna-Marche, which has become Coop Adriatica after several mergers and which is today the main shareholder of IGD, purchased a first stake of 53% of the company. This led to the opening, in 1998, of the first shopping center containing a hypermarket as main anchor.

In 2000, Coop Adriatica transferred several retail assets to ESP which changed definitively its name to IGD Immobiliare Grande Distribuzione. Over the following years, other assets were transferred to the portfolio, which rapidly reached a value of 550 million. At the end of 2004, it was then composed of 7 shopping centers and 6 hypermarkets.

In February 2005, as the portfolio had reached a critical size and new developments were in the pipeline, IGD decided to enter the public market. The transaction was a success as the company was able to raise 150 million through the IPO.

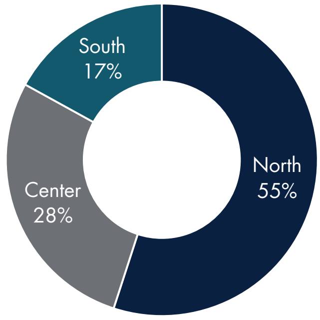
In 2008, IGD was the first real estate company to achieve the SIIQ status in order to benefit from a preferential fiscal regime and gain attractiveness. During the same period, the company also entered the Romanian market through the acquisition of a shopping center chain. This investment hasn't returned the expected yields. These assets are no longer considered as strategic and might be sold in the future.

Since then, IGD has kept expanding, increasing its portfolio value to more than 2 billion at the end of 2016. The company owns and manages now more than 50 properties.

Geographic exposure

IGD's primary market is Italy, where the company owns 56 properties (end of 2016). The portfolio is

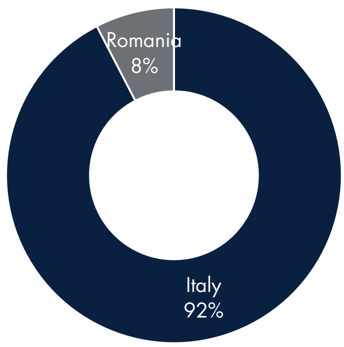
Fig. 2: Italian portfolio geographical distribution (end of 2016)
Source: Company Data



well-diversified across the country, but with a stronger focus on the north region, which is the most dynamic.

To a lesser extent, IGD is also present on the Romanian market, where it owns a shopping centers chain called Winmarkt comprised of 15 properties. This is a small activity for the group as Romania accounts only for 8% of the total portfolio value.

Fig. 3: Portfolio breakdown Italy and Romania (end of 2016)
Source: Company Data

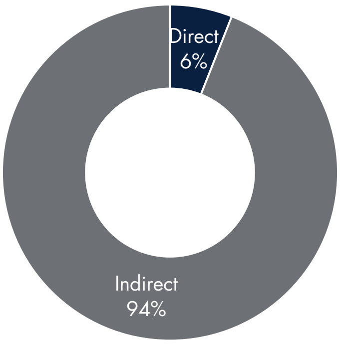


In terms of asset situation, IGD's centers are mainly located in strategic catchment areas, in order to maintain a high occupancy ratio over time.

Industry Overview & Competitive positioning

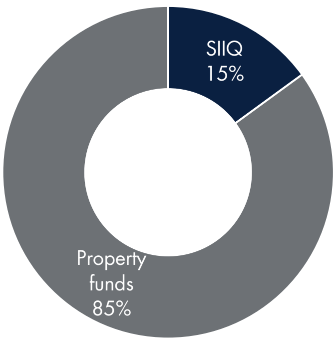
The Italian commercial real estate market is worth around 830 billion euros and is dominated by direct owners. In fact, the indirect market accounts only for a tiny part (6%) of the whole market.

Fig.4: Italian commercial real estate market
Sources: Société Générale, EPRA



Meanwhile, closed-end funds dominate the indirect market as they account for 85% of the market. This is due to advantageous fiscal status.

Fig.5: Categories of indirect real estate
Source: Société Générale



As a consequence, the listed real estate market is very small. It is worth only 2.6 billion euros, of which 50% is free float. There are only four SIIQs: Beni Stabili, IGD, Coima Res and Aedes.

Although there are four listed companies, in actual fact the market is split in two, between Beni Stabili and IGD as they account together for 85% of the total market value. Beni Stabili, which is worth around 1.6 billion euros, is the largest player, but it principally owns offices. As a result, the market is composed of two leaders within their respective markets.

Being a SIIQ with a dominant position could be a huge advantage in the coming years for IGD (and Beni Stabili). As a matter of fact, the Italian market is quite particular and currently faces a big issue as real estate funds were created with an expiry date upon which assets have to be sold and profits returned to shareholders. Based on the expiry date of existing funds, between 2017 and 2022 around 3 billion of properties should arrive on the market. There is a high probability that these assets will be sold at a discount, as there is a limitation time to sell them. Moreover, the volume of sales will be significant, which could put supplemental pressure on prices. As a consequence, there could be soon good opportunities of acquisitions at interesting prices. This should benefit the leaders as they have a bigger firepower in terms of purchases. They can borrow more money and they are also more attractive for investors if they need to raise capital, as they are liquid securities.

Financial analysis

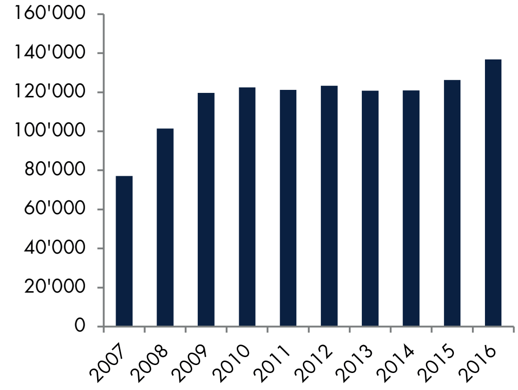
Growth

As we can see, IGD has been quite successful in growing its revenue over the years. In fact, within a decade, the company has almost doubled its revenue; more precisely they have grown at a compounded annual growth rate of 5.9%.

Though, we notice that this growth has been realized in two phases. The first took place between 2007 and 2011, the second from 2014 until now. The slowdown between 2011 and 2014 is due to the sovereign debt crisis that put a drag on investments and consequently on growth.

IGD's growth should continue at least another few years as the company launched a 2016-2018 bu-

Fig.6: Revenue growth (EUR mn)
Source: Company Data



siness plan. The aim is to invest more than 250 million (of which 185 in development) over three years at an average yield on cost of 7%. Besides, the plan seems to be well on track as 80 million were already succesfully invested in 2016 according to the last results.

Funds from operations

Funds From Operations (FFO) is a key figure used exclusively in the real estate industry. It is an operating performance figure allowing investors to measure the real profitability of a property portfolio. The main characteristic of this measure is to consider only incomes generated by the activity. As a result, profit (or loss) realized on sales of assets and revaluation gains (or loss) are not taken into consideration. Thus, the ability of a company to pay its dividends heavily depends on its FFO generation (Fig. 7).

In comparison with revenue, we can see that FFO growth hasn't been smooth at all. Between 2011 and 2014, while revenues were stagnating margins were deteriorating. This is mainly due to the economic situation of the country, which was worsening at that time. In fact, the unemployment rate increased to 13% in 2014 from 8% in 2011. As real estate is a cyclical activity, IGD's business was negatively impacted. However, since 2014 the economy is recovering and so is IGD, which has already reached its margins of pre-2011. This is rather encouraging for the future as the country has still room to improve its economy. For instance, the unemployment rate is still above 10% (latest value: 11%).

Dividend

As we can see, over the last ten years the dividend has been quite volatile. It experienced a strong growth from 2008 to 2011 before sharply declining the following next three years. Dividend heavily depends on FFO generation. As analyzed previously, this latter experienced a significant decrease during this period, which consequently forced IGD to cut the dividend.

Though, it seems that 2014 acts as a turning point for the company. Indeed, the dividend has been increased twice over the last three years, in 2015 and 2016, while the payout ratio has decreased. Besides, IGD guides another increase in 2017. We can also notice that IGD adopts a conservative dividend policy, as the payout ratio has rarely exceeded 75%. This is a good sign for the future as the company currently offers an attractive dividend yield of more than 6% and has developments to finance (Fig. 8).

Fig. 7: Fund From Operation Growth (EUR mn) & Margin
Source: Company Data

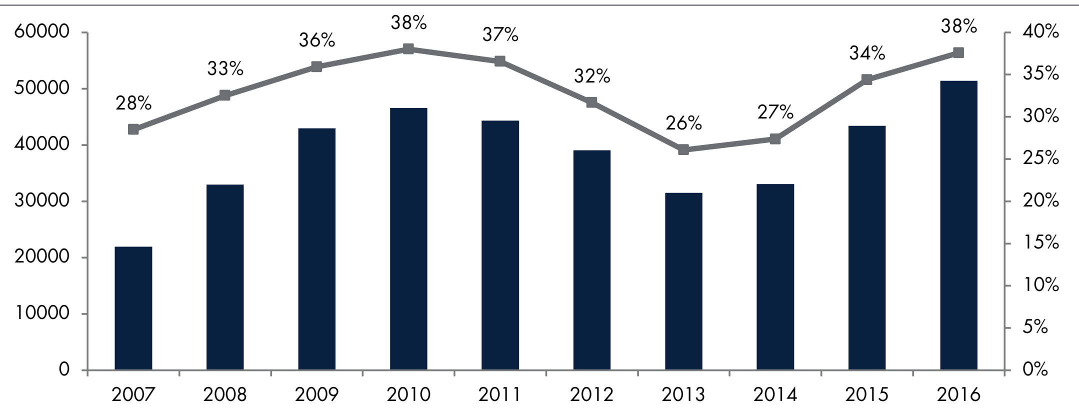


Fig. 8: Dividend per share & payout ratio
Source: Company Data

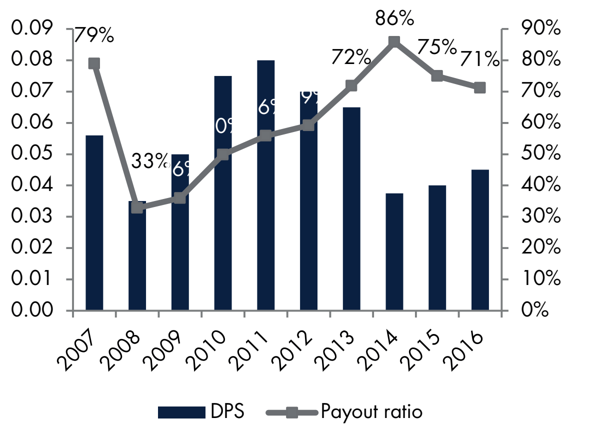
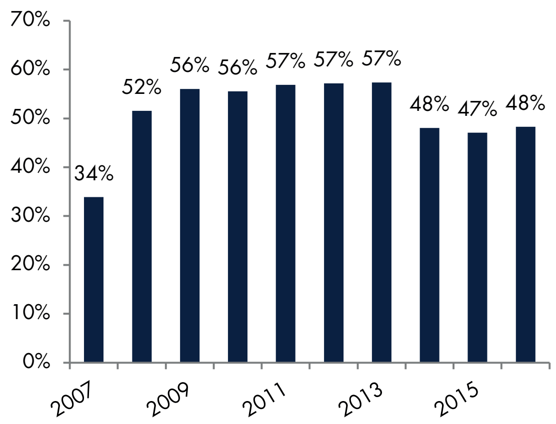


Fig. 9: Loan-To-Value
Source: Company Data



Balance sheet

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

As we can see, IGD's LTV ratio has ranged from 47% to 57% over the last ten years, if we don't take into account 2007. We can also notice that it has stabilized below 50% for three years now, much lower than in the past. Although it has improved, it is still a bit high in comparison with its European peers. The average LTV ratio on the continent (excluding the UK) is around 43%.

Even if the LTV is a bit above the market average, we assume it is still at a reasonable level. In terms of capital structure, it even makes more sense to keep it higher as debt is cheap nowadays in the current environment of low interest rate. Besides, IGD returns only 70% of its income to shareholders. As a result, the company has a significant amount that can be re-invested in new developments, while keeping the level of indebtedness stable. Furthermore, IGD has a comfortable interest coverage ratio of 2.24 (Fig. 9).

Investment case

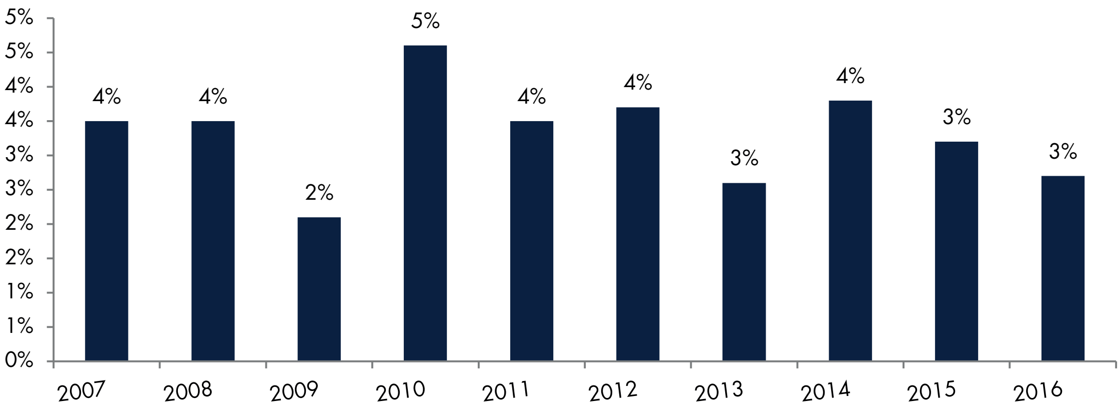
In 2016, the Italian GDP has grown by 0.9% and is expected to grow by another 1% in 2017 according to the OECD forecast. Although it is still below the Eurozone average (2017e: +1.8%), it is improving and signals a positive development of the Italian economy. As a result, the retail real estate market has gained appeal and investments have boosted in 2016, increasing by 89% compared to 2015 to reach 2.6 billion euros.

As we have seen, IGD is well positioned in this segment and should therefore benefit from this positive trend. Besides, the company owns a property portfolio of good quality in Italy as attests its historical low vacancy rate, which means that it is in a good position to increase rents in an uptrend market (Fig. 10).

Besides, IGD has a very good pipeline. It aims to invest around 200 million euros by 2018 at an average yield on cost of 7%. The company has recently revised its FFO guidance for the current year from +18% to +20%. The initial guidance was based on the completion of several developments. The increase announced is the result of an improvement of the activity. In fact, during the year, the company was able to increase its expiring rents in average by +4.7%. As a result, IGD seems to be well positioned for the coming years as it should benefit from two vectors of growth: developments and the activity itself.

Furthermore the Romanian market, after several years of very bad performances, is now recovering too. Even though it represents only a small part of IGD's revenue, it is still a positive contribution to total profits. The company hasn't communicated about it, but we can assume that it might sell it. Indeed, this portfolio doesn't really make part of IGD's core business.

Fig. 10: Vacancy rate
Source: Company Data



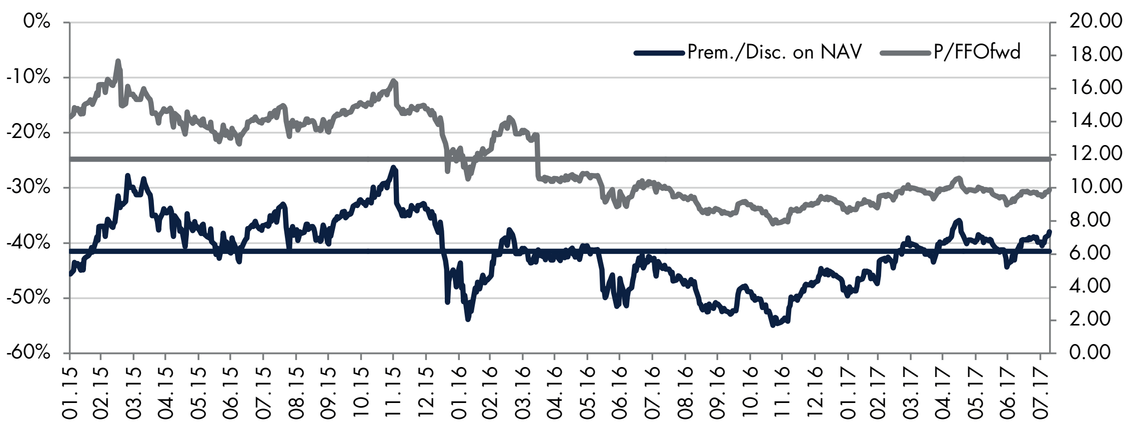
The only negative element we can point out concerns the hypermarket portfolio, which accounts for around 35% of total revenue. Even if it offers a good stability, as leases are signed on the long term and the occupancy rate is 100%, the hypermarkets' business has been experiencing negative growth since a few years now. Indeed, between 2012 and 2016, hypermarket sales growth have been negative, ranging from -1.3% to -2.9% on annual comparisons.

Valuation

Although the case seems strong, valuation remains the key element in investment decision. In terms of premium/discount on NAV, IGD is more or less valued in line with its two years average (~-40%). However, if we look at the 12 months forward Price/FFO, the company looks cheap as the current ratio (10x) is 20% below its two years average (Fig. 11).

As we can see, over the last two years, the relative value that investors have given to IGD has significantly decreased. In fact, the P/FFOfwd has peaked to16x before bottoming up at 8x, the actual level of 10x is still very low and quite far from its average. If the current discount on NAV is in line with its average, it is still a wide discount (-38%). Two different reasons might explain such a low valuation. First, the company is owned at 40% by its main tenant COOP, which means it almost controls the company. This is perceived

Fig. 11: P/FFOfwd & Premium/Discount
Sources: Company Data, Datastream



negatively as for instance COOP could force IGD to take some decisions that go in their favor while having an adverse impact on the profitability of the whole company, like proposing a rent reduction. Second, the politic situation is not very stable. Last year, the vote on the referendum to reform the parliament, which led to the resignation of the prime minister, brought lots of uncertainties and penalized the whole stock market. The next general election is scheduled in May 2018, but the president Sergio Mattarella is thinking of calling it this fall, in order to form a stable government as quickly as possible, which should bring uncertainty in the short-term.

Despite these two elements, which justify a lower valuation, the actual level still looks too low. As we have seen, IGD's activity is improving quite well; rents are increasing, several developments are in progress and the outlook is very impressive (IGD guides an FFO growth of +20%). Besides, if we compare the FFO yield and dividend yield of the company against its European peer (ex UK), we observe a large difference. In fact, IGD offers the highest FFO yield (8.94%) as well as one of the highest dividend yield (6.3%), while having a payout ratio of only 67% and a growth of +20%.

Fig. 12: FFO & Dividend Yield in Europe
Sources: Company Data, Datastream