Paramount Group Inc (PGRE)

Updated October 29th, 2021 by Quinn Mohammed

Key Metrics

Current Price:	$9	**5 Year CAGR Estimate:**	10.5%	**Market Cap:**	$1.9 B
Fair Value Price:	$11	**5 Year Growth Estimate:**	3.0%	**Ex-Dividend Date[1]:**	12/30/2021
% Fair Value:	78%	**5 Year Valuation Multiple Estimate:**	5.0%	**Dividend Payment Date:**	01/15/2021
Dividend Yield:	3.3%	**5 Year Price Target:**	$13	**Years of Dividend Growth:**	0
Dividend Risk Score:	D	**Retirement Suitability Score:**	C	**Last Dividend Increase:**	-

Overview & Current Events

Paramount Group Inc is a real estate investment trust which acquires, manages, and redevelops office properties in the central business district submarkets of New York City, Washington DC, and San Francisco. Paramount's primary customers are financial services firms, legal services firms, and technology and media industries. The trust was established in 1978, and the current president and CEO, Albert Behler, has been at the helm since 1991. Paramount owns or has an interest in 10.4 million square feet of high quality office building investments, retail property, and debt and equity investments. Paramount Group trades on the NYSE under the ticker symbol PGRE and is one of the largest publicly-owned real estate companies headquartered in New York, NY. PGRE has a market capitalization of $1.9 billion.

PGRE released third quarter results on October 27th. The trust announced core funds from operations of $50.1 million, or $0.23 per diluted share. Results compared favorably to the prior year, with core diluted FFO increasing by one penny. Paramount also reported a 6.0% increase in same-store cash net operating income (NOI) and a 9.8% decrease in same store NOI compared to the prior year quarter.

The trust leased a total of 374,385 square feet during the quarter. At quarter end, Paramount had roughly $1.5 billion in liquidity, consisting of $523 million of cash and restricted cash, and $1.0 billion of borrowing capacity on its revolving credit facility.

Leadership raised their estimated core FFO guidance for the 2021 fiscal year. Based on the trust's performance year-to-date and its outlook on the remainder of the year, Paramount estimates core FFO to come in between $0.90 and $0.92, for a mid-point of $0.91.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
AFFO	---	---	---	---	$0.81	$0.89	$0.87	$0.94	$0.90	$0.97	***$0.91***	***$1.05***
DPS	---	---	---	---	$0.42	$0.38	$0.38	$0.40	$0.40	$0.37	***$0.28***	***$0.29***
Shares[2]	---	---	---	---	212.1	218.1	236.4	239.6	231.5	222.4	***220.0***	***210.0***

While Paramount Group is a trust with a long history, being established in 1978, it has only been publicly-traded for a short period of time. Thus, we can only use historical data back to 2015 to form an opinion and estimate forward growth. Since 2015, PGRE has grown adjusted FFO at a rate of 3.7% annually, which is decent. The trust managed to grow year-over-year into the pandemic year, but it slashed its dividend and its valuation plummeted. We believe the trust can continue growing at roughly 3.0% per year.

The trust derives nearly 96% of annualized rent from its office properties, which limits the retail exposure which suffered greatly in 2020. The trust led in same store cash NOI growth from 2017 to 2020 among its peers. Paramount has embedded rent growth within the portfolio due to strong historical and projected future rental rate growth in their submarkets, and contractual fixed rental rate increases in leases and rent from the lease-up of vacant and expiring leases. The trust targets acquisitions opportunities with a value-add component where PGRE can leverage their

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[1] Estimate

[2] In millions

operating expertise, tenant relationships, and asset and property management approach. The trust will also incrementally grow AFFO with value-add renovations and redevelopments of office properties.

Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/AFFO	---	---	---	---	22.4	18.3	18.6	15.7	15.4	9.3	**9.4**	***12.0***
Avg. Yld.	---	---	---	---	2.3%	2.3%	2.4%	2.6%	2.9%	4.7%	**3.3%**	***2.3%***

The current P/AFFO of 9.4 is heavily discounted in comparison to its average nine- and five-year valuations of 16.6 and 15.5. Despite the ongoing pandemic, PGRE has shielded itself from the dangers of retail properties by focusing primarily on office properties. Still, the possibility of permanent remote work taking off and the necessity of office properties diminishing is real, and thus the valuation warrants a slight discount, to trade at roughly 12.0 times AFFO. The 3.3% yield is just slightly above the average yield of 3.0%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

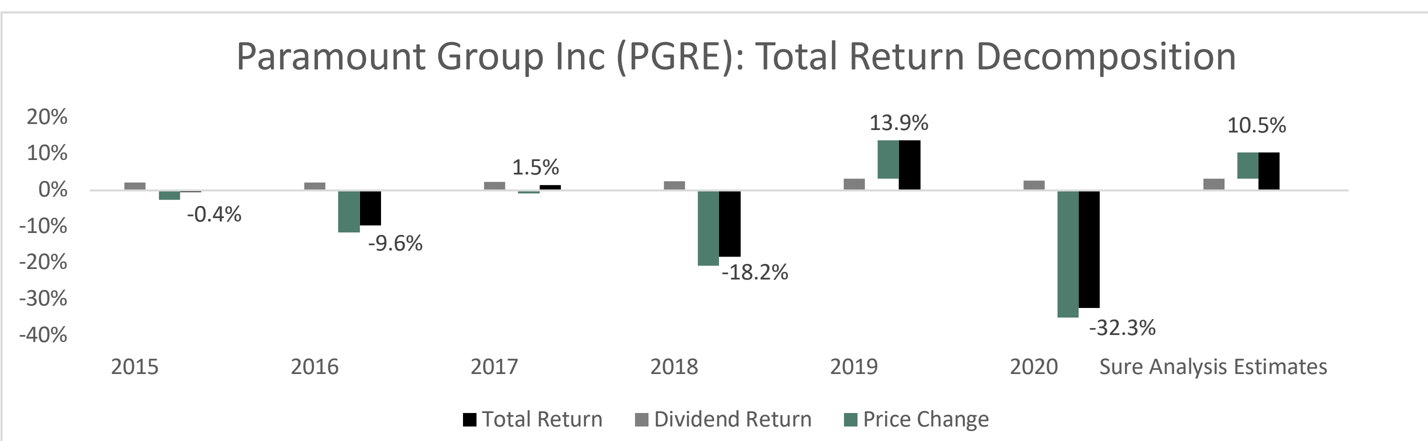
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	---	---	---	---	52%	43%	44%	43%	44%	38%	***31%***	***28%***

Paramount's dividend has been choppy since it was instated in 2015, and the pandemic has brought it to its lowest rate of $0.28 in 2021, even though the dividend appeared to be fairly covered by adjusted FFO. The trust believes that their proven acquisition and operating expertise enables them to gain advantages over competitors through superior acquisition sourcing, focused leasing programs, active asset and property management and first-class tenant service. The trust was not publicly traded at the time of the Great Recession, and we believe the trust would only be moderately recession resistant given the stickiness of office leases. We would have expected a dividend cut if the trust were trading at the time, as it has cut during the pandemic.

Final Thoughts & Recommendation

Paramount Group has a long history as a trust but only recently came to the public markets, debuting only five years prior to the pandemic. It cut the dividend during this time, even though it was fairly covered by AFFO. The 3.3% dividend yield is modest for an REIT. However, we also estimate a 5.0% tailwind due to the valuation expansion, and the trust can reasonably be expected to grow AFFO by 3.0% from here on out. Paramount Group trades at 78% of our fair value, and with total expected returns of 10.5%, we rate shares a Buy, but caution investors that the dividend may not be a reliable one.

Total Return Breakdown by Year



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Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	57	54	59		662	683	719	708	744	714
Gross Profit	42	39	42		418	433	453	453	479	447
Gross Margin	74.3%	71.6%	72.4%		63.1%	63.4%	63.0%	64.0%	64.4%	62.5%
SG&A Exp.	104	46	57		42	54	62	58	69	65
D&A Exp.	11	10	11		295	269	266	258	248	236
Operating Profit	(78)	(24)	(30)		81	110	125	155	170	147
Op. Margin	-136%	-43.7%	-50.5%		12.2%	16.1%	17.4%	21.8%	22.9%	20.5%
Net Profit	54	2	17		(4)	(10)	86	9	(37)	(25)
Net Margin	94.5%	4.2%	28.2%		-0.7%	-1.5%	12.0%	1.3%	-5.0%	-3.5%
Free Cash Flow	(329)	(83)	33		(17)	148	190	157	285	237
Provision for Tax	43	7	11		3	2	5	3	0	1

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets		2,612	2,923	9,030	8,775	8,867	8,918	8,756	8,734	8,554
Cash & Equivalents		305	307	439	144	163	219	340	306	435
Accts. Receivable		5	10	8	11	15	17	20	19	18
Goodwill & Int.			-	669	511	412	352	270	203	154
Total Liabilities		874	897	3,475	3,465	3,981	3,896	3,864	4,103	4,038
Accounts Payable		4	11	93	103	104	118	124	117	102
Long-Term Debt		517	500		2,988	3,595	3,541	3,567	3,821	3,801
Total Equity		420	322	3,911	3,761	3,990	4,177	4,001	3,786	3,653
D/E Ratio		1.23	1.55		0.79	0.90	0.85	0.89	1.01	1.04

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets			0.6%		-0.1%	-0.1%	1.0%	0.1%	-0.4%	-0.3%
Return on Equity			4.4%		-0.1%	-0.3%	2.1%	0.2%	-0.9%	-0.7%
ROIC			0.7%		-0.1%	-0.1%	1.0%	0.1%	-0.4%	-0.3%
Shares Out.					212.1	218.1	236.4	239.6	231.5	222.4
Revenue/Share	0.23	0.22	0.24		3.12	3.13	3.04	2.95	3.21	3.21
FCF/Share	(1.35)	(0.34)	0.14		(0.08)	0.68	0.80	0.65	1.23	1.07

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.