Graphisoft Park BUY

Graphisoft Park: 4Q22 – 0.5x P/NAV, 15% FFO yield, 6% dividend yield, stays BUY (PT changed to EUR 10.5)

BBG Ticker	GSPARK HB
Market Cap (USD mil)	92.1
Price	8.56
Price target	10.5
Upside	22.7%

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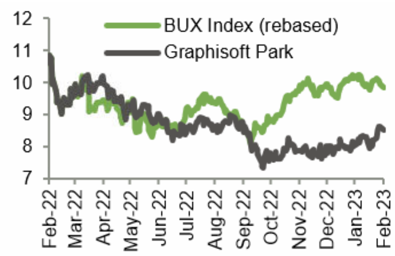

Trading at 0.5x P/NAV and a 15% FFO yield, and offering a 6% dividend yield, Graphisoft Park remains one of the most attractively valued names in the CEE real estate universe, in our view – albeit relevant for only a limited number of institutional investors, due to its small size and low liquidity. While we expect to see further market-wide upward pressure on yields, with an LTV of 36%, the risk for Graphisoft Park's balance sheet is low. Going forward, Graphisoft Park may continue to de-risk via deleveraging. If there is demand for space from its tenants, it may expand its portfolio via developments in the Southern part of the Park, which could drive growth in the FFO. In the absence of developments and a reduction of leverage, we would see room for substantially higher dividend payments, with the dividend yield in double digits at the current share price. A takeover bid and the decontamination of the Northern Area of the Park – while neither perhaps likely in the near term – remain potential upside triggers. We reiterate our BUY rating (with our price target (PT) changed to EUR 10.5/share, following the switch in the trading currency to EUR, from HUF, this month).

POSITIVE

Graphisoft Park: 4Q22 review

EUR m	4Q21	1Q22	2Q22	3Q22	4Q22	qoq	yoy	WOOD	vs. W
Rental income	3.7	3.8	3.9	3.9	3.9	2%	7%	3.8	4%
Service charge income	1.5	1.6	1.4	1.4	1.8	28%	18%	1.5	18%
Service charge expense	-1.4	-1.4	-1.3	-1.3	-1.6	25%	17%	-1.4	15%
Direct property related expenses	0.0	0.0	0.0	0.0	-0.1	1.9x	2.8x	0.0	4.7x
Net rental income	**3.8**	**3.9**	**4.0**	**4.0**	**4.0**	2%	6%	**3.9**	3%
Operating expenses	-0.2	-0.2	-0.6	-0.2	-0.3	13%	9%	-0.3	-13%
Other income (expense)	0.0	0.0	0.2	0.0	0.0	-3.1x	15%	0.0	n/a
EBITDA	**3.5**	**3.7**	**3.5**	**3.7**	**3.7**	0%	6%	**3.6**	4%
D&A and revaluation gains	-0.3	-0.1	-0.7	-1.7	-1.7	0%	4.1x	0.0	n/a
Operating profit	**3.2**	**3.6**	**2.8**	**2.0**	**2.1**	1%	-36%	**3.6**	-43%
Interest income	0.0	0.0	0.0	0.0	0.1	2.1x	2.6x	0.0	n/a
Interest expense	-0.4	-0.4	-0.4	-0.4	-0.4	-2%	-3%	-0.5	-15%
FX differences - realized	-0.2	-0.2	-0.1	-0.2	-0.1	-43%	-45%	0.0	n/a
FX differences - not realized	0.1	0.0	0.1	0.2	0.1	-35%	95%	0.0	n/a
PBT	**2.7**	**3.0**	**2.4**	**1.6**	**1.7**	7%	-35%	**3.1**	-44%
Current income tax	0.0	0.0	0.0	0.0	0.0	50%	-2.0x	0.0	-25%
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	**2.7**	**3.0**	**2.4**	**1.6**	**1.7**	7%	-35%	**3.1**	-44%
FFO reconciliation	**4Q21**	**1Q22**	**2Q22**	**3Q22**	**4Q22**	**qoq**	**yoy**	**WOOD**	**vs. W**
Net rental income	3.8	3.9	4.0	4.0	4.0	2%	6%	3.9	3%
Operating expenses	-0.2	-0.2	-0.6	-0.2	-0.3	13%	9%	-0.3	-13%
Other income / expense	0.0	0.0	0.2	0.0	0.0	-3.1x	15%	0.0	n/a
Net interest expense	-0.4	-0.4	-0.4	-0.4	-0.3	-19%	-21%	-0.5	-34%
Realized FX differences	-0.2	-0.2	-0.1	-0.2	-0.1	-43%	-45%	0.0	n/a
FFO I - pre-tax	**2.9**	**3.1**	**3.0**	**3.1**	**3.3**	6%	13%	**3.1**	7%
Current income tax	0.0	0.0	0.0	0.0	0.0	50%	-2.0x	0.0	-25%
FFO I	**2.9**	**3.1**	**3.0**	**3.1**	**3.3**	6%	12%	**3.1**	7%
# of shares (ex.treasury and employee)	10.1	10.1	10.1	10.1	10.1	0%	0%	10.1	0%
FFO I / sh	**0.29**	**0.31**	**0.30**	**0.31**	**0.33**	6%	12%	**0.31**	7%
Annualized FFO yield*	13.7%	14.6%	14.2%	14.6%	15.4%	6%	12%		
NAV	150.9	157.3	151.6	156.0	157.6	1%	4%		
NAV/sh	15.0	15.6	15.0	15.5	15.6	1%	4%		
P/NAV*	0.57x	0.54x	0.57x	0.55x	0.54x	-0.01x	-0.04x		

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

Recurring results on track, occupancy remains high, at 97%. During the last quarter of last year, Graphisoft Park generated EUR 3.3m of FFO, which translates into a 15.4% FFO yield, if annualised.

Guidance revised up. The new guidance pencils in an increase in the rental income of c.5% yoy in 2023E, as management expects the benefit of the rental indexation to be partly offset by vacancy, which may increase from the nearly fully occupied level of 97%. Additionally, with a WAULT of 2.8Y, it may be challenging to pass the full cumulative indexation onwards, into the new rent levels, when rolling over contracts. Still, the guidance implies a 2023E FFO of around EUR 13.2m. This is some 5% higher yoy, and translates into a c.15% FFO yield on the current share price.

Dividend proposal implies a 6.4% dividend yield. Management has proposed to pay out EUR 5.4m, or a EUR 0.54/share dividend, from the 2022 earnings. This is a touch above our estimate of EUR 0.50/share and, at the current share price, translates into a 6.4% yield. This level of dividend implies a payout of around 43% of the FFO, and allows Graphisoft Park to continue to amortise its loans (the total outstanding loans were reduced from EUR 97m to EUR 91m over the year). Going forward, we believe that the earnings power of the current portfolio should allow Graphisoft Park to: 1) continue to deleverage the portfolio; 2) launch further developments in the Southern Area of the Park; or 3) increase the dividend payments (or a combination thereof).

LTV at 36%, down from 39% as of the end of 2021. Graphisoft Park reduced its net debt by 10% during the year, to EUR 79m. The company is paying a 1.9% average interest rate on its total loan portfolio, and the rate is fixed for the remaining duration of the loans.

Revaluation result: 1% write-down of the value of the standing portfolio

During the year, Graphisoft Park booked a revaluation loss of EUR 3m on the value of the standing portfolio, reducing it from EUR 218m to EUR 215m. At the same time, the company booked a c.EUR 7m loss on its landbank, reducing its value from EUR 23m as of the end of 2021 to EUR 16m as of the end of 2022. Despite the write-downs, the NAV has increased to EUR 158m (EUR 15.6/share), up EUR 7m yoy. The increase is driven by a higher value of interest rate swaps (driven by ECB rate hikes) and by retained earnings.

The write-down of the value of the land plots is chiefly a function of the limited visibility of the likelihood and timing of the prospective remediation works in the Northern Development Area of the Park. Throughout the year, the rents have been trending up and, on average, the portfolio now seems to be rented at EUR 16-17/sqm per month, up from EUR 15-16/sqm during 2018-21. Going forward, we expect this level to increase further, due to the indexation.

As the rents have increased marginally and the value of the standing assets has declined slightly, the portfolio is now booked at a yield of around 7.3% on the in-place rental income, or 7.6% if adjusted for full occupancy. This represents around a 50bps increase in the yield compared to the YE21 level, and around a 130bps higher yield than as of the end of 2019. So far, realtors are estimating the prime office yield in Budapest to have increased by around 75bps yoy.

While further market-wide upward pressure on yields seems likely, the delta between the reported prime yields in Budapest and the yields at which Graphisoft Park books its properties – of around 150bps – seems fairly wide, especially considering that the indexation of the rents will likely bring the yield to around 8% next year, assuming that the value of the properties remains stable.

Graphisoft Park: monthly rents at around EUR 16-17/sqm, properties booked at 7+% yield

	4Q15	4Q16	4Q17	4Q18	4Q19	4Q20	4Q21	4Q22
GLA ('000 sqm)	59,000	59,000	67,000	82,000	82,000	82,000	82,000	82,000
BV, standing portfolio (EUR m)				235	241	217	218	215
Rental income, annualized (EUR m)	9.4	9.5	11.5	14.8	14.5	14.3	14.8	15.8
Average monthly rent	13.5	13.5	14.4	15.8	15.1	15.5	15.6	16.5
Average occupancy	98%	100%	99%	95%	97%	94%	96%	97%
Gross rental yield				6.3%	6.0%	6.6%	6.8%	7.3%
Gross rental yield (adj for full occupancy)				6.6%	6.2%	7.0%	7.1%	7.6%

Source: Company data; WOOD Research

**We have retrospectively adjusted the area between 4Q15 and 4Q17 in order to roughly reflect the different reporting. Each year, we increased the area by 6k sqm, which is the difference between the 1Q18 GLA and the 1Q18 "Area" Graphisoft Park reported previously.*

Yields: realtors are pencilling around a 75bps yoy expansion, but there is likely further to go

Cushman and Wakefield pencil in the prime office yield in Budapest at 5.5% as of the year-end, up 75bps yoy. CBRE estimates the prime office yield at 6.0%, which, on its figures, also marks a 75bps step-up compared to the 2021 year-end levels, and brings us back to the levels of early-2018. Colliers estimates the prime office yield at 5.75%, up from the 5.0-5.25% it was estimating as of the end of 2021.

The feedback from the real estate companies under our coverage suggests that the cost of funding for good office assets has shifted up by around 300-400bps over the past year. The ECB rate has increased by 300bps, and the markets are pricing in another c.100+bps of rate hikes in the coming months. With ECB rate at around 3.5-4.0% by the middle of this year, we believe the all-in secured funding costs for many of the assets will be north of 5.0%.

Going forward, the length of the period during which the rates remain elevated will prove crucial, we believe. The longer the rates stay high, the higher the share of debt that will be refinanced at substantially higher rates. We expect that the refinancing, coupled with what could be a more cautious stance from the banks, and covenant breaches, in some cases, will be likely to push sellers to accept even higher yields, which could lead to a new price equilibrium forming.

The following table illustrates the evolution of the prime yields in Hungary over time. We note that, during most of this period, the ECB rate has been around zero. If the ECB's key rate remains at a level of 2.5-3.0% even throughout 2024E, we cannot rule out that the yields will expand beyond the long-term historical averages – although the impact on values should be moderated by the rental growth, a function of indexation and higher construction costs.

Prime yields in Budapest

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	15Y avg	'21 vs avg
Budapest																		
Office	5.75	6.75	8.00	7.50	7.25	7.50	7.50	7.25	7.20	6.75	6.00	5.75	5.25	5.30	5.25	6.00	6.60	1.35
Logistics	6.75	9.50	9.50	9.00	9.00	9.00	9.00	9.00	9.00	8.25	7.75	7.50	7.00	7.00	5.75	6.25	8.20	2.45
Retail	5.75	6.50	7.75	7.00	7.00	7.00	7.00	7.00	7.00	6.75	6.00	5.65	5.25	5.50	6.50	6.50	6.51	0.01

Source: CBRE, Colliers, Bloomberg, WOOD Research

Budapest office market: 11.3% vacancy, average rent stabilised at EUR 14/sqm last year

CBRE estimates that the Budapest office market reached 4.25m sqm as of the end of 2022, as 267k sqm of new space was handed over to tenants in the past year. Going forward, the pipeline thins out, as is the case in many of the CEE capitals and major cities. CBRE expects c.180k sqm to be completed in 2023E, and around 120k sqm in 2024E. CBRE expects the revival of the economic activity to start to push vacancy down throughout this year. While the lower volume of new completions should be helpful, as is the still strong labour market, in our view, the jury is still out on the impact of flexible working patterns on the space requirements of tenants. We cannot rule out that, against a weaker economic backdrop, companies may be looking at various ways to save costs and, at the same time, retain existing talented employees – and reducing their office footprint could be something that companies might be considering as their leases expire. As the energy prices remain elevated, we expect tenants to continue shifting into green buildings, and we expect that some of the older office stock may have to be repurposed.

The average monthly rents, which have been rising gradually, from around EUR 10-11/sqm in Budapest offices in 2013-15, have now stabilised at around EUR 14.0/sqm. There is a visible bifurcation, with rents in the CBD still growing (up by around 6% yoy), while rents in the Non-Central Pest submarket declining marginally, according to CBRE's estimates.

In 2023E, most of the rents will be subject to a step-up increase, driven by indexation. Going forward, the evolution of vacancy and the level of market rents is, together with the yield and cost of funding evolution, the key driver of value. If vacancy remains elevated and the market rents stop growing, rents may see a step-down once contracts expire and are rolled over, as landlords may not be able to pass the cumulative indexation increases onto the new contracts. In this case, there would be little to mitigate the impact of prospective further rate hikes on value.

We change our PT to EUR 10.5/share, following the switch in the trading currency to EUR, from HUF. Conceptually, we have always seen Graphisoft Park as a EUR business, and we have always modelled and valued the company in EUR (subsequently converting our PT to HUF using the spot rate). While largely cosmetic, we welcome the change in the listing currency, as it simplifies the equity story slightly for investors, in our view.

Year	BV	BVPS	Net LTV	Equity	FFO	FFOPS	FFO ROE	P/BV	FFO	DPS	Div. Yield
2019	179	17.7	25%	60%	12.0	1.2	6.9%	0.5x	14.4%	2.9	34.9%
2020	133	13.2	37%	54%	10.4	1.0	6.7%	0.7x	12.0%	0.9	11.0%
2021	136	13.5	38%	57%	12.1	1.2	9.0%	0.6x	14.1%	0.5	5.6%
2022E	135	13.4	36%	56%	12.2	1.2	9.0%	0.6x	14.3%	0.5	5.9%
2023E	123	12.2	37%	54%	10.6	1.0	8.2%	0.7x	12.3%	0.3	4.0%
2024E	130	12.9	34%	55%	11.0	1.1	8.7%	0.7x	12.8%	0.4	4.4%

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		19/11/2021	HUF 5,123
		20/09/2022	HUF 4,144
		22/02/2023	EUR 10.5

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