Answers to the MAB case, out of 42 points

1. Carry out a financial analysis of MAB. **6 points**

MAB is a property company that has seen significant growth in its business since 2018, with average annual sales growth of 8.9% driven by:

- *A reduction in the vacancy rate from 14% to 5%.*
- *An increase in the surface area it owns from 136,860 m² in 2018 to 162,787 m² in 2023.*
- *An increase in rents per m² from €53 to €64.*

Operating expenses were remarkably stable at around €1.5m, giving a very clear scissor effect to operating income, which rose by 15% a year over the same period.

Between 2018 and 2023, MAB invested €39m and sold €9.5m of assets, compared with cumulative depreciation of €21.5m over the same period. This shows the effort made in a relatively short space of time, and the transformation of MAB's asset base.

Working capital is tangent to 0, and even if it is negative, is not a significant source of financing for MAB.

MAB has self-financed its investments. Its level of net debt, thanks to a dividend payout rate of only 40% of net profit, is stable at around €15m, or 1.7 times EBITDA, which is a very low level in the property sector and sets MAB apart from other entities in the sector (median net debt/EBITDA ratio of 11.1).

The ROCE doubled over the period to 6%, despite the investments made and thanks to the strong growth in EBIT seen above. At 9.3%, return on equity benefited from the leverage effect and was well above the cost of equity of 3.1% + 0.44 x (8.1% - 3.1%) = 5.3%.

MAB therefore creates value for its shareholders and has no solvency problems.

2. Spontaneously, how would you go about valuing a company whose business is holding property assets to let? **1 point**

By an evaluation using prices per square metre of similar assets observed in recent transactions nearby, such as when you want to buy or sell a house or an appartment.

3. The property assets sector can be segmented into several sub-sectors, each with its own dynamics in the light of economic and societal developments. These include shopping centres and retail premises, offices, residential properties, hotels and lastly logistics buildings. In your opinion, what are the 2 major societal trends that have had the greatest influence, positive or negative, on the evolution of these segments in Western Europe over the last few years? Why? Which two segments have suffered the most? Which segment has benefited most from these trends? Why? **2 points**

The 2 major trends affecting real estate in the developed world are the emergence and institutionalisation of teleworking, and the continuing development of e-commerce.

They are having a negative impact on the office property sector (too much available office spaces compared with needs that have been scaled down by teleworking and flex-office) and on shopping centres and retail outlets (lower footfall and sales given the continuing rise of e-commerce).

They benefit the logistics real estate sector (the continuing growth of e-commerce requires more warehouses).

4. In view of your answer to question 3, what do you think of the choice of the 24 companies comparable to MAB made by the independent expert, whose business characteristics are compared with those of MAB in Appendix 3? Why? **1 point**

Of the 24 comparable companies selected by the expert, only 4 have comparable activities in the logistics and business premises sector. Of these 4, Altarea has other business lines and is expanding its activities in Europe. CBO Territoria operates overseas and also has retail and office activities.

The expert therefore assimilates all the property sub-sectors, even though they have their own very different dynamics.

5. What is the condition for applying the P/E of a sample of peer companies to value a company, rather than an EBITDA multiple or an EBIT multiple? Is this condition met here? In this particular case, does the use of the P/E of peers companies have the effect of increasing or reducing the value of MAB equity? **3 points**

Valuation using the direct method (P/E x net current profit) assumes that the peers companies and the company have a comparable financial structure, which is not the case, as shown by the net debt/EBITDA ratio of the peers at 11.1 for the median ratio and 1.7 for MAB.

Since the higher the risk and the lower the growth, the lower the P/E, taking the P/E of peers that are not really comparable in terms of their activities (doing less well than logistics) and with more debt necessarily pushes down MAB's share price.

6. What do you think of the independent expert's calculation of the value of shareholders' equity using the P/E ratio of peers, which is reproduced in Appendix 5? Leave aside at this stage the discounts for non-SIIC status and size. **2 points**

He makes a monumental error by calculating equity value as Net profit x P/E = enterprise value, then Equity value = enterprise value - net debt; which amounts to Equity value = Net profit x P/E - net debt.

As a result, debt is counted twice. In fact, net profit has been calculated after deducting the financial costs of debt. Subtracting the amount of indebtedness from the P/E multiplied by net profit (which first takes into account indebtedness via financial expenses), as Paper Audit et Conseil does on page 28 of the information memorandum, results in counting net indebtedness twice.

7. Most listed property companies have opted for the SIIC (*Société d'Investissements Immobiliers Cotée*) tax status, which allows them to be fully exempt from corporate income tax, in exchange for an obligation to pay 95% of rents and 70% of capital gains realised as dividends to shareholders.

In addition, the vast majority of listed property companies have opted to recognise properties on their balance sheet at market value (in accordance with IFRS standard IAS 40), which are revalued each year on the basis of valuations by property experts (on the basis of prices per square metre observed for transactions involving similar assets). As a result, there are no depreciation charges in the income statement, but only positive or negative changes in value. As a result, operating income is essentially made up of rental income less (low) management costs.

Show that this status necessarily leads to the regular sale of assets in order to repay the debt, given that property companies have no source of income other than rental income.

3 points

As MAB's income statement shows, management costs are relatively modest, ranging from 14% to 25% of sales, i.e. rental income. The balance is profit before tax and finance costs, and depreciation and amortisation. As there is no corporation tax under the SIIC regime, and the vast majority of property companies apply IAS 40, profit corresponds to a very large proportion of rental income. This would be 84% for MAB if it had adopted the SIIC regime and IAS 40. As 95% of rental income must be paid in dividends, an SIIC property company has no other source of liquidity to repay its debt than to sell assets to obtain cash for this purpose.

8. In a property market whose values have a tendency to fall as a result of the sharp rise in interest rates from 2022 onwards, is SIIC status, over and above the associated tax benefits, an advantage or a handicap? Why? **2 points**

In the event of a downturn in the property market, SIICs are obliged, in order to meet their debt repayments, to sell buildings at a price that is likely to be temporarily depressed. At a time when, financially speaking, it would be a good time to buy new property assets. In this environment, SIIC status is proving to be a handicap.

9. In this context, is MAB, which has not adopted the SIIC status, in a good or bad situation? Why or why not? **2 points**

MAB is in a very good position to make acquisitions at good prices, particularly from SIICs that have to dispose of assets to meet debt repayments. MAB has very little debt (net debt/EBITDA of 1.7, compared with an average ratio of 11.1 for other property companies).

10. Accordingly, what do you think of the 18% discount applied by the expert to value MAB shares because it has not adopted the SIIC status? **1 point**

It makes no financial sense. On the contrary, we could almost include a non-SIIC premium in the calculation, rather than a discount, since in the current environment SIIC status is financially penalising, since the obligation to pay 95% of rents in dividends means that assets have to be sold at the wrong time (low real estate prices) to meet the debt burden.

11. Furthermore, do you find it logical to apply this 18% discount for the absence of corporation tax (at the rate of 25%) to net income and not to current income before corporate income tax, as the expert does? Why is this? **2 points**

Applying a lower multiple to net income on the grounds that MAB is not exempt from corporation tax like SIICs is a double penalty, since net income has already borne corporate income tax. If a smaller multiple were to be applied because of a non-SIIC discount, it would be to the operating income.

12. In MAB's business plan, drawn up by its chairman and 94% shareholder, it is planned to demolish and rebuild of warehouses and business premises with the same surface, to comply with a new regulation which calls for buildings to be more energy efficient, reducing energy consumption by 40% by 2030. As a result, MAB will not be receiving €2.7m in yearly rent during the works. Once the work is complete, the buildings are expected to generate new yearly rental income of €1.6 million. What are your thoughts on this? **1 point**

Who can believe that it is not possible to raise rents, when the new buildings will enable their occupants to reduce their energy bills by 40%, but on the contrary will have to lower them?

13. In order to establish their sales projections, MAB's chairman and the expert have deemed that the vacancy rate of 7% in 2024 is exceptionally low and that therefore expected it at 15% per annum in the future. What do you think of this when you compare it to the historical vacancy rate given in Appendix 1 and to those of the peers in Appendix 4? The vacancy rate is the proportion of m^2 held by MAB that are not let at a given time. **1 point**

It is not true to say that the 7.9% vacancy rate is exceptionally low, as over the last 4 years it has been systematically below 7.9%:
6% in 2020,
3% in 2021,
4% in 2022,
5% in 2023, i.e. a rate comparable to that of the 3 companies in appendix 5, which is between 2% and 5%.

This erroneous statement makes a sharp rise in the vacancy rate seem plausible.

14. Rents for 2024 are €11m. The expert's forecast for 2035 is €11.2m. The amount of capital expenditure anticipated in the company's business plan for the period 2024-2028 is €64.6m. Those forecast in the business plan extension drawn up by the expert between 2029 and 2035 are €43.4m. What do you think? **2 points**

It stands to reason that if the investment plan did indeed provide for an increase in rents in 2035 of just €0.2m compared with the 2024 level, at the cost of an investment of €108m, these investments would never be approved by any board of directors, and even less so by the majority shareholder holding 94% of the capital, because their profitability would be so ridiculously low.

15. Calculate MAB's average cost of financial and bank debt in 2023 from its accounting statements. MAB has 15-20 year debt at a fixed rate, and gross financial costs in 2023 were €0.386m. **1 point**

Average gross debt in 2023 was (30.9 (end 2023) + 27.8 (end 2022))/2 = €29.3m.
Hence a gross debt cost of 0.386 / 29.3 = 1.3%.

16. What do you think of the present value of this long-term debt, given a similar borrowing rate of 4.4%? **1 point**

This debt is worth less than its nominal amount because it yields an interest rate well below the current market rate of 4.4%, and for a residual period that is still long since the loans were taken out for long periods (property financing).

17. What impact does this have in determining the value of shareholders' equity? Has the expert taken this into account? **2 points**

The value of the gross debt should be deducted from the entreprise value and not its book value, as the expert does on page 17 of his report (appendix 5).

18. Given the offer price of €230, the number of shares outstanding of 193,521, and a value of the gross bank and financial debt of 80% of its book value, what is the implicit value of MAB's real estate assets? **2 points**

Equity value at offer price = €230 x 0.194 million shares = €44.5 million
Value of net bank and financial debt = 80% x 30.9 - 16.2 = €8.5m
Value of MAB's real estate assets = 44.5 + 8.5 = €53m

19. Given the 165,288 square metres held by MAB, what average price per square metre does the €230 offer show for MAB's real estate assets? **1 point**

53 M€ / 165.288 m^2 = 321 €/m^2

20. Given the 2024 rental income estimated by the expert at €11m, what gross rental yield does the €230 offer show? The gross rental yield is the ratio of rental income to the value of the buildings. **1 point**

11 M€ / 53 M€ = 20.8 %, which seems an exceptionally high rate.

21. Compare your results for the previous two questions with the data in Appendix 4. What is your opinion? **2 points**

The closest peers to MAB show prices per m^2 of between €907 and €1,525/m^2, i.e. 3 to 5 times higher than those implicit in the MAB offer; and a gross rental yield of between 5% and 7%, i.e. 3 to 4 times lower than the value reflected in the offer price. It therefore appears that the offer price is massively undervalued.

22. Use the data in Appendix 4 to derive a range for the value of the MAB share. **3 points**

Using the highest gross rental yield in the sample of logistics property companies, i.e. 7%, MAB's entreprise value comes to €11m / 7% = €157m. This gives an equity value of €157m - €8.5m of net bank and financial debt = €148.5m, or €767 per share.

Based on the lowest price per m^2 in the sample of logistics property companies, i.e. €907/m2, MAB's entreprise value is €907 x 0.165 = €149.7m. This gives an equity value of €149.7m - €8.5m of net bank and financial *debt = €141.2m, or €730 per share.*

This gives an estimated share price of around €750, compared with the offer price of €230, which is 226% higher!

23. If you were a MAB shareholder, what would you do? **3 points**

I would certainly not tender my shares to this offer, or even try to position myself on the market to buy above the offer price. I would also consult a lawyer about the steps I should take to protest against this abuse of process and this complacent valuation, even if it means taking the matter public to shame the bidder and the expert.