October 8th, 2021
Research update

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The Grounds AG

Strong privatisation business to ensure target achievement

Rating: Buy (unchanged) | **Price:** 2.16 € | **Price target:** 3.60 € (unchanged)

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Recent business development

Basic data

Based in:	Berlin
Sector:	Residential properties
Headcount:	12
Accounting:	IFRS
ISIN:	DE000A2GSVV5
Ticker:	AMMN:GR
Price:	2.16 Euro
Market segment:	Düsseldorf
Number of shares:	17.8 m
Market Cap:	38.5 m Euro
Enterprise Value:	93.9 m Euro
Free Float:	26.5 %
Price high/low (12M):	3.16 / 1.99 Euro
Ø turnover (Xetra, 12 M):	9,800 Euro / day

In the first six months of the year, The Grounds generated revenues of EUR 4.9 m, a multiple of the previous year's figure. The most important source of revenue was the sale of inventory properties (privatisation), which generated EUR 2.6 m. Since this year's acquisitions for the investment portfolio were only transferred to The Grounds in the course of the first half of the year (or in some cases even afterwards), the increase in rental revenues was still comparatively moderate at 27 percent to EUR 0.7 m. This is likely to change in the second half of the year, as the investment portfolio now includes properties with an annualised rental volume of EUR 1.7 m, 76 percent more than at the beginning of the year. Nevertheless, privatisation will continue to account for the lion's share of revenues and earnings for the entire year. Based on the sales planning and the very lively demand so far, The Grounds has confirmed the forecast for 2021, which envisages revenues of EUR 23 m and EBIT at the previous year's level of EUR 6.1 m. In addition, the company has confirmed its goal of rapidly expanding its real estate portfolio, for which a second tranche of the convertible bond with a volume of EUR 4.8 m was recently issued.

FY ends: 31.12.	2018	2019	2020	2021e	2022e	2023e
Sales (m Euro)	31.1	13.9	31.3	23.4	55.0	75.0
EBIT (m Euro)	11.4	2.0	6.0	6.2	11.9	10.5
Net profit	3.5	0.0	3.6	2.5	8.8	5.1
EpS	0.23	0.00	0.22	0.14	0.49	0.29
Dividend per share	0.00	0.00	0.00	0.00	0.15	0.17
Sales growth	64.2%	-55.2%	124.3%	-25.2%	135.2%	36.4%
Profit growth	196.1%	-	-	-29.4%	245.1%	-41.4%
PSR	1.24	2.76	1.23	1.65	0.70	0.51
PER	10.9	-	10.7	15.1	4.4	7.5
PCR	-	2.9	-	2.1	64.0	-17.3
EV / EBIT	8.3	47.7	15.7	15.1	7.9	9.0
Dividend yield	0.0%	0.0%	0.0%	0.0%	6.9%	7.9%

Half-year sales still moderate

In the first half of the current financial year, The Grounds turned over EUR 4.9 m, which is almost a tenfold increase compared to the same period last year, but only about a fifth of this year's revenue target. More than half of the proceeds (EUR 2.6 m) were generated from the sale of inventory properties, i.e., the individual sale of flats in Meppen and Magdeburg (Lenné Quartier). The final completion of the residential project in Leipzig brought in around EUR 1 m, while rental revenues amounted to EUR 0.7 m. The remaining revenues were generated from the operation of the logistics property sold last year and from construction management for a project already sold and now under construction.

Positive valuation result

Less the cost of materials amounting to EUR 3.1 m, of which the largest part represents the book value of the sold properties, and plus the other operating income (EUR 0.6 m), a gross profit of EUR 2.7 m was achieved. In addition, The Grounds recorded a valuation gain of EUR 0.6 m resulting from the purchase of further properties for investment portfolio management (see below). Compared to the first half of 2020, when the large residential portfolio in Stendal was acquired and subsequently enhanced in value, the valuation result has thus fallen by around half (previous year: EUR 1.5 m).

Significant cost increase

At the same time, the expansion of the organisation and the business model have left clear traces in the cost structure. Personnel expenses almost tripled to EUR 0.8 m, reflecting above all the almost doubled number of employees compared to the previous year. In addition, the amount includes almost EUR 0.14 m from the non-cash expense from the valuation of stock options, without which the increase in personnel expenses would have been "only" 140 percent. Depreciation and amortisation also increased very significantly, albeit at a much lower level in absolute terms (from EUR 13,000 to 77,000). In contrast, there was only a moderate increase in other operating expenses, which at EUR 0.9 m exceeded the previous year's level by 23 percent.

Business figures	**HY 20**	**HY 21**	***Change***
Revenues	0.56	4.92	*+786.7%*
Of which sales	0.00	2.60	-
Of which lettings	0.55	0.70	*+26.8%*
Gross profit	0.93	2.72	*+193.1%*
Gross margin	*166.9%*	*55.2%*	
Valuation result	1.50	0.64	*-57.3%*
EBIT	1.42	1.61	*+13.3%*
EBIT margin	*255.9%*	*32.7%*	
Financial result	-0.09	-0.97	-
EBT	1.33	0.64	*-51.7%*
EBT margin	*239.8%*	*13.1%*	
Net profit	0.96	0.09	*-90.2%*
Net margin	*172.2%*	*1.9%*	
Free cash flow	-2.29	0.28	-

In m Euro and percent, source: Company

EBIT slightly improved, EBT decreased

The combination of higher revenues on the one hand and the lower valuation gain as well as increased costs on the other resulted in a moderate EBIT growth of 13 percent to EUR 1.6 m. However, since the interest expense increased to a much greater extent to EUR 1.0 m due to the significantly expanded credit volume used to finance the portfolio growth since last year, the pre-tax profit of EUR 0.6 m was half of what it was a year ago.

Half-year profit marginally positive

Since income taxes amounted to more than EUR 0.5 m, in sum there remained only a minimal surplus of EUR 93,000. Upon enquiry, the company cites several factors as the reason for the high tax burden. These include deferred taxes on the valuation result and on the effective interest calculation from the financing and the convertible bond, as well as the deferred taxes that had been acquired with the earlier purchase of the Leipzig project (as a share deal) and had to be reversed after the sale.

Free cash flow slightly positive

Despite the intensive sales activities, inventories increased by half to EUR 48.7 m in the first half of the year, reflecting the acquisition of the 28 units in Dallgow-Döberitz as well as continued investments in project developments. But since other receivables, which had swelled to EUR 20.4 m at the beginning of the year due to a high credit balance on a notary escrow account from a property sale that had not yet been fully completed, have at the same time decreased again (to EUR 8.4 m), as have contract assets (from EUR 12.4 to 6.7 m), and since advance payments received increased by EUR 6 m on the liabilities side, the operating cash flow was still clearly positive at EUR 5.3 m. The investment cash flow, on the other hand, was characterised by the expansion of the investment portfolio by a further 65 units, which led to a cash outflow of just under EUR 5 m. Thus, the free cash flow remained slightly positive at EUR +0.3 m. As the balance of the financing cash flow was also of a similar magnitude, the balance sheet liquidity increased by EUR 0.6 m to EUR 1.2 m in the course of the first half-year.

Property portfolio expanded

However, the positive free cash flow is likely to be only a snapshot, as The Grounds continues to pursue portfolio growth as a high priority. At the end of the first half of the year, a further 83 units with a purchase value of EUR 8.7 m had already been notarised, but were only transferred to The Grounds in September. Including these acquisitions, The Grounds has purchased a total of 176 units (including 28 for privatisation) worth EUR 25 m so far this year. As a result, the investment portfolio has grown to 410 units with a rental area of 26,000 square metres and annual rental income of EUR 1.7 m. The privatisation portfolio comprised 87 units in August, all of which are now in the sale process.

Project developments are progressing

The Grounds was also able to report successes with regard to project developments. For example, construction of the 181 residential units already sold in Magdeburg's Lenne Quartier project has already begun and, according to the company, is so far on schedule in terms of time and budget. In addition, sales for the Magdeburg Halberstädterstraße project have started successfully. Regarding the 64 flats planned there, The Grounds reports a very high reservation rate and a significant number of sales.

Convertible bond increased

In order to secure further development and especially the planned portfolio growth, The Grounds has now increased the convertible bond issued in February (then EUR 12 m) by EUR 4.8 m. The second tranche has the same conditions as the first: an interest rate of 6 percent, a three-year term and a conversion price of EUR 3.20 per share. According to the company, the issue was significantly oversubscribed.

Forecast confirmed

Based on the half-year figures and the plans for the remaining six months, The Grounds has confirmed the forecast for 2021. Accordingly, revenues this year are expected to amount to EUR 23 m, which would correspond to growth of an estimated 40 percent in the core business (adjusted for last year's sale of the logistics property). On this basis, EBIT is expected to remain at the previous year's level of EUR 6.1 m. Compared to the half-year figures (revenues: EUR 4.9 m and EBIT of EUR 1.6 m), the forecast implies strong growth for the second half of the year. This is to be made possible on the one hand by the extensive sale of the current privatisation portfolio (Meppen and Pankow completely and part of the terraced houses in Dallgow-Döberitz) and on the other hand by the proportional realisation of the flats already sold in Magdeburg as construction progresses. Furthermore, due to the larger portfolio, rental revenues will also increase compared to the first half of the year, which should also be helped by the noticeable increase in rents in some cases. The Grounds explained this potential of the portfolio at the Annual General Meeting. According to this, rents for new lettings are more than 30 percent above the previous level on average across the portfolio. This potential is likely to justify a further appreciation, but the greatest valuation effect is to be expected from new acquisitions or from the properties that were already notarised as of 30 June, but that were only transferred to The Grounds in the second half of the year.

Revenue estimates unchanged

There was little need to change our estimates as a result of the half-year report. We also consider the revenue forecast for the current year to be well within reach and have therefore left our revenue expectation of EUR 23.4 m unchanged. As we have not adjusted the assumptions regarding the further portfolio development and the projects, the revenue estimates for the following years have also remained the same.

Expense items adjusted

On the other hand, we have slightly adjusted the expense estimates, with some of the changes offsetting each other. The largest shifts have occurred in personnel expenses and in the tax result, but parts of these modifications are not cash-effective and therefore only affect the calculated P&L values, but not the model result. Overall, this has slightly reduced our profit estimate for the current year: We now expect EBIT to be EUR 6.2 m instead of EUR 6.3 m, while net profit is now at EUR 2.5 m (instead of EUR 3.5 m). This still includes a valuation result of EUR 2.0 m, which we only apply in this year. The remaining years of the estimation model do not contain any valuation effects. The target EBIT margin also remains unchanged at 18.5 percent. The table below summarises the model business development for the next eight years resulting from our assumptions. Further details are to be found in the Annex.

Framework data unchanged

We have left the basic data of the model unchanged. We discount the cash flows resulting from our estimates at a WACC rate of 4.6 percent, based on a cost of equity of 9.1 percent (consisting of: risk-free interest rate: 1.0 percent, risk premium 5.8 percent, beta factor: 1.4), borrowing costs of 4.5 percent, a target

m Euro	**12 2021**	**12 2022**	**12 2023**	**12 2024**	**12 2025**	**12 2026**	**12 2027**	**12 2028**
Sales	23.4	55.0	75.0	78.5	67.3	65.2	63.3	66.6
Sales growth		135.2%	36.4%	4.7%	-14.2%	-3.2%	-2.9%	5.3%
EBIT margin	26.6%	21.7%	14.0%	14.6%	16.0%	16.9%	17.9%	18.5%
EBITx	**6.2**	**11.9**	**10.5**	**11.5**	**10.7**	**11.0**	**11.3**	**12.4**
Tax rate	25.0%	26.0%	27.0%	27.5%	27.5%	27.5%	27.5%	27.5%
Adjusted tax payments	1.6	3.1	2.8	3.2	3.0	3.0	3.1	3.4
NOPAT	**4.7**	**8.8**	**7.6**	**8.3**	**7.8**	**8.0**	**8.2**	**9.0**
+ Depreciation & Amortisation	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
+ Increase long-term accruals	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
+ Others*	-1.8	0.3	0.3	0.3	0.0	0.0	0.0	0.0
Gross operating cash flows	2.9	9.1	7.9	8.6	7.8	8.0	8.2	9.0
- Increase Net Working Capital	17.8	-8.9	-7.9	-6.9	-5.9	-4.9	-3.9	-2.9
- Investments in fixed assets	-14.0	-15.1	-15.1	-15.1	-15.1	-15.1	-15.1	-15.1
Free cash flows	**6.7**	**-14.9**	**-15.1**	**-13.4**	**-13.1**	**-12.0**	**-10.7**	**-9.0**

SMC estimation model

**2021 with valuation result, from 2022 on without* debt ratio of 78 percent and a tax rate for the tax shield of 27.5 percent.

Price target: EUR 3.60 per share

The model results in a market value of equity of EUR 66.0 m or EUR 3.71 per share, so we leave our price target unchanged at EUR 3.60. We have left the rating of the estimation risk unchanged, for which we continue to assign four points on a scale of 1 (low) to 6 (high).

Sensitivity analysis

For our sensitivity analysis, we have varied the input parameters WACC (between 3.6 and 5.6 percent) and perpetual growth (between 0.0 and 2.0 percent). The fair value calculated in this way lies between negative values and EUR 18.48 per share. The very wide range emphatically illustrates the outstanding importance of the interest rate for the valuation. This results, on the one hand, from the high target debt ratio and, on the other hand, from the high growth of real estate assets assumed in the model until the end of the detailed forecast period, which ensures that positive cash flows only accrue thereafter, within the scope of the terminal value, which massively increases the sensitivity for the interest rate development due to the very long discounting period. However, the interest rate sensitivity is only a theoretical consideration – at least in the medium term – because, due to the fixed interest rate, changes in market interest rates are only reflected in the cost of debt on a pro rata basis and with a long delay with regard to the overall portfolio. At the same time, a significant rise in interest rates would certainly lead to a discontinuation or at least a significant slowdown in portfolio growth, so that the continued investments assumed here would no longer apply and would enable positive cash flows much sooner. The very high and low market values resulting from interest rate changes therefore significantly overstate the effect.

Sensitivity analysis	Perpetual cash flows growth				
WACC	**2.0%**	**1.5%**	**1.0%**	**0.5%**	**0.0%**
3.6%	18.48	12.34	8.60	6.09	4.29
4.1%	11.76	8.16	5.73	3.99	2.68
4.6%	7.73	5.39	**3.71**	2.44	1.45
5.1%	5.05	3.43	2.21	1.25	0.49
5.6%	3.17	1.98	1.06	0.32	-

Conclusion

As announced, The Grounds grew significantly in the first half of the year. This concerns both the revenues and, above all, the property portfolio. The development projects were also advanced according to plan.

Nevertheless, with half-year sales of EUR 4.9 m and EBIT of EUR 1.6 m, only a small part of the annual targets (sales of EUR 23 m and EBIT of EUR 6.1 m) was achieved. The fact that The Grounds has still confirmed the forecast is primarily due to the comprehensive sales plans in the privatisation business, which is also to a large extent already underpinned by reservations and signed contracts. In addition, the company expects that new flats already sold and currently under construction will contribute to the revenues in line with the progress of construction.

With the projects progressing and the property portfolio growing, the basis for the next few years is also promising, especially as The Grounds intends to continue expanding the property portfolio at a rapid pace. This is one of the reasons why the convertible bond issued in February was recently increased by a further EUR 4.8 m.

Overall, the development shown in the half-year report is largely in line with our expectations and the assumptions made in our model. Accordingly, we have only made minor adjustments to our estimates. We see the fair value unchanged at EUR 3.60 per share, on the basis of which we confirm our "Buy" rating.

Annex I: Balance sheet and P&L estimation

Balance sheet estimation

m Euro	12 2020	12 2021	12 2022	12 2023	12 2024	12 2025	12 2026	12 2027	12 2028
ASSETS									
I. Total non-current assets	21.6	37.6	52.7	67.7	82.8	97.8	112.8	127.9	142.9
1. Intangible assets	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
2. Tangible assets	0.6	0.6	0.7	0.7	0.8	0.8	0.8	0.9	0.9
3. Properties held as investment	14.0	30.0	45.0	60.0	75.0	90.0	105.0	120.0	135.0
II. Total current assets	65.8	68.9	79.7	83.9	89.6	94.0	98.3	102.6	107.3
1. Inventories	32.2	15.5	25.5	34.5	42.5	49.5	55.5	60.5	64.5
LIABILITIES									
I. Equity	20.4	23.0	32.2	34.7	38.7	41.7	44.7	47.5	50.8
II. Accruals	2.4	2.5	2.6	2.7	2.8	3.0	3.1	3.2	3.3
III. Liabilities									
1. Long-term liabilities	21.5	36.5	51.5	62.0	72.5	81.5	90.5	98.0	105.5
2. Short-term liabilities	43.1	44.5	46.0	52.1	58.3	65.6	73.0	81.8	90.6
TOTAL	**87.4**	**106.6**	**132.4**	**151.6**	**172.4**	**191.8**	**211.2**	**230.5**	**250.2**

P&L estimation

m Euro	12 2020	12 2021	12 2022	12 2023	12 2024	12 2025	12 2026	12 2027	12 2028
Sales	31.3	23.4	55.0	75.0	78.5	67.3	65.2	63.3	66.6
Gross profit	6.0	7.5	10.5	14.0	15.2	14.3	14.7	15.2	16.3
EBITDA	3.3	4.2	12.0	10.5	11.5	10.8	11.0	11.3	12.4
EBIT	6.0	6.2	11.9	10.5	11.5	10.7	11.0	11.3	12.4
EBT	5.1	4.1	12.5	7.4	7.8	6.5	6.1	5.9	6.3
EAT (before minorities)	4.0	2.7	9.2	5.4	5.7	4.7	4.5	4.2	4.6
EAT	3.6	2.5	8.8	5.1	5.4	4.5	4.2	4.0	4.3
EPS	0.22	0.14	0.49	0.29	0.30	0.25	0.24	0.23	0.24

Annex II: Cash flows estimation and key figures

Cash flows estimation

m Euro	12 2020	12 2021	12 2022	12 2023	12 2024	12 2025	12 2026	12 2027	12 2028
CF operating	-24.0	18.7	0.6	-2.2	-0.9	-1.2	-0.4	0.4	1.7
CF from investments	-12.6	-14.0	-15.1	-15.1	-15.1	-15.1	-15.1	-15.1	-15.1
CF financing	35.8	15.0	14.9	12.1	13.3	13.2	13.5	13.6	13.7
Liquidity beginning of year	1.3	0.6	20.3	20.8	15.7	13.0	10.0	8.1	7.0
Liquidity end of year	0.6	20.3	20.8	15.7	13.0	10.0	8.1	7.0	7.3

Key figures

percent	12 2020	12 2021	12 2022	12 2023	12 2024	12 2025	12 2026	12 2027	12 2028
Sales growth	124.3%	-25.2%	135.2%	36.4%	4.7%	-14.2%	-3.2%	-2.9%	5.3%
Gross margin	19.3%	32.1%	19.0%	18.7%	19.4%	21.3%	22.6%	23.9%	24.4%
EBITDA margin	10.5%	18.2%	21.7%	14.0%	14.7%	16.0%	16.9%	17.9%	18.6%
EBIT margin	19.1%	26.6%	21.7%	14.0%	14.6%	16.0%	16.9%	17.9%	18.5%
EBT margin	16.4%	17.6%	22.7%	9.9%	10.0%	9.6%	9.4%	9.3%	9.5%
Net margin (after minorities)	11.5%	10.9%	15.9%	6.8%	6.9%	6.6%	6.5%	6.4%	6.5%

Disclaimer

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Charts
The charts were made with Tai-Pan (www.lp-software.de).

Disclaimer

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3) sc-consult GmbH has submitted this report to the customer or the company before publishing

4) sc-consult GmbH has altered the content of the report before publication due to a suggestion of the customer or the company (with sc-consult GmbH being prepared to carry out such an alteration only in case of reasoned objections concerning the quality of the report)

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10) sc-consult GmbH has included the company's shares in a virtual portfolio managed by sc-consult GmbH

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II) Preparation and updating

The present financial analysis was prepared by: Dipl. Volkswirt Dr. Adam Jakubowski

Participants in the preparation of the present financial analysis: -

The present analysis was finished on 08.10.2021 at 7:40 and published on 08.10.2021 at 8:40.

For the preparation of its financial analyses, the sc-consult GmbH uses a five-tier rating scheme with regard to price expectation in the next twelve months. Additionally, estimation risk is quantified on a scale from 1 (low) to 6 (high). The ratings are as follows:

Strong Buy	We expect an increase in price for the analysed financial instrument by at least 10 percent. We assess the estimation risk as below average (1 to 2 points).
Buy	We expect an increase in price for the analysed financial instrument by at least 10 percent. We assess the estimation risk as average (3 to 4 points).
Speculative Buy	We expect an increase in price for the analysed financial instrument by at least 10 percent. We assess the estimation risk as above average (5 to 6 points).

Hold	We expect that the price of the analysed financial instrument will remain stable (between -10 and +10 percent). The forecast risk (1 to 6 points) has no further impact on the rating. The rating "hold" is also used in cases where we perceive a price potential of more than 10 percent, but explicitly mentioned temporary factors prevent a short-term realization of the price potential.
Sell	We expect that the price of the analysed financial instrument will drop by at least 10 percent. The forecast risk (1 to 6 points) has no further impact on the rating.

The expected change in price refers to the current share price of the analysed company. This price and any other share prices used in this analysis are XETRA closing prices as of the last trading day before publication. If the share is not traded on XETRA, the closing price of another public stock exchange is used with a separate note to that effect.

The price targets published within the assessment are calculated with common methods of financial mathematics, especially with the DCF (discounted cash flow) method, the sum of the parts valuation and a peer group analysis. The valuation methods are affected by economic framework conditions, especially by the development of the interest rates.

The rating resulting from these methods reflects current expectations and can change anytime subject to company-specific or economic changes.

More detailed explanations of the models used by SMC Research can be found at:
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An overview of the recommendations prepared and distributed by SMC Research in the last 12 months can be found at: http://www.smc-research.com/publikationsuebersicht

In the past 24 months, sc-consult GmbH has published the following financial analyses for the company:

Date	Rating	Price target	Conflict of interests
09.07.2021	Buy	3.60 Euro	1), 3), 4)

In the course of the next twelve months, sc-consult GmbH will presumably prepare the following financial analyses for the company: two updates.

The publishing dates for the financial analyses are not yet fixed at the present moment.

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