Company Report

GTC

Buy

Poland, Real estate

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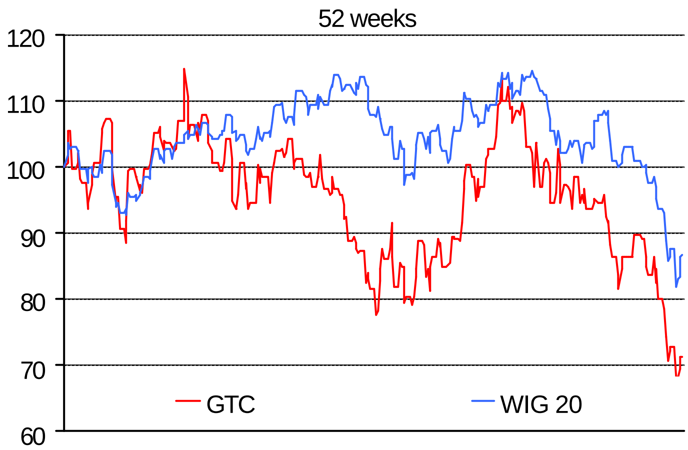
EUR mn*	2007e	2008e	2009e	2010e
Sales	102.9	323.3	860.3	838.3
Revaluation gains	263.7	148.6	494.3	174.3
EBIT	305.0	254.9	730.7	434.6
Net profit	197.3	139.5	452.3	227.1
EPS (basic, EUR)	0.90	0.63	2.05	1.03
EPS (diluted, EUR)	0.89	0.63	2.04	1.02
NAV/share (EUR)	11.2	10.7	11.1	11.3
BV/share (EUR)	4.2	4.8	6.9	7.9
DPS (EUR)	0.00	0.00	0.00	0.00
P/E (basic, x)	10.8	15.4	4.8	9.5
P/NAV (x)	0.87	0.92	0.88	0.87
P/BV (x)	2.3	2.0	1.4	1.2
Dividend yield	0.0%	0.0%	0.0%	0.0%

**All valuation ratios are based on the current stock price.*



Share price (PLN)	35.4	Reuters	GTCE.WA	Free float	41.3%
Number of shares (mn)	219.4	Bloomberg	GTC PW	Shareholders	GTC Real Estate N.V. 46.1%
Market capitalization (PLN mn)	7,766	Div. ex-date	--		
Enterprise value (PLN mn)	8,380	**Target price:**	**47 PLN**	Homepage:	www.gtc.com.pl

Value is there but waiting for a trigger

- **GTC fits nicely with our preferred strategy - large cap, low gearing, cash in hand, development focus, quality properties in good locations and potential upside from planned expansion in CIS. Large caps with strong balance sheets and cash in hand have great opportunity to take over smaller competitors or enter joint ventures at favorable prices these days.**

- **We expect yields in CEE markets and Romania to go up by up to 50bp due to an increasee in risk premiums in 1H08. Prices of commercial property - mainly in B and C locations - are thus predicted to decline by some 8-12% in CEE and Romania.**

- **We have cut not only expected property values, but also estimated development margins for ongoing commercial projects (by 4% to 27%), due to yield outshift and continued pressure on wages. Positive news came from residential housing, where margins went up in 3Q07. GTC also lifted sales estimates by some 19% for Southeast Europe (no change in Poland). However, we expect also residential housing to temporarily cool down, due to growing interest costs and low affordability.**

- **We lower our twelve-month target price by 18% to PLN 47 based on SOTP valuation. As the stock now offers 33% upside potential, we maintain our Buy recommendation. We expect the stock to approach our target price only gradually, as it is now traded at a significant premium to its peers. We see the whole sector at low multiples now, so the comparison does not mean very much. GTC's premium is justified, given its strong balance sheet and quality portfolio.**

Investment case

GTC fits nicely with our preferred strategy

GTC fits nicely with our preferred strategy - large cap, low gearing, cash in hand, development focus, quality properties in good locations and potential upside from planned expansion in CIS.

We prefer large caps with cash in hand in current environment

In the current environment, which features overall difficulty in finding debt financing, we prefer large caps with strong balance sheets and cash in hand. Such companies have the opportunity to take over smaller competitors or enter joint ventures at favorable prices. This is a way to get around declining prices of commercial property and higher construction costs and secure high margins on future projects.

A landbank is, at least for the near future, not such an advantage. As we expect a decrease in development activity across Europe, we also expect prices of land to stabilize or even slide, especially in non-central locations. Companies that revalue land could thus post losses on their landbanks. GTC only has land committed to projects to be finished before 2011 and does not revalue land.

We expect yields in all CEE markets and Romania to go up by up to 50bp

We expect yields in CEE markets and Romania to go up by up to 50bp due to an increasee in risk premiums in 1H08. Prices of commercial property - mainly in B and C locations - are thus predicted to decline by some 8-12% in CEE and Romania. As most of GTC's projects are at the upper end of the market, GTC should not have problems finding tenants in an environment of still healthy demand. Nevertheless, overall growing vacancy levels and stagnating rents will weigh on sentiment towards the region.

Also margins in commercial development are predicted lower

We have cut not only expected property values, but also estimated development margins for ongoing commercial projects (by 4% to 27%), due to yield outshift and continued pressure on wages. We estimate GTC's margins in Poland to have fallen from 40% in 1H07 to 30% in YE07, and we expect another decline to 14% in 2008. On the other hand, margins in Southeast Europe went up sharply in 2007. Even though we also expect yield outshift in Romania, margins should remain above 30% there. Serbia and Bulgaria should enjoy more or less stable (and high) margins in 2008-09, in our view.

We have also cut our margin estimates for GTC's future projects from 30% to 20%, as the company has not announced any projects in high-growth CIS markets yet, and the margin convergence in CEE to WE has been faster than expected. We left expected volumes of future projects unchanged at 300k sqm/year, in spite of the bullish targets set by the company (600k sqm).

Residential is still healthy, margins and prices are predicted higher for 08-09

GTC delivered very healthy 43% margins in residential housing and reported further fast price growth in SEE, with prices stable in Poland. We thus adjusted our sales and margins predictions for 2008-09 upwards. We discounted GTC's sales estimates by 5% for residential projects to be delivered later, as we see residential housing at a short-term peak in SEE and declining in Poland.

We have increased our EPS estimate for 2007 by 56% to EUR 0.90, thanks to earlier completion of two office projects and faster yield compression in Poland and Romania in 2007. However, for 2008, we cut our EPS estimate by 58% to EUR 0.63, as the predicted yield outshift should result in a EUR 40mn loss on investment assets, while a few development projects are postponed to 2009. The majority of projects will be completed in 2009, when EPS should jump by 223% to EUR 2.05.

Company Report

We set our twelve-month target at PLN 47 based on SOTP valuation

We lower our twelve-month target price by 18% to PLN 47, using the SOTP approach. While the estimated value of residential business went up by 19%, thanks to higher margins and sales prices in 2008-09, the value of rental business went down by 5%, due to expected lower development gains.

As the stock offers 33% upside potential, we maintain our Buy recommendation

As the stock now offers 33% upside potential, we maintain our Buy recommendation. We expect the stock to approach our target price only gradually, as it is now traded at a significant premium to its peers. We see the whole sector at low multiples now, so the comparison does not mean very much. GTC's premium is justified, given its strong balance sheet and quality portfolio.

Portfolio overview

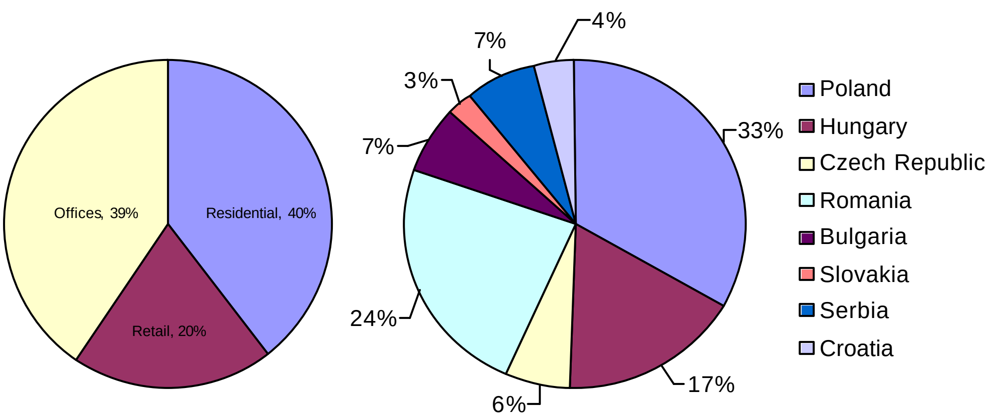
No significant changes in portfolio in last few months

The company has not changed the structure of its property portfolio since our initial coverage in September. The company sold a very successful 27k sqm office project in Bucharest at a 5.6% yield and its associate sold a matured 8k sqm office project (GTC's stake) in Prague at a 5.7% yield. New additions include a shopping center and residential development in Burgas, Bulgaria (GTC's stake: 65k sqm), land for the extension of a 76k sqm office development in Budapest and three smaller retail developments in Romanian regional cities (37k sqm). The total size of GTC's project portfolio comprises some 1.9mn sqm.

GTC is focused on development

The balance of development projects/investment property remains at 90/10, thanks to selective asset sales. We see a high share of development as a clear advantage, as there is no big threat that growing yields would result in a negative revaluation result, even though they mean significantly lower development margins (which are booked in revaluation profit in the P&L after completion).

Portfolio breakdown by sqm (as of year-end 07e)



Source: GTC, EB estimates

The company is still a pure bet on CEE (58%) and SEE (42%)

The regional split shows that the company is still a pure bet on CEE (58%) and SEE (42%), as GTC did not announce any project in the booming CIS region. We see the regional economies as relatively protected from the ongoing global slowdown, which should ensure solid tenant and household demand - at least for class A properties. The markets in Serbia and Bulgaria (together: 14%) should prove to be drivers of value creation, thanks to their strong economies and continued yield compression. In spite of its uncertain macro prospects, Romania (24%) is a market in which GTC should reach relatively high margins. High supply in commercial projects is something to watch in CEE, as well as in SEE.

High share of residential is only short term

In terms of segments, we understand that the high residential exposure is short-term (according to management). Ongoing projects have relatively high pre-sales and GTC reports fast price growth in SEE (prices are flat in Poland and slightly growing in the Czech Republic), so there should be hefty margins reported in 2008-09. However, we see the housing markets as at a short-term peak and prefer a focus on offices.

GTC has quality portfolio in good locations

In terms of quality and location, we prefer class A projects in prime/established locations at present, which should not see the same yield expansion such as class B and C properties. Such projects should also not suffer from a possible slowdown of the economy, thanks to their lower supply and blue chip tenants. GTC has only own-built and mostly class A quality properties. Projects are usually located in non-central, but established or strategically located business areas. While we are not able to evaluate each project, GTC's strong track record (e.g. MBP Warsaw, America House in Bucharest and Avenue Mall in Zagreb) and pre-leases on ongoing projects are a kind of guarantee. For example, 23k sqm (52%) out of 44k sqm is already pre-leased in the City Gate project in Bucharest (scheduled for completion in 2009). Out of the total of 1.9mn sqm, 1.2mn (68%) is based in capital cities.

GTC's main target is to start projects in CIS markets as soon as possible

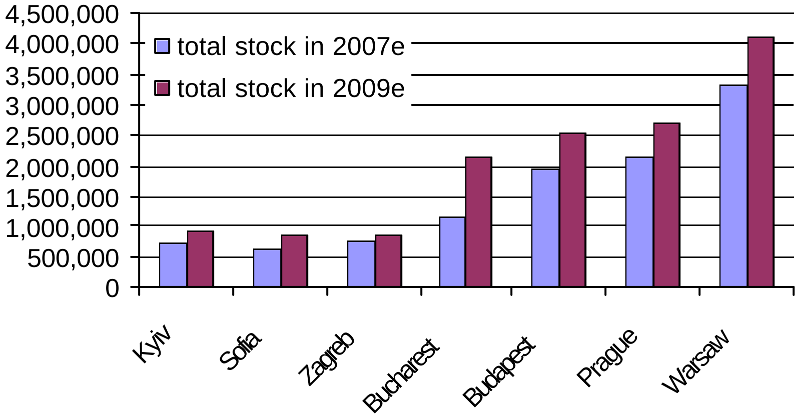
Looking to the future, GTC's main target is to start projects in CIS markets as soon as possible. Our recommendation would be precisely this, as we believe that the announcement of a (of course good) project in Kiev or Moscow would be a trigger for the share price. In terms of sqm, the company expects to add some 260k sqm to its development pipeline in 2008 - roughly in line with our estimates. The company wants to add 600k sqm/year to the pipeline later on. We see this target as possible, but demanding.

Office market in CEE - continued high supply in worse environment

Still high supply in worse macro environment in CEE

While the huge supply seen in CEE was absorbed and vacancy levels fell in all CEE markets in 2007, completions planned for 2008-09 are again at similar or higher levels in terms of sqm. However, the outlook for the office market is not as bright. Lower unemployment will limit outsourcing from Western Europe. Also, banks - as one of the largest sectors driving demand for offices (approximately 20%) - will probably be cautious, in light of the slower housing market in 2008-09. Some subsidiaries of western banks hit by the sub-prime crisis could also see cash outflow to mother companies. Looking at the supply side, we are somewhat concerned about Bucharest (80% stock increase in 2008-09) in the short term.

Total office stock (sqm)



Source: DTZ, CBRE, JLS, EB estimates

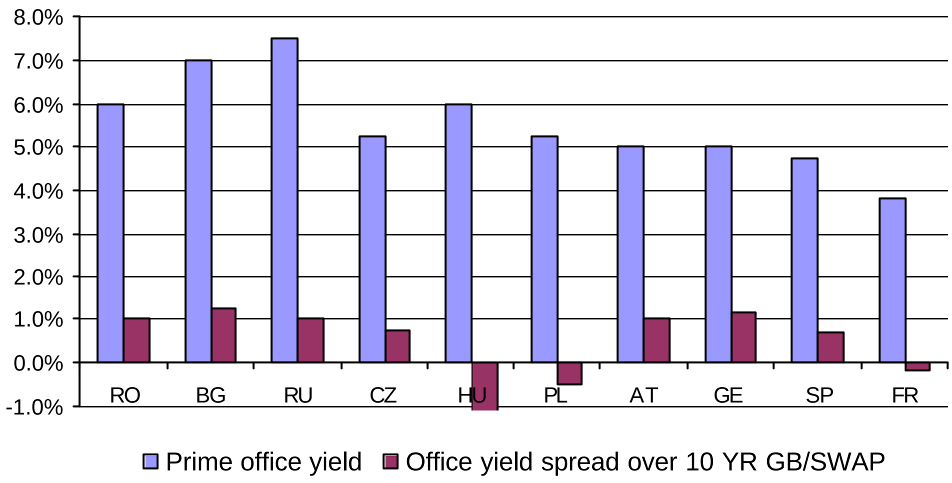
We thus expect slight rise in vacancy rates

Overall, we expect a slight 4-5% rise in vacancy levels and consequently weaker rent growth in 2008-09. We also expect there to be a notable performance differentiation between prime and secondary products, as is usual in tenant-driven markets.

Yields are fine compared to bonds, but higher risk premiums will lead to yield increase

As a consequence of weaker rent growth in an environment of elevated risk premiums on the debt markets, we also expect rental yields to grow in 1H08. The yield spread over risk-free rates is below our estimated long-term risk premium (50bp) in Poland and Hungary, but is higher in the Czech Republic and elsewhere. When considering EUR bonds as risk-free (CEE office markets mainly use EUR as their functional currency), all markets are above our long-term hurdle. Thus, we do not see current yield levels as a "bubble". We thus expect slight yield outshift by 50bp for GTC's projects in the CEE region. On the other hand, we expect continued yield declines in Serbia (50bp) and Bulgaria (25bp), as their spreads are high and we believe in their strong local economies.

Prime office yields and spread over 10 year gov. bond yield (loc. curr.)



Source: CBRE, CW, Bloomberg, EB calculations

GTC will have good development margins even with 50bp yield growth

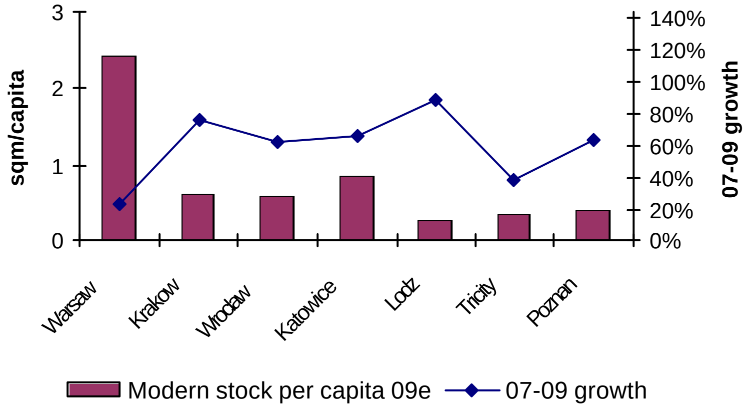
The implications for GTC are as follows: Real estate investors would book a 7-10% loss from a 50bp yield outshift (ceteris paribus), multiplied by their leverage to NAV. GTC has "only" 40% of its assets as investment property (by sqm, it is only 10%), while the rest are mainly properties under development. GTC thus will directly bear just a 40% impact from the yield outshift, multiplied by assets/equity of 1.9. Properties under development (or the remaining 60% of assets) are booked at cost and thus have no negative revaluations until they are completed. After completion, GTC shows the "development margin", or the difference between the market price and cost value in the revaluation line. GTC will have good development gains that outpace losses made on the investment portfolio, even if yields were to increase by 50bp in all markets and for all classes (which we do not expect). The development result should turn negative with some 100bp yield growth, accompanied by a rent decline of approximately 10%, in our view.

Polish regional office market

Margins on Polish offices: No bonanza anymore

Office projects in Poland make up 15% of GTC's portfolio; 60% of these are projects outside Warsaw. There have been a lot of fears from the high expected supply, margin squeeze and construction cost growth in Poland. We agree that 30% y/y average stock growth in regional cities and 14% y/y growth in Warsaw is something unimaginable from the Western European perspective.

Polish office stock development



Source: DTZ, KS, EB estimates

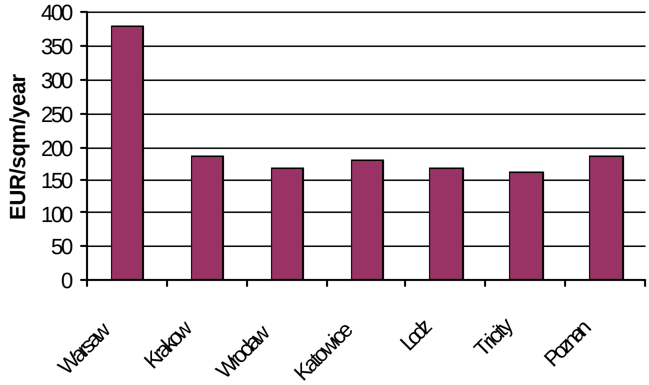
Polish regional office markets are in an infant stage

Nevertheless, if all of the planned supply for 2008-09 comes to the market (which we doubt, especially for 2009), penetration levels will still be in an infant stage in all regional cities. Taking into account the 20% lower wages (EUR 780/month) in Polish regions compared to Warsaw (and 80% lower than in Berlin, for example) and fast growing domestic demand, we see the Polish regions as very bullish office markets in the mid term.

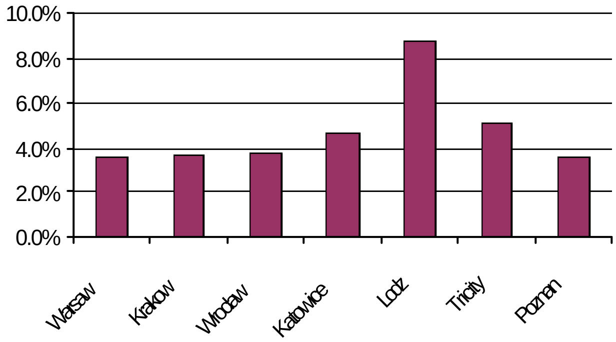
But low unemployment could be a problem for BPO

From the short-term perspective, vacancy levels are below 5%, due to the high demand from WE companies for business process outsourcing (FMCG, IT, banks, manufacturing, pharma) in all regions at present. However, while take-up was 70k-80k sqm in Krakow in 2007, the planned delivery of new office space is 80k in 2008 and 120k sqm in 2009 there. Unemployment in regional cities is (at 10.2%) high only in Lodz, while other cities range from 3.8% to 6.1%. Low unemployment could be a problem for future BPO demand and consequently for the office market, as we do not think local demand would fully compensate for less BPO in regional cities. We thus expect vacancy levels to come back to 8-10% in 2008-09, which will lead to supply/demand equilibrium, i.e. stable rents.

Polish rent levels in 1H07:



Polish vacancy rates in 1H07:



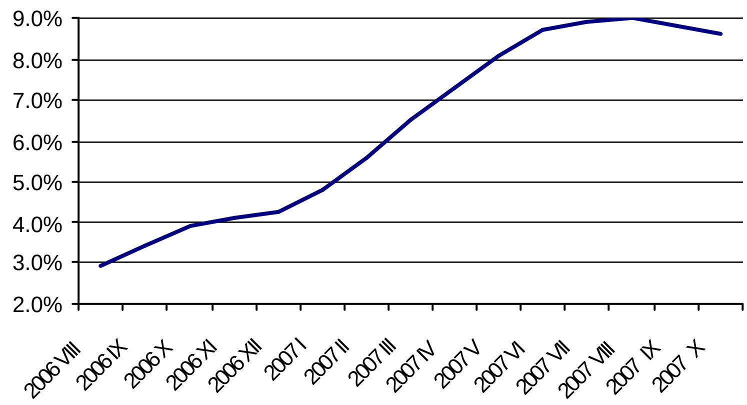
Source: KS

With stable rent levels and increased vacancy in the short term, but with a good mid-term outlook, we see slight yield outshift as appropriate from the current levels of around 6.0-6.25% in the Polish regions.

Construction inflation was at 9% in 07 in Poland

With average yield growth of 50bp on GTC's Polish office projects and increased vacancy, prices of offices should decrease by up to 10% to 12% in 2008-09, before recovering in 2010. On the cost side, construction inflation grew from 4% in 2006 to a peak of 9% in 3Q07, but 4Q07 showed slowing price growth again. We expect construction inflation to stay at 6-7% level also in 08-09 due to finalisation of huge development pipeline started in 06-07.

Construction and assembly price growth in Poland:



Source: GUS

Main reason for lower margins were high land prices in 07…

As rent levels went up on average by 6% and yields went down by 50bp in Poland in 1H07, the construction inflation numbers suggest that the more important reason for the lower margins - which we see from cost estimates for new projects provided by several companies - is high land prices (and increased interest costs).

…in 08 growing yields will be main problem

We now conservatively estimate that GTC's projects started two to three years ago (i.e. at lower land prices) will have development margins at around 30% in 4Q07 (down from our previous estimate of 40%). With expected yield outshift in 2008-09 and higher vacancy rates, margins will drop to 14% for office projects to be delivered in 2008 in Poland. This is not nice from the historical perspective (40% to 50% margins in 2006/ 1H07), but should still ensure good return on investment, using usual 75% leverage (15% development margin at approx. 6.5% selling yield is, in other words, 7.6% yield on capex).

Of course, developers that accepted high land prices in 2007 might see margins at close to zero now. This is potential upside for our vacancy rates/rent growth estimates, as a lot of scheduled projects will probably be halted in Poland.

Residential developments - currently high margins should drop

Sky high margins on residential develop-ments in 3Q 07 should last until 09

Residential development showed a very healthy 43% margin in 3Q07, thanks to the delivery of the high-end Konstancja project in Warsaw (EUR 2,380/sqm). We expect the margin to widen further to 45% in 4Q (our previous expectation was 34%), thanks to the delivery of another successful project, the Park Apartments in Belgrade, Serbia. Margins should remain above 40% in 2008, as the company will deliver two very successful projects in Romania that were largely sold in 2007 (prices around EUR 1,500/sqm). GTC recently increased its sales estimates for projects in Romania, the Czech Republic and Serbia by 19%, on average:

Residential sales estimates:

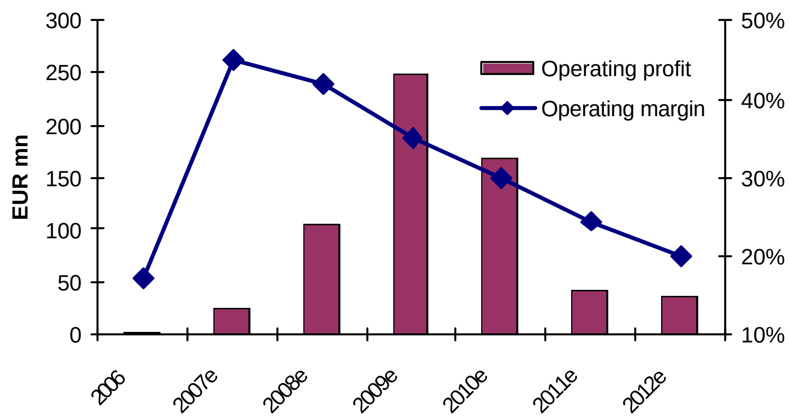
Sales estimates	Current	Previous	Change
Czech Republic	EUR mn	EUR mn	
Prague Marina	75	65	15%
Romania			
Grean Dream Bucharest	37.8	34.7	9%
Rose Garden Bucharest	111	101	10%
Felicity Bucharest	210	170	24%
Serbia			
Park Apartments	29.5	20	48%
Slovakia			
Vinohrady	117	97	21%
Average			**19%**

Source: GTC, EB calculations

We expect a slowdown in flat price growth, due to the already low affordability of housing, accompanied by relatively high (or growing) interest rates in the region. We also predict a gradual decrease in margins later on. While residential housing in most markets should enjoy only moderate or zero price growth, construction costs should still grow in 2008-09, as construction activity remains at peak levels, while new capacities are added only gradually. Only prices of land should ease, in our view.

However, GTC's ongoing residential projects are in the upper/luxury segment, which is less competitive and less sensitive to interest rates, driven by cash-rich residents and expats. We thus expect successful delivery of all projects. We applied a 5% discount to sales estimates provided by the company for Polish and Romanian projects in 2009-10, due to the predicted slowdown of the market.

Expected profit on residential housing and margins:



Source: GTC, EB estimates

As residential housing is not a long-term priority for GTC, we expect the company to be active only in the luxury segment, with selectively picked projects after 2010. We thus see certain upside to our long-term margin forecast (20%).

By country, we see the situation as follows:

Poland: Relatively high supply and growing interest rates (now at 5.0%) will weigh on prices in lower and middle level projects in 2008. The decline should be around 10%, depending on the local situation (the supply is highest in the biggest cities). With prices at 0.4 sqm/monthly salary and wage growth at some 8% y/y, interest rates are crucial, in our view. Nevertheless, we do not expect a long-term correction, as household debt is still very low and the overall quantity and quality of residential properties is low.

Czech Republic: Interest rates are 1.5% lower than in Poland and supply is not too high in Prague, and still low in regional cities. Affordability (0.5 sqm/monthly salary) and the expected rise in interest rates are reasons for a slowdown in price growth to low single-digit territory, in our view.

Hungary: Weak GDP and wage growth (real), relatively high household debt and budget austerity packages. Locals often take mortgages in euro, so interest rates are currently not the biggest problem. We see small price increases, just to cover higher costs.

Romania: The SEE region has very low affordability of housing, which was counterbalanced by low (zero) supply, low household debt and low euro interest rates in the past. Household debt and supply are still low, but, as local interest rates are at 8% (exp. growth to 9%) and the leu is strongly depreciating against the euro (the main lending currency for mortgages), we expect prices to stabilize/slightly decline in the low to mid segments and remain stable in the luxury segment. The reasons for a "soft landing" are low supply and high wage growth (above 15%).

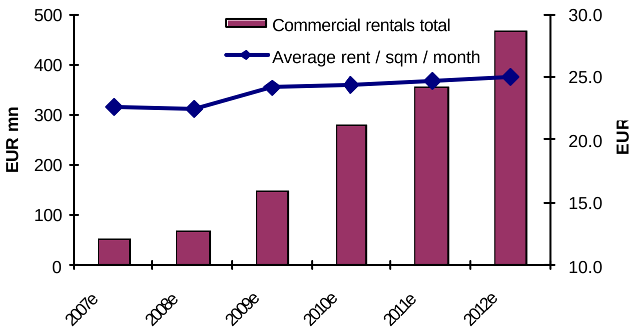
Serbia: Prices are driven up by fast wage growth (approximately 30%y/y) and low supply. Lending is limited by high local rates and tight reserve requirements for loans in foreign currencies. There is mainly a market for luxury projects.

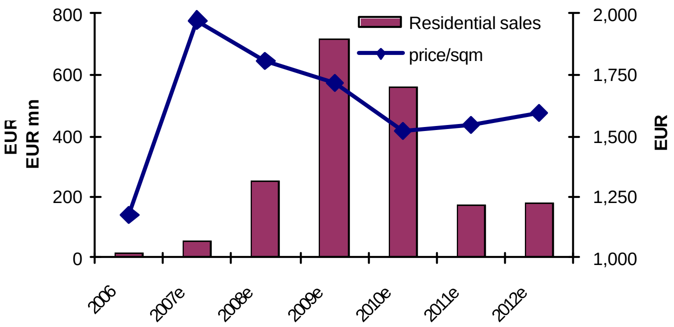
Financial forecasts

Sales and gross profit should grow by a CAGR of 45% in 2007-12

We expect sales and gross profit (i.e. EBIT before revaluations and corporate costs) to grow by a CAGR of 45% in 2007-12, thanks to both growing rental income from finished commercial assets and the delivery of the current huge residential pipeline. While the headline numbers look superb, rent per sqm is expected to grow by just some 1.5% y/y, due to the increase in vacancy rates in the region. Also, the price per sqm for residential projects will decrease by 5-10%, on average, but the main reason here is GTC's move to the SEE region, with lower price levels compared to CEE.

Sales and selling price forecast:

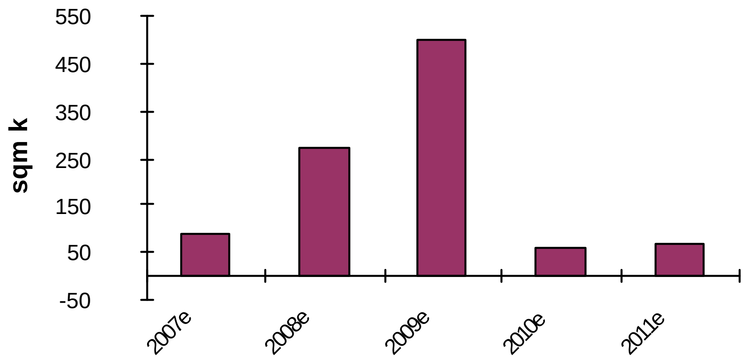




Source: GTC, EB estimates

On the gross profit level, we expect fast growth in 2008-10, thanks to the huge current pipeline and decrease to some "stable" levels later on, as we predict much lower volumes in residential housing. The gross margin will then be quite volatile at around 50% in 2007-12 and will follow shifts in the share of residential development in total sales.

Delivery of commercial projects:



Source: EB estimates

EBIT will be volatile due to revalutions

Although gross profit will enjoy a fast increase, thanks to the growing amount of rentable space, EBIT and net income will be volatile, due to revaluation profits. Revaluations include recognition of development margins, i.e. (I) timing of the development pipeline and (II) development margins. It also, of course, includes revaluations of the investment portfolio.

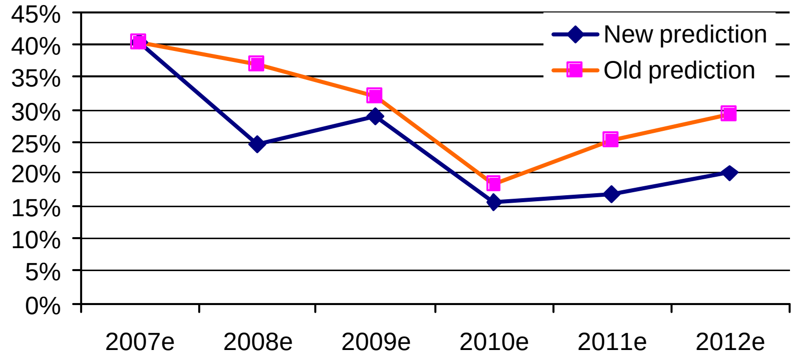
EBIT should drop by 16% to EUR 255mn in 2008, as we expect lower development margins compared to 2007 and a EUR 40mn revaluation loss on investment property (due to expected yield outshift). With record delivery of new projects at stable yields, we expect EBIT to jump by 186% to EUR 731mn in 2009. As we left our long-term estimates for the delivery of 300k sqm of commercial space per year (the company expects to add 260k sqm to its development pipeline in 2008, compared to some 800k sqm in 2007), we predict the EBIT to drop in 2010.

It is worth mentioning that our estimates for future projects are at half of the targets set by management (600k sqm) in November. GTC's targets are achievable, as they still assume a single-digit market share in the region. However, we will wait for the successful delivery of the 2008 pipeline before lifting our estimates.

We expect development margins to decrease by 4% at current pipeline

It is better to look at compound development margins on ongoing projects and total sqm in the pipeline, rather than the insignificant shifts in completion dates (from the valuation point of view) and their impact on EBIT each year. The development pipeline now stands at 940k sqm of commercial properties (and 760k sqm of residential), in line with our estimates. We now predict the average development margin at 27%, vs. previous estimate of 31%.

Development margins on commercial projects:



Source: EB estimates

Financing and leverage

GTC has a sound balance sheet at present…

GTC has a sound balance sheet at present. Its gearing was at 18% in 3Q07. The company has good liquidity, with EUR 436mn in cash and cash/current liabilities at 270%. While 34% of the debt is in 7YR bonds with a hedged interest rate (5.75%), only 7% of the debt (EUR 43mn) is short-term. The average cost of debt was 6.1% in 1H07 and approximately 80% of the debt is hedged, according to the company.

…and should not have problems with financing in our view

However, as the company has an extensive development pipeline, we do not expect it to keep its low leverage without future asset sales or raising equity. Our prediction is that GTC will raise its debt to assets ratio from some 40% in YE07e to its maximum target level of 60% in 2011. We do not expect the company to have problems getting debt financing on a project basis, as local banks have good liquidity. As the ECB's interest rates are expected to be stable or only slightly growing, we also expect GTC's average cost of debt to grow moderately, to 6.5% in 2008-09.

Potential stock price triggers and risks

Takeover of smaller developer would be a clear value added for GTC

We see GTC as well positioned in the current environment of overall difficulty in obtaining debt financing. Large caps with strong balance sheets and cash in hand have the opportunity to take over smaller competitors or enter joint ventures at favorable prices. This is a way to get around the declining prices of commercial property and higher construction costs and secure high margins on future projects. The takeover of smaller competitors at the currently depressed price levels would be a clear value added for GTC. We would prefer that GTC take over smaller competitors with good office/retail projects, rather than start its own new development (e.g. in Poland or Romania).

We wait for first project in CIS

We are still waiting for the first project to be announced in Ukraine or Russia. GTC formed a 90/10 joint venture with EBRD, with a planned equity investment of USD 100mn, to enter the Ukrainian market in 2007. As the company has already been in Ukraine for two years, we expect the first project to come very soon and other projects to follow at short intervals. This would be a new impulse for the stock, as Ukraine is an under-penetrated market, with an outlook for continued yield compression and heavy development margins in all sectors (one exception could be in residential).

The supply does not have to be as high as expected

Further tightening of lending policies from banks towards real estate companies could lead to suspension of some planned projects in CEE and SEE. While this is certainly not the case for GTC, the company and the whole market would benefit from lower supply (while we expect demand for offices and retail at healthy levels). This could lead to lower than expected vacancies and moderate further rental growth.

Interest rates are crucial for residential housing

The end of interest rate increases from national banks in the region would be positive for residential housing. With strong fundamentals and still not too high supply, residential markets could recover very quickly.

Risks

Higher yield outshift could squeeze development margins to unacceptable levels

Higher construction cost growth (due to higher wage growth), accompanied by higher yield outshift than we predict could squeeze development margins to unacceptable levels in CE4. However, we believe that we are already on the conservative side with expected 6-7% cost growth in 2008 and an up to 50bp yield increase in CEE (given GTC's class A portfolio). Looking at the latest development on bond yields and Fed rates, we see little possibility of a worse than predicted scenario.

Low unemployment is an issue

We see relatively low unemployment and consequently high pressure on wage growth as a threat for core CEE markets. Low availability of skilled workers could lead to slower BPO from WE to CEE and consequently lower demand for offices. Nevertheless, demand from growing local companies (thanks to strong economies) is supportive for the markets.

Further fast increases of interest rates in Poland (now at 5.00%) and the Czech Republic (3.50%) would significantly cool demand for residential housing, especially in the lower and middle segments. Further weakening of the Romanian leu against the euro would put a lid on mortgage lending in Romania.

Valuation

We value GTC using an SOTP valuation

We valued GTC using an SOTP valuation, as the company runs two different businesses. Residential housing brings regular profit and cash flow, and we will value it using discounted cash flows. Rental business brings cash flow from rent that is relatively small compared to the quickly expanding asset base, i.e. capex. We thus (I) take rental income and all ex-capex costs (including corporate level expenditures) to capture the operating performance of the rental business until 2012; (II) to get a perpetual value of the rental business, we calculated NAV to all stakeholders of all completed, under-development and expected future projects as of 2012 and discounted it to the present using WACC.

Finally, we summed up the enterprise value of the residential business and the operating and perpetual valuation of the rental business and deducted net debt as of YE07e to arrive at GTC's net present value for shareholders. Our 12M target price is then NPV forwarded by the cost of equity.

Residential development (EURmn)

Residential housing	2008e	2009e	2010e	2011e	2012e	TV
Sales	217.3	591.7	440.1	173.3	178.5	183.9
EBIT margin	*27%*	*23%*	*18%*	*10%*	*6%*	*12%*
EBIT	59.0	134.8	77.7	17.7	10.9	22.1
Tax rate	18%	18%	18%	18%	18%	18%
NOPAT	**48.4**	**110.6**	**63.7**	**14.5**	**8.9**	**18.1**
WC change, Capex	- 65.5	200.7	94.7	- 58.0	3.1	-
Depreciation	-	-	-	-	-	-
FCFF	**- 17.1**	**311.2**	**158.4**	**- 43.5**	**12.0**	**466.3**
DFCFF	**- 16.0**	**270.7**	**129.0**	**- 33.3**	**8.6**	
DCFF 08-12	**359.1**					
Terminal growth rate	**3.0%**					
Discounted TV	**312.8**					
Enterprise value	**671.9**					

	2008e	2009e	2010e	2011e	2012e	TV
Risk free rate	5.90%	5.90%	5.90%	5.90%	5.90%	5.90%
Premium to equity	5.50%	5.50%	5.50%	5.50%	5.50%	5.50%
Beta	1.30	1.30	1.30	1.30	1.30	1.30
Cost of equity	**13.1%**	**13.1%**	**13.1%**	**13.1%**	**13.1%**	**13.1%**
Cost of debt	6.5%	6.4%	6.2%	6.0%	5.9%	5.9%
Tax rate	18.0%	18.0%	18.0%	18.0%	18.0%	18.0%
Effective cost of debt	**5.3%**	**5.3%**	**5.1%**	**4.9%**	**4.8%**	**4.8%**
Debt/(Debt+equity)	75%	75%	75%	75%	75%	75%
WACC	**7.2%**	**7.2%**	**7.1%**	**7.0%**	**6.9%**	**6.9%**

Source: Erste Bank estimates

Rental business (EURmn)

Rental business 08e-12e	2008e	2009e	2010e	2011e	2012e
Rental income	**65.8**	**144.8**	**259.5**	**324.9**	**421.5**
EBIT margin	62%	65%	65%	63%	63%
EBIT	40.8	94.8	168.9	203.6	264.4
Tax rate	18%	18%	18%	18%	18%
NOPAT	**33.5**	**77.7**	**138.5**	**166.9**	**216.8**
Depreciation	1.6	3.7	3.9	7.8	8.3
WC change, Capex	-	-	-	-	-
FCFF	**35.1**	**81.5**	**142.4**	**174.7**	**225.2**
DFCFF	**32.8**	**71.2**	**116.8**	**134.9**	**163.5**
DCFF 07e-12e	**519**				

	2008e	2009e	2010e	2011e	2012e
Risk free rate	5.90%	5.90%	5.90%	5.90%	5.90%
Premium to equity	5.50%	5.50%	5.50%	5.50%	5.50%
Beta	1.10	1.10	1.10	1.10	1.10
Cost of equity	**12.0%**	**12.0%**	**12.0%**	**12.0%**	**12.0%**
Cost of debt	6.5%	6.4%	6.2%	6.0%	5.9%
Tax rate	18.0%	18.0%	18.0%	18.0%	18.0%
Effective cost of debt	**5.3%**	**5.3%**	**5.1%**	**4.9%**	**4.8%**
Debt/(Debt+equity)	75%	75%	75%	75%	75%
WACC	**7.0%**	**6.9%**	**6.8%**	**6.7%**	**6.6%**

Rental business TV (2012e)	*sqm k*	*GDV/sqm*	*GDV*	*Minorities*	*Resid. capex*	*NAV*
Completed projects	182	3,848	702	-	217	485
Running projects	992	3,069	3,045	240	1,315	1,489
Future projects	1,600	2,408	3,853	-	3,044	810
Total	**2,774**		**7,600**	**240**	**4,575**	**2,784**

2012e NAV	2,784
WACC	6.6%
PV of 2012e NAV	**2,022**

We estimate GTC's enterprise value at EUR 3,213mn

Using our SOTP valuation, we arrived at GTC's enterprise value of EUR 3,213mn, out of which residential development accounts for 21% and rental business 79%.

SOTP (EURmn)	
Residential housing	672
Rental business 08-12	519
Rental business TV	2,022
Enterprise value	**3,213**
2007e Net debt	- 564
Equity value	**2,650**
Fully diluted shares [mn]	221.9
NPV per share	**11.9**
COE	12.0%
12M target price [EUR]	**13.4**
PLN/EUR YE 08e	3.51
12M target price [PLN]	**46.9**

We set 12M target price at PLN 47 per share, 33% above current share price

After deducting the EUR 564mn net debt (YE07e), we estimate the net present value of GTC's equity per share at EUR 11.9 and set our 12M target price at EUR 13.4, or PLN 47 per share (fully diluted), i.e. 33% above the current share price.

Peer comparison

GTC is significantly above its peers

For information purposes only we compared GTC to the peer group of similar companies with substantial shares of development in their portfolios and with operations in the CEE, SEE and CIS regions. While we usually use P/NAV as the best tool, it is quite tricky for GTC, as the firm does not report NAV.

	Share price	Currency	P/E				Dividend yield				P/ EPRA NAV				
			2006	2007e	2008e	2009e	2006	2007e	2008e	2009e	2006	2007e	2008e	2009e	last rep.
Austria-based															
Immoeast	6.00	EUR	5.9x	7.1x	5.3x	4.7x	0.0%	0.0%	0.0%	0.0%	0.59x	0.53x	0.48x	0.43x	0.57x
Meinl European Land	6.73	EUR	5.1x	n.a.	n.a.	n.a.	0.0%	n.a.	n.a.	n.a.	0.43x	n.a.	n.a.	n.a.	0.44x
Immofinanz	6.40	EUR	6.2x	7.1x	6.3x	3.7x	5.2%	5.5%	5.9%	6.4%	0.59x	0.53x	0.49x	0.43x	0.57x
CA Immo	13.29	EUR	11.5x	12.2x	10.2x	8.1x	0.0%	0.0%	0.0%	0.0%	0.63x	0.60x	0.56x	0.53x	0.60x
conwert	10.09	EUR	10.4x	7.8x	7.0x	7.6x	0.0%	0.0%	1.7%	4.0%	0.66x	0.61x	0.56x	0.53x	0.65x
Sparkassen Immo	6.69	EUR	10.8x	13.8x	8.8x	4.7x	0.0%	0.0%	0.0%	0.0%	0.75x	0.69x	0.64x	0.56x	0.69x
CA Immo Int.	10.30	EUR	5.6x	6.8x	6.0x	3.2x	0.0%	2.7%	3.0%	2.9%	0.75x	0.68x	0.60x	0.56x	0.70x
ECO	6.29	EUR	6.4x	6.4x	6.1x	4.8x	0.0%	0.0%	0.0%	0.0%	0.52x	0.50x	0.46x	0.42x	0.50x
Average			**7.7x**	**8.8x**	**7.1x**	**5.2x**	**0.6%**	**1.2%**	**1.5%**	**1.9%**	**0.61x**	**0.59x**	**0.54x**	**0.49x**	**0.59x**
CEE-based															
GTC	9.78	EUR	10.7x	10.8x	15.4x	4.8x	0.0%	0.0%	0.0%	0.0%	n.a.	0.87x	0.92x	0.88x	n.a.
Orco	63.90	EUR	5.0x	4.9x	5.0x	8.2x	1.6%	1.7%	1.9%	2.1%	0.64x	0.51x	0.45x	0.41x	0.55x
ECM	31.78	EUR	6.3x	5.0x	10.9x	7.5x	0.0%	0.0%	0.0%	0.0%	0.61x	0.52x	0.45x	0.49x	0.55x
Average			**7.4x**	**6.9x**	**10.5x**	**6.8x**	**0.5%**	**0.6%**	**0.6%**	**0.7%**	**0.63x**	**0.63x**	**0.61x**	**0.59x**	**0.55x**

Source: JCF, Erste Bank estimates
1) EPRA NAV CAGR 07e-09e

But we do not use the peer comparison as a valuation tool

GTC is valued with a significant premium to average P/NAV multiples. But note that indicated NAV is our rough estimate as GTC does not report NAV comparable to peers. While we see a certain premium to peers in terms of P/NAV as justified, given GTC's strong fundamentals and focus on SEE and CIS, today's premium also shows that investors prefer companies with transparent accounting, strong balance sheets and solid track records. As we see the whole sector at relatively low multiples, we do not use the peer comparison as a valuation tool.

Recommendation

We recommend buying GTC shares as they offer 33% upside…
…but expect only gradual recovery

We cut our target price for GTC by 18% to PLN 47 per share, due mainly to expected yield outshift in the region in 1H08 and higher interest and construction costs. Also, the supply of commercial projects is expected to be relatively high in CEE. Nonetheless, we maintain our Buy recommendation on the stock, as it offers 33% upside potential from the current depressed levels. As GTC is traded relatively highly compared to its peers, we expect only a gradual recovery of the stock. On the other hand, we see GTC as a relatively defensive bet in the current environment, as it has a strong balance sheet and a quality project portfolio. Also its current price already include much worse than predicted scenario in our view. GTC can act as a consolidator at very favorable prices also an announcement of a new project in the booming CIS region would be a clear trigger for the stock.

Company Report

Income Statement (IFRS, EUR mn, 31/12)	**2006**	**2007e**	**2008e**	**2009e**	**2010e**
Sales revenues	**80.9**	**102.9**	**323.3**	**860.3**	**838.3**
- Residential housing	15.9	53.9	255.1	712.6	560.6
- Commercial rental	65.0	49.1	68.3	147.7	277.8
Grross margin from operations	**48.8**	**60.5**	**158.4**	**360.2**	**375.5**
- Residential housing	2.7	24.2	107.1	249.4	168.2
- Commercial rental	46.1	36.3	51.3	110.8	207.4
Selling expenses	-2.9	-5.7	-22.8	-62.6	-53.3
Administration expenses	-14.9	-15.5	-30.7	-61.2	-61.9
Profit from revaluation of investment property	199.1	263.7	148.6	494.3	174.3
Other income / expenses	2.5	2.0	1.5	0.0	0.0
EBIT	**232.6**	**305.0**	**255.0**	**730.8**	**434.6**
Financial expense net	-0.6	-16.1	-56.4	-95.6	-128.7
Profit on sale of shares in subsidiaries	1.3	0.7	0.0	0.0	0.0
Share of profit in associates	4.2	3.8	1.6	13.7	1.8
PBT	**237.6**	**293.4**	**200.2**	**649.0**	**307.7**
Tax expenses	-39.6	-52.8	-36.0	-116.8	-55.4
Net profit	**197.9**	**240.6**	**164.2**	**532.1**	**252.3**
Attributable to minority interests	-2.9	-43.3	-24.6	-79.8	-25.2
Net result after minorities	**195.1**	**197.3**	**139.5**	**452.3**	**227.1**

Balance Sheet* (IFRS, EUR mn, 31/12)	**2006**	**2007e**	**2008e**	**2009e**	**2010e**
Investment property	541.8	846.9	1,578.1	3,136.3	3,672.8
PP&E	170.3	358.6	524.9	408.5	641.9
Investment in associates	28.5	32.4	33.9	47.7	49.4
Deferred tax asset	3.0	3.0	3.0	3.0	3.0
Other tangible assets	32.2	31.0	22.0	22.0	22.0
Total fixed assets	**775.8**	**1,271.8**	**2,162.1**	**3,617.6**	**4,389.2**
Inventories	115.8	421.6	602.8	424.4	293.4
A/R, accured income	16.8	9.8	13.7	29.5	55.6
Other current assets	16.9	43.5	139.0	369.9	293.4
Cash and cash equivalents	285.5	152.4	33.2	96.5	308.2
Total current assets	**435.0**	**627.4**	**788.7**	**920.4**	**950.6**
TOTAL ASSETS	**1,210.8**	**1,899.2**	**2,950.7**	**4,538.0**	**5,339.8**
Shareholders' equity	**731.1**	**928.4**	**1,067.9**	**1,520.2**	**1,747.3**
Minorities	**0.0**	**43.3**	**68.0**	**147.8**	**173.0**
LT loans	258.5	596.8	1,215.6	1,702.6	2,327.1
Other L-T payables	13.6	13.6	13.6	13.6	13.6
Deferred tax liability	54.3	84.1	59.4	199.1	97.5
Total long-term liabilities	**326.4**	**694.5**	**1,288.6**	**1,915.2**	**2,438.2**
A/P	45.6	41.4	131.0	343.1	289.0
ST loans and current portion of LT loans	51.1	119.4	243.1	340.5	465.4
Advances received	14.1	38.3	71.3	56.1	17.3
Other ST liabilities	42.5	34.0	80.8	215.1	209.6
Total current Liabilities	**153.3**	**233.0**	**526.2**	**954.8**	**981.3**
TOTAL LIAB. & EQUITY	**1,210.8**	**1,899.2**	**2,950.7**	**4,538.0**	**5,339.8**

Cash Flow Statement (IFRS, EUR mn, 31/12)					
Cash flow from operating activities	-81.1	-89.6	11.2	840.9	207
Cash flow from investing activities	-8.8	-493.4	-897.6	-1,441.8	-770
Cash flow from financing activities	300.0	449.9	767.2	664.2	775
CHANGE IN CASH & CASH EQU.	**210.1**	**-133.1**	**-119.2**	**63.3**	**212**

Margins & Ratios*					
Revenue growth	5.3%	27.3%	214.1%	166.1%	-1.6%
EBITDA margin	83.2%	83.3%	54.4%	54.2%	43.3%
EBIT margin	83.1%	83.2%	54.0%	53.9%	42.9%
Net profit margin	69.7%	53.8%	29.6%	33.4%	22.4%
ROE	32.7%	23.8%	14.0%	36.9%	13.9%
Cash-ROE	-0.7%	-8.0%	-0.9%	-3.2%	3.2%
Equity ratio	60.4%	51.2%	38.5%	36.8%	36.0%
Net debt	24	564	1,426	1,947	2,321
Gearing	3.3%	58.0%	125.5%	116.7%	120.9%
Capital employed	823	1,633	2,634	3,827	4,353

Source: Company data, Erste Bank estimates

Company Report

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Rating History

Date	Product	Rating	Price	Target price
7. Sep 07	IC/CR	initiate coverage with Buy	43.70	57.50
1. Oct 07	SR	Buy	49.00	57.50

Company	Disclosure	Comment
GTC	--	--

Erste Bank rating definitions

Buy	> +20% to target price
Accumulate	+10% < target price < +20%
Hold	0% < target price < +10%
Reduce	-10% < target price < 0%
Sell	< -10% to target price

Our target prices are established by determining the fair value of stocks, taking into account additional fundamental factors and news of relevance for the stock price (such as M&A activities, major forthcoming share deals, positive/negative share/sector sentiment, news) and refer to 12 months from now. All recommendations are to be understood relative to our current fundamental valuation of the stock. The recommendation does not indicate any relative performance of the stock vs. a regional or sector benchmark.

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