Progressive EQUITY RESEARCH

GRAINGER

REAL ESTATE INVESTMENT & SERVICES

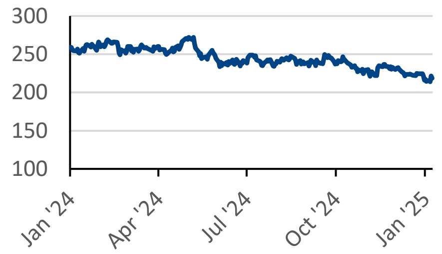
20 January 2025

GRI.L

221p

Market Cap: £1635.2m

SHARE PRICE (p)



12m high/low	272p/214p

Source: LSE Data (priced as at prior close)

KEY DATA

Net (debt)/cash	£(1,499.7)m *(at 30/09/24)*
Enterprise value	£3134.9m
Index/market	LSE
Next news	AGM, 5 February
Shares in issue (m)	741.6
Chairman	Mark Clare
Chief Executive	Helen Gordon
CFO	Robert Hudson

COMPANY DESCRIPTION

Grainger is the UK's largest listed residential landlord, owning 11,000 private rental and regulated tenancy homes.

https://www.graingerplc.co.uk

GRAINGER IS A RESEARCH CLIENT OF PROGRESSIVE

ANALYSTS

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Switched on to income surge from Generation Rent

Grainger, the UK's largest quoted landlord, is at an 'inflexion point' in its nine-year transformation strategy to focus on build-to-rent (BTR), we believe, just as the new government is actively supporting measures to boost the undersupplied private rental market. This has been exacerbated by buy-to-let (BTL) landlords exiting the market. Grainger could be a proxy for these and other investors: income and capital growth, at scale, without the inconvenience of property management – plus greater tax efficiency once Grainger converts to a REIT in FY26E.

- **Growth in volumes, rents and margins to lift earnings by 50%.** The group predicts EPRA earnings growth of around 50% over five years, driven by: huge rental demand; a committed pipeline of 1,130 BTR homes; a 600bp increase to c.60% in the EBITDA margin; and de-gearing as pipeline investment starts generating income. We believe the group's 50% target is conservative; we estimate 40% EPRA growth over our three-year forecast period (page 6).
- **Rental demand overwhelms supply.** Private rents have outpaced house prices since 2022 due to increasing numbers of median earners being priced out of the sales market and a rapid decline in BTL landlords, under a rising tax and regulatory burden since 2015 (page 4). Industry observers expect a surge in BTR development for at least the next 10 years. We expect Grainger's evolving model and increasing economies of scale to make it a leading player in this long-term growth sector.
- **Government's housing revolution.** Housing was a rare 'winner' in the Budget, with the Chancellor reiterating Labour's pledge to build 1.5 million homes, including increased support for private rental. Deputy PM Angela Rayner has led robust new planning rules, described in the industry as 'a changed mindset' to accelerate housebuilding roll-out (page 5).
- **REIT conversion to boost dividends and returns.** Grainger plans to convert to a REIT in October. This will have no impact on the business but allow tax savings of 25% on BTR profits. There will be an accompanying rise in dividend payout ratios, to at least 80%, following conversion.
- **Valuation.** The stock is trading at a PTNAV of 0.72x FY24. In addition to the clear discount to underlying net assets, the imminent REIT conversion and rental market's long-term growth prospects emphasise its income characteristics, with a FY27E dividend yield of 4.5%. We suggest Grainger offers a similar profile to BTL investments – without the hassle (page 12).

FYE SEP (£M)	2023	2024	2025E	2026E	2027E
Net rental income	96.5	110.1	126.6	137.4	146.4
EPRA earnings before tax	39.5	48.0	54.4	60.9	67.2
EPRA EPS, before tax* (p)	5.3	6.5	7.3	8.2	9.1
Dividend per share (p)	6.7	7.6	8.5	9.1	9.8
PER (x)	41.4x	34.1x	30.1x	26.8x	24.3x
EPRA PTNAV (x)	0.69x	0.72x	0.74x	0.72x	0.71x
Dividend yield	3.0%	3.4%	3.9%	4.1%	4.5%

*Source: Company Information and Progressive Equity Research estimates. *REIT basis*

Grainger explored: UK's largest quoted landlord

At the forefront of Britain's private rental revolution

Grainger, which was founded in Newcastle upon Tyne in 1912, is the UK's largest listed residential landlord and property manager, providing c.11,100 rental homes to over 20,000 customers. Its portfolio comprises 9,597 PRS/BTR apartments across the UK and 1,472 historical regulated tenancy 'reversionary' homes, together valued at £3.4bn. It is in the process of steadily disposing the reversionary portfolio to fund growth in new PRS homes, either buying from developers or, increasingly, its own purpose-built build-to-rent (BTR) pipeline. The pipeline of BTR apartments totals 4,730 with a value of £1.4bn. The group intends to convert into a tax-efficient real estate investment trust (REIT) in October 2025.

The BTR developments typically comprise one or more blocks with 50-500 apartments mainly in 'clusters' of regional city centres, maximising efficiencies and the gross-to-net ratio. They are aimed at middle earners, with most split fairly evenly between studios/one-bed and two-bed flats. Facilities often include gyms and superfast broadband, and Grainger offers a full range of property management services. Typical leases last one to three years.

The group works in partnership and in joint venture with public sector organisations including Transport for London, Network Rail, Ministry of Defence, Lewisham Borough Council and the Local Pensions Partnership.

Strategic recycling of regulated tenancies into BTR

Helen Gordon's strategy culminating at the ideal time

A major strategy undertaken since Helen Gordon became CEO in 2015 has been to gradually recycle the proceeds from the group's longstanding reversionary portfolio of individual homes on controlled, sub-market rents as they naturally become vacant into funding a growing BTR estate. Both aspects of the business have their attractions: a funding source through the cash-generative reversionary portfolio and the prospect of a rapidly growing number of BTR apartments with rental growth as an effective inflation hedge, underpinned by a shortage of modern rental properties. Nine years on, we judge now to be an inflection point, with the culmination of the strategy, and the imminent REIT conversion, coming at a time of burgeoning demand for rental properties.

Regulated tenancies: cash-generative portfolio

Cash-generative portfolio supporting roll-out of BTR investment

The number of regulated tenancies owned by Grainger has reduced steadily from 8,234 in 2015 to 1,472. Although the rents are sub-market and set externally, the benefits are a long-term, predictable and generally inflation-hedged income with strong cashflow characteristics, with the ultimate proceeds from disposal being recycled into BTR/PRS:

- Occupants have right to live in properties for life.
- Sub-market rents are set every two years by the Valuation Office Agency.
- Grainger sells these properties following vacancy, with a consistent track record of selling them through cycles in line with valuations.
- Returns comprise:
  - Resilient rental income, with a gross yield of typically 2%-4%, with rents generally increasing in line with RPI.
  - Capital growth.
  - 'Reversionary surplus' (the difference between the market value when occupied and the estimated sales price) realised upon vacancy, typically generating a 15%-17% uplift on book value (purchase price).

Pipeline will grow BTR portfolio by 50% - addressing middle earners increasingly priced out of home ownership

BTR/PRS: growth supported by long-term demand

As the regulated tenancy portfolio has shrunk, proceeds have funded growth in the PRS portfolio, which now stands at 9,597 units, with a total pipeline of 4,730 at the FY24 year-end (Figure 1). In the early part of the strategy, the majority of this was done via Grainger forward-funding third-party developers and contractors. Looking forward, the group has guided that the balance is likely to shift toward growth also coming from a great proportion of direct development and, as the BTR sector matures, acquiring existing assets from other institutional investors.

The portfolio's characteristics include:

- Full market rents, targeted at middle earners (average rents 28% of household income).
- The wider rental market is underpinned by long-term structural trends (page 3).
- Grainger's developments are located in cities with high demand and growth potential.
- Returns are based on:
  - Securing new development opportunities at gross yields of 55%-75%.
  - Capital growth driven by rental growth.

Future newsflow

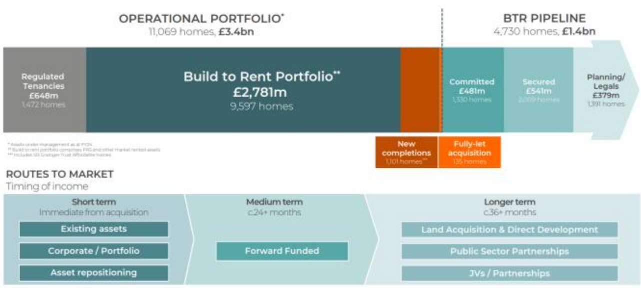
AGM and trading update, 5 February

HY results, 15 May

Trading update, September (TBC)

FY results, 20 November

Figure 1: Build-to-rent pipeline, LHS; Windlass Apartments, Tottenham Hale, RHS



Source: Company presentations and material

Rental market: structural attractions

Underlying market: shrinking supply drives record rental growth

Underlying rental growth driven by swelling demand and limited supply

Rental inflation has been driven by soaring demand as increasing numbers of people have been priced out of the sales market, particularly since the pandemic, with more people choosing to rent for longer, and also by restricted supply. The latter has been exacerbated by BTL landlords selling out because of a succession of tax rises since 2015 and steadily mounting regulation. There is anecdotal evidence of a surge in this trend ahead of the 30 October Budget, with landlords selling up to avoid anticipated increases in Capital Gains and/or Inheritance Tax.

Annual growth in asking rents peaked at 14.3%, according to Zoopla (Figure 2, LHS), and since 2023 rents has exceeded increases in house prices. Even although the demand-supply imbalance has been stabilising over the past year, Zoopla estimates demand remains 31% above pre-pandemic levels, according to the property portal's latest UK Rental Market Report. It predicts further rental growth of 4% in 2025.

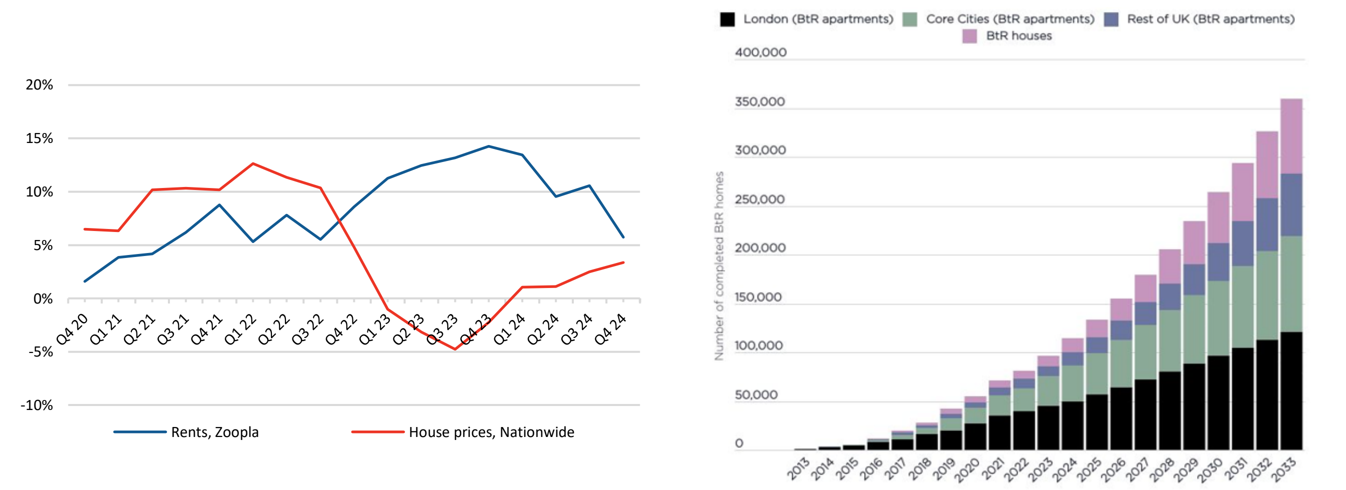
PRS includes both existing homes bought by individual or corporate investors; BTR refers exclusively to new homes developed for rental. There are two main categories within BTR: apartment blocks ('multi-family'), which Grainger predominantly focuses on, and 'single family housing' (SFH). Definitions can be blurred, but we include bulk purchases of newly built homes from housebuilders within SFH rather than BTR.

Build to rent: two main markets

Grainger focuses on apartments in 'core cities'; other companies addressing single family market

This generally entails modestly sized two-storey detached, semi-detached or terraced housing, and is served by companies such as PRSR REIT (PRSR.L). Grainger focuses predominantly on multi-family apartment developments. The need for greater supply and attractive income characteristics are likely to attract substantial BTR investment for years to come, according to most industry researchers, including Savills. The agency forecasts the total number of BTR apartments will almost triple, from 100,000 in 2024 to c.280,000 in 2033, most in London and 'core' cities, with an additional 800,000 SFH units (Figure 2, RHS).

Figure 2: Rents vs house prices, Y/Y growth (%) – LHS; Projected number of BTR homes – RHS



Source: Source: Zoopla (rents), ONS (prices); Savills Research, British Property Federation, Molior, DLUHC (BTR)

Newfound government support bolsters sector outlook

Labour's conversion to private rental is evident in what is not in the Budget rather than what is

The 30 October Budget contained a small but symbolic shift in Labour rhetoric, which had for decades viewed the private rental sector adversely, partly due to historical perceptions of 'rogue landlords'. What it pointedly did *not* do was introduce rental controls on private landlords, which some in the party had pushed for vigorously ahead of the election. (The argument against this stance is that average Scottish rents for new tenancies have grown faster than any UK region following the imposition in September 2022 of rent controls on existing tenancies by the Scottish government.)

There was only one actual reference to BTR in the Budget documentation, £3bn of additional support split between SMEs and BTR (the proportions not specified), but we see this as acceptance that ministers now view that private rental represents an important element of housing delivery. The funding is in the form of housing guarantee schemes, similar to those introduced in 2020, which allowed low-cost, flexible and long-term loans for social housing providers.

Rayner launches a rocket under the planning system

New rules and Rayner's robust approach 'galvanise' the planning system

Since the general election in July, Housing Secretary and Deputy PM Angela Rayner has overseen a raft of new planning initiatives and, possibly more importantly, has taken high-profile personal decisions in favour of building more homes and other facilities considered national priorities, which had been opposed by local authorities. In Berkeley's HY results presentation on 6 December, CEO Rob Perrins remarked that the latest moves – including the highly symbolic decision to demolish M&S's Marble Arch flagship store – "have led to a mindset change from a default 'no' to a default 'yes'". Key features include:

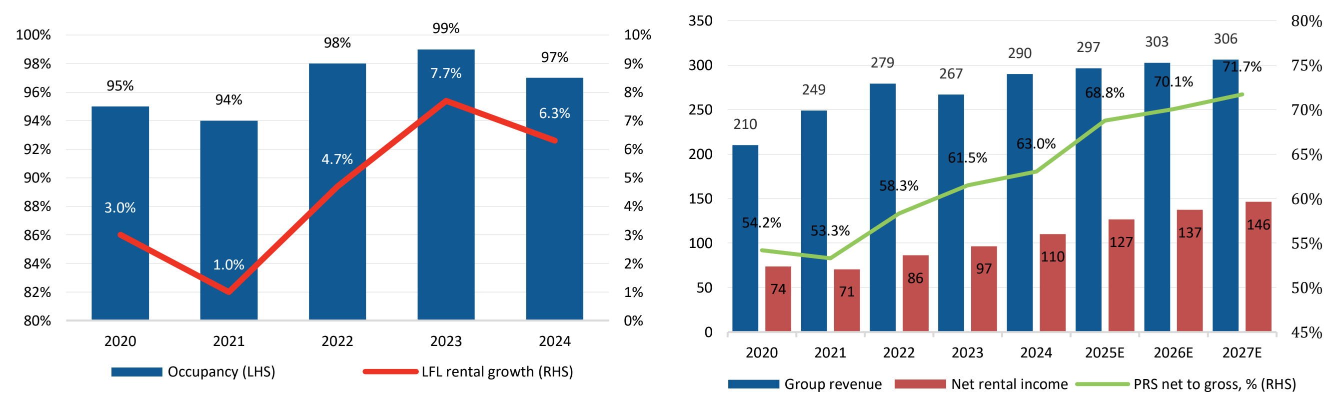
- Planning officers will be able to bypass council committees to speed through approval of housing schemes. Applications that comply with local development plans could bypass the lengthy planning committee process entirely.
- The reinstatement of local housing targets and strict 12-week deadlines for councils to formalise their local plans. Councils will be given mandatory housing targets totalling 370,000 pa.
- The government will provide £100m to councils to help update their local plans and review their greenbelt land, in addition to 300 extra planning officers.
- The government has dropped its original requirement for 50% affordable housing on 'greybelt' developments, in final revisions to the National Planning Policy Framework (NPPF). New speculative developments will have to deliver 15% more affordable homes than in the relevant local housing policy – up to a cap of 50%.
- Rayner has also 'called in' a number of applications blocked by councils. The first, two days into her tenure, involved a datacentre; others have included a prison, housing developments and a film studio complex. Berkeley Group and developer and land promoter Henry Boot are among the groups that have formally stated that planning decisions have already speeded up under a 'galvanised' regime.

Financials

Strong growth already…

Between FY20 and FY24, Grainger's gross revenue has grown by a CAGR of 8.4% (17.9% for the PRS segment), while adjusted EPRA earnings have increased by a compound 16.5% and adjusted EPRA EPS by 11.2%. Dividend growth has been 8.2% over this period. The growth has been driven by Grainger's strategy of expanding the size of the PRS portfolio and underlying rent rises. Occupancy has remained high over the past three years, with strong rental growth, reflecting the much-publicised undersupply in the market (Figure 3, LHS). This and operational leverage have helped propel net rental income.

Figure 3: Occupancy and LFL rental growth, FY20-24 (%), LHS; Total revenue and net rental income, FY20-27E (£m), RHS

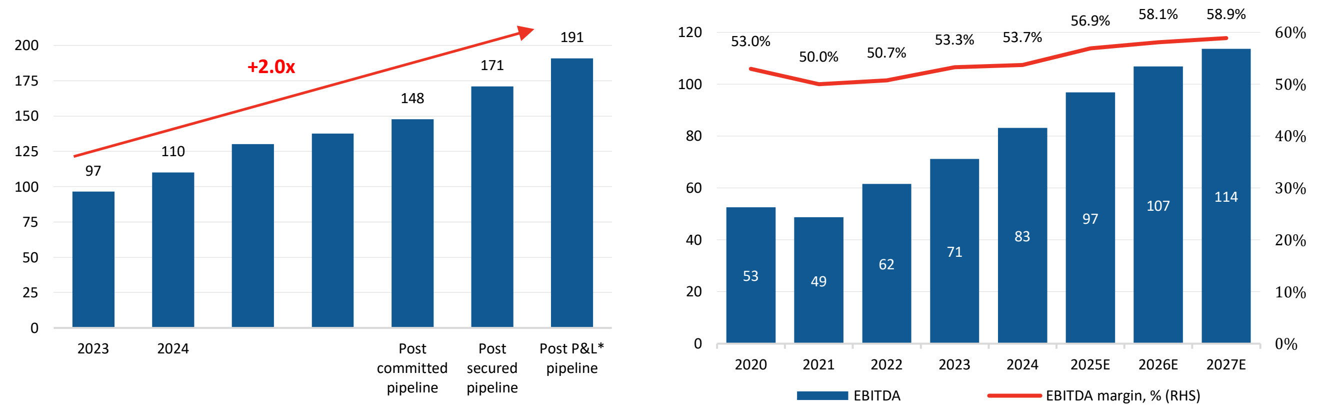


Source: Company Information and Progressive Equity Research estimates

…with pipeline and higher margins to deliver even greater growth

The group's latest guidance offers a potential 'double whammy' of factors to boost earnings and dividend growth. Our FY27E net rental income, £148m (Figure 3, RHS), is in line with the level that it expects when the current committed pipeline is on-stream; taking this further (**Error! Reference source not found.**, LHS), the secured pipeline and pipeline projects that are in the process of planning and legal agreements ('P&L') are forecast by management to take this to £191m (timing not specified). The second driver is the group's guidance that the EBITDA margin will improve by 600bps to at least 60% by 2029, taking advantages of economies of scale and operational leverage (**Error! Reference source not found.**, RHS).

Figure 4: Guidance on NRI growth from pipeline (£m), LHS; EBITDA (£m), RHS



Source: Company Information and Progressive Equity Research estimates

EPRA vs IFRS performance measures

EPRA offers clearer measure o core operational activities

Grainger has adopted EPRA (European Public Real Estate Association), rather than IFRS, for a number of its key performance measures. These are explained in detail from page 171 of the latest annual report, but are designed to give clearer measures of the group's core operational activities.

EPRA earnings will become the key P&L metric from FY26E, in line with REIT peers that the group will join from 1 October 2025. EPRA earnings records recurring pre-tax earnings: reversing valuation gains and losses; excluding profits on disposals of non-core trading and investment properties and other adjustments.

Revenue and net rental income

Strong growth in NRI driven by BTR

Rather than revenue, the key 'top line' for Grainger is net rental income (NRI), which has grown by 15% CAGR over the past nine years.

IFRS Revenue comprises gross rental income (FY24: £154.8m) plus gross proceeds from the disposals of the reversionary trading properties (FY24: £127.2m) and fees and other income (FY24: £8.1m).

NRI comprises gross rental income less property operating expenses (FY24: £44.7m). As a greater proportion of the portfolio becomes 'stabilised' the net-to-gross ratio should rise,

We have used NRI as the 'starting point' in driving our P&L estimates. This primarily comprises rents from: the PRS segment, which should grow due to ongoing development of new assets, as well as underlying rental growth; and from net rents from reversionary properties, which should steadily decline as the portfolio shrinks.

For PRS, we have assumed growth in net rental income for PRS of 20%, 10% and then 7.5%, respectively, for the three years of the forecast period. We have assumed similar rates, but for the rate of decline in NRI for reversionary.

Profits

Rental growth and operational gearing to drive EPRA earnings growth

Our estimates imply 40% growth in EPRA earnings over the three-year forecast period, CAGR of 11.9%, well on course for the group's five-year target of 50%, which we have described as conservative.

We have assumed administrative expenses to increase by 4% in FY25E, followed by 2% in both FY26E and FY27E, as wage inflation is offset by group efficiencies. The group's earnings guidance is based on delivery from its committed pipeline and excludes the secured pipeline and schemes in the planning & legals pipeline – so could well be conservative, in our view.

An additional contributor to NRI is 'other'. This includes management fees earned from third-party activities and liquidated and ascertained damages (LADs), financial compensation for the loss of rental income caused by delays to the practical completion of group properties, and a small amount of income related to the Church of England mortgage portfolio. The group's expectations are that these will amount to c.£8-10m pa in NRI over the forecast period, with LADs specifically contributing to £1.5-3.0m pa to profitability (reversed out for EBITDA disclosure).

We anticipate a steady increase in finance cost, reflecting ongoing investment in group BTR properties. It is the group's strategy to deleverage over the medium term (c.FY29), but it emphasises that financial costs are well hedged or fixed until then.

Our assumption for tax is 18.5% for FY25E – lower than the UK Corporation Tax of 25% because of adjustments in relation to prior periods, generally capital allowances. Thereafter the rate will drop to zero for rental earnings, as a result of the move to REIT status, with non-rental earnings resulting in an underlying rate of c.2%. Our headline EPRA EPS excludes tax – for comparison with other REITs and with Grainger pre- and post-conversion.

Forecast to be well on course for 60% margin target

The EBITDA margin will be a key element in board remuneration. EBITDA is defined as EPRA earnings, adding back interest, tax, depreciation and amortisation. The margin is based on gross rental income, rather than IFRS revenue. We estimate it will rise from 53.7% in FY24 to 58.9% – close to the Board's 60% mid-term target.

Dividends

REIT structure to underpin dividend growth

Dividends have grown by a CAGR of 19% over the nine years to FY24. The group intends to maintain its progressive policy: from FY26E dividends will total a minimum of 80% of EPRA earnings; they are expected to be covered by EPRA earnings within approximately two years of conversion, with a top-up from regulated tenancy sales profits in the interim. The company has guided that the dividend will continue to be progressive and grow post-REIT.

Cash flow and balance sheet

Net debt to stay broadly flat during forecast period then fall

We anticipate net debt to stay broadly flat at £1.5bn, and then fall post FY27E. During the forecast period, we expect capex in new rental properties to be partly offset by sales of reversionary properties (reported within the changes in working capital line in the cashflow statement).

EPRA definitions:

- EPRA NRV: Net asset value adjusted to include properties and other investment interests at fair value and to exclude certain items not expected to crystallise in a long-term property business model.
- EPRA NTA: EPRA NRV adjusted to include deferred tax on assets that may be sold by the business and exclude intangible assets.

Figure 5: Revenue and earnings

YE September (£m)	2020	2021	2022	2023	2024	2025E	2026E	2027E
Gross rental income	99.3	97.4	121.4	133.7	154.8	170.3	183.9	193.1
Change (%)		*-1.9%*	*24.6%*	*10.1%*	*15.8%*	*10.0%*	*8.0%*	*5.0%*
Gross proceeds from disposal of trading properties	107.2	146.4	153.4	128.4	127.2	120.8	114.8	109.1
Fees and other income	7.5	5.1	4.4	5.0	8.1	5.5	4.0	4.0
Group revenue	**214.0**	**248.9**	**279.2**	**267.1**	**290.1**	**296.6**	**302.7**	**306.2**
Less: disposal proceeds, fees and other	(110.7)	(151.5)	(157.8)	(133.4)	(135.3)	(126.3)	(118.8)	(113.1)
Gross rental income	**99.3**	**97.4**	**121.4**	**133.7**	**154.8**	**170.3**	**183.9**	**193.1**
Property operating expenses	(25.7)	(26.8)	(35.1)	(37.2)	(44.7)	(43.7)	(46.5)	(46.7)
Net rental income	**73.6**	**70.6**	**86.3**	**96.5**	**110.1**	**126.6**	**137.4**	**146.4**
Of which, PRS	53.8	51.9	70.8	82.2	97.6	117.1	128.8	138.5
Change (%)		*-3.5%*	*36.4%*	*16.1%*	*18.7%*	*20.0%*	*10.0%*	*7.5%*
Net to gross (%)	*54.2%*	*53.3%*	*58.3%*	*61.5%*	*63.0%*	*68.8%*	*70.1%*	*71.7%*
Of which, Reversionary	19.6	18.4	15.2	13.4	11.5	9.5	8.5	7.9
Other	0.2	0.3	0.3	0.9	1.0	-	-	-
Profit on disposal of development properties	61.3	67.8	63.6	54.8	49.4	45.0	40.0	35.0
Profit on disposal of investment properties	2.3	1.5	1.7	3.3	(5.8)	(5.0)	-	-
Administrative expenses	(28.7)	(30.2)	(31.8)	(33.5)	(35.3)	(36.7)	(37.4)	(38.2)
Other[1]	(1.8)	4.1	2.4	7.3	0.7	8.5	7.0	7.0
Operating profit, group only	**106.7**	**113.8**	**122.2**	**128.4**	**119.1**	**138.4**	**146.9**	**150.2**
Share in net income of associates, JVs	(1.5)	0.5	(0.5)	(0.4)	(0.6)	-	-	-
Net valuation gains/(losses)	28.4	73.0	210.2	(68.8)	(39.1)	-	-	-
Net finance costs	(34.5)	(35.2)	(33.3)	(31.8)	(38.8)	(44.0)	(46.0)	(48.0)
PBT, reported	**99.1**	**152.1**	**298.6**	**27.4**	**40.6**	**94.4**	**100.9**	**102.2**
Add back net valuation gains/(losses)	(28.4)	(73.0)	(210.2)	68.8	39.1	-	-	-
Additional adjustments	11.1	4.4	5.1	1.4	11.9	-	-	-
Adjusted earnings	**81.8**	**83.5**	**93.5**	**97.6**	**91.6**	**94.4**	**100.9**	**102.2**
EPRA adjustments [2]	(63.6)	(69.3)	(65.3)	(58.1)	(43.6)	(40.0)	(40.0)	(35.0)
EPRA earnings	**18.2**	**14.2**	**28.2**	**39.5**	**48.0**	**54.4**	**60.9**	**67.2**
EPRA EPS, diluted, post-tax[3] (p)	**2.8**	**2.1**	**3.8**	**5.3**	**6.5**	**7.3**	**8.2**	**9.1**

Source: Company data, Progressive Equity Research estimates [1] Includes LADs; [2] Mainly disposal profits [3] For comparison with other REITs.

Figure 6: P&L and per share data

YE March (£m)	2020	2021	2022	2023	2024	2025E	2026E	2027E
Group revenue	214.0	248.9	279.2	267.1	290.1	296.6	302.7	306.2
Net rental income	**73.6**	**70.6**	**86.3**	**96.5**	**110.1**	**126.6**	**137.4**	**146.4**
Operating and other expenses	33.1	43.2	35.9	31.9	9.0	11.8	9.6	3.8
Group operating profit	**106.7**	**113.8**	**122.2**	**128.4**	**119.1**	**138.4**	**146.9**	**150.2**
Share in net income of associates	(1.5)	0.5	(0.5)	(0.4)	(0.6)	-	-	-
Valuation movements etc	28.4	73.0	210.2	(68.8)	(39.1)	-	-	-
Net interest	(34.5)	(35.2)	(33.3)	(31.8)	(38.8)	(44.0)	(46.0)	(48.0)
PBT, reported	**99.1**	**152.1**	**298.6**	**27.4**	**40.6**	**94.4**	**100.9**	**102.2**
Underlying tax rate (%)	*62.5*	*163.8*	*225.4*	*4.5*	*19.6*	*18.5*	*2.0*	*2.0*
Reported tax	(16.3)	(42.6)	(69.2)	(1.8)	(9.4)	(10.1)	(1.2)	(1.3)
Net attrib. profit	**82.8**	**109.5**	**229.4**	**25.6**	**31.2**	**84.3**	**99.7**	**100.9**
EPRA earnings	**18.2**	**14.2**	**28.2**	**39.5**	**48.0**	**54.4**	**60.9**	**67.2**
EBITDA	**52.6**	**48.7**	**61.6**	**71.2**	**83.1**	**91.9**	**106.9**	**113.7**
Margin, on gross rental income (%)	*53.0%*	*50.0%*	*50.7%*	*53.3%*	*53.7%*	*54.0%*	*58.1%*	*58.9%*
Period end shares (million)	675.3	742.8	742.9	743.0	743.1	743.1	743.1	743.1
Wtd. ave. shares (million)	649.1	677.7	740.5	739.9	738.2	738.2	738.2	738.2
Diluted shares (million)	651.7	680.4	743.1	742.4	741.5	741.5	741.5	741.5
IFRS EPS, basic (p)	12.8	16.2	31.0	3.5	4.2	11.4	13.5	13.7
EPS, EPRA, pre-tax, diluted (p)	**2.8**	**2.1**	**3.8**	**5.3**	**6.5**	**7.3**	**8.2**	**9.1**
DPS - declared (p)	**5.5**	**5.2**	**6.0**	**6.7**	**7.6**	**8.5**	**9.1**	**9.8**
Dividend cover, EPRA (x)	0.51	0.40	0.63	0.80	0.86	0.86	0.90	0.92
NAV (p)	213.7	234.1	264.7	259.6	254.8	258.3	263.1	267.3
EPRA NAV (p)	**326.8**	**297.2**	**317.5**	**305.2**	**298.5**	**305.4**	**310.2**	**314.4**
FCFPS (p)	(10.7)	(24.3)	(21.7)	(7.1)	(4.0)	3.6	9.2	8.7

Source: Company information and Progressive Equity Research estimates

Figure 7: Adjusted cash flow and summary balance sheet

YE September (£m)	2020	2021	2022	2023	2024	2025E	2026E	2027E
Adjusted cash flow statement								
Group operating profit	106.7	113.8	122.2	128.4	119.1	138.4	146.9	150.2
Depreciation	1.2	1.2	0.9	1.1	1.5	1.5	1.5	1.5
Intangible amortisation	-	-	-	0.1	-	-	-	-
Other, non-cash	(6.4)	(7.0)	(6.0)	28.4	(24.0)	-	-	-
Changes in working capital	42.9	103.1	39.8	71.2	105.1	110.4	115.9	121.7
Operating cash flow	**144.4**	**211.1**	**156.9**	**229.2**	**201.7**	**250.3**	**264.3**	**273.3**
Dividends from associates	-	-	-	0.8	0.5	0.5	0.5	0.5
Capex, net	(151.1)	(313.5)	(263.4)	(237.9)	(166.8)	(170.0)	(150.0)	(160.0)
Net interest	(37.4)	(45.6)	(42.0)	(47.2)	(52.6)	(44.0)	(46.0)	(48.0)
Tax	(25.4)	(16.9)	(12.3)	2.7	(12.5)	(10.1)	(1.2)	(1.3)
Free cashflow	**(69.5)**	**(164.9)**	**(160.8)**	**(52.4)**	**(29.7)**	**26.7**	**67.6**	**64.5**
JV investments	(10.2)	(2.4)	(10.8)	(37.0)	(1.4)	-	-	-
Dividends - paid	(33.5)	(36.8)	(40.0)	(45.7)	(51.0)	(58.3)	(64.7)	(69.6)
Share (purchase)/proceeds	182.4	203.8	(3.3)	-	-		-	-
Other financing	110.6	(51.2)	(6.8)	160.2	54.3	-	-	-
Change in net cash/(debt)	**179.8**	**(51.5)**	**(221.7)**	**25.1**	**(27.8)**	**(31.6)**	**2.9**	**(5.1)**
Summary balance sheet								
Intangible fixed assets	0.8	0.5	0.5	1.0	1.8	1.8	1.8	1.8
Property, tangible fixed assets	1,854.2	2,252.3	2,849.2	3,024.5	3,064.8	3,233.3	3,381.8	3,540.4
Investments, other TA	50.9	52.1	66.2	104.3	103.9	103.4	102.9	102.4
Working capital	615.4	523.9	388.4	305.5	339.9	229.5	113.7	(8.0)
Provisions, others	(55.5)	(59.9)	(75.8)	(94.2)	(117.0)	(117.0)	(117.0)	(117.0)
Retirement benefit liabilities	-	-	-	-	-	-	-	-
Net cash/(debt)	(1,022.8)	(1,029.9)	(1,261.7)	(1,412.5)	(1,499.7)	(1,531.3)	(1,528.4)	(1,533.5)
Net assets (IFRS)	**1,443.0**	**1,739.0**	**1,966.8**	**1,928.6**	**1,893.7**	**1,919.8**	**1,954.8**	**1,986.1**
IFRS NTA	1,964.8	1,965.8	1,966.8	1,928.6	1,893.7	1,919.8	1,954.8	1,986.1
Adjustments	242.0	242.0	392.2	338.9	324.4	350.0	350.0	350.0
EPRA NTA	**2,206.8**	**2,207.8**	**2,359.0**	**2,267.5**	**2,218.1**	**2,269.8**	**2,304.8**	**2,336.1**

Source: Company information and Progressive Equity Research estimates

REIT conversion aimed to further boost returns

REIT structure should boost dividends and returns

Grainger remains on track to convert to a REIT structure in October 2025, with FY26E to be the first year. This will have no impact on the business or strategy, and the key P&L metric will become EPRA earnings, in line with commercial REIT peers.

The move will enhance returns, with a tax saving of 25% on *BTR profits* post-conversion, which Grainger estimates will enhance total returns by 50bps. There will be a dividend change in FY26E, with a minimum payout of 80% of EPRA earnings. The group's expectation is that dividends will be fully covered by EPRA earnings within around two years of conversion, with a top-up from regulated tenancy sales in the interim.

Valuation discussion

Focus on long-term rental support, we see Grainger as a potentially attractive income investment. A similar profile to buy-to-let investments – without the hassle?

For some years before Grainger's PRS strategy was fully established, there was much debate among investment professionals as to how the share price would relate to the published net asset value (reflecting the valuation of reversionary properties at cost) and to what degree it would reflect current market levels and future capital growth – the 'reversionary surplus'.

In our view, the current growth-orientated strategy and move to REIT structure make the stock more of an income growth play, with additional taxation attractions – with those earnings being *asset-backed* (as opposed to the shares being an asset play *per se*).

Grainger points out that one of its main financial targets is total returns, and indicates that – without any changes in property yields – it aims for around 8% pa. This would be driven both by rental growth directly and by the implied increase in capital values resulting from the increase in underlying rents.

Our estimates – conservative, in our view – result in CAGR of 11.9% in EPRA EPS for FY24-27E and 9.1% in dividends. For FY27E, this equates to a dividend yield of 4.5%, with good prospects of long-term dividend growth beyond the forecast period.

As we have argued, we view Grainger as a proxy for the undersupplied rental market – with the income characteristics but without the costs and hassle of being an institutional, let alone buy-to-let, landlord.

Financial Summary: Grainger

Year end: September (£m unless shown)

PROFIT & LOSS	**2023**	**2024**	**2025E**	**2026E**	**2027E**
Net rental income	96.5	110.1	126.6	137.4	146.4
Revenue	267.1	290.1	296.6	302.7	306.2
Adj EBITDA	71.2	83.1	91.9	106.9	113.7
Reported PBT	27.4	40.6	94.4	100.9	102.2
EPRA earnings before tax	39.5	48.0	54.4	60.9	67.2
NOPAT	122.5	95.8	112.8	144.0	147.2
Reported EPS (p)	3.5	4.2	11.4	13.5	13.7
EPRA EPS, before tax* (p)	5.3	6.5	7.3	8.2	9.1
Dividend per share (p)	6.7	7.6	8.5	9.1	9.8
CASH FLOW & BALANCE SHEET	**2023**	**2024**	**2025E**	**2026E**	**2027E**
Operating cash flow	229.2	201.7	250.3	264.3	273.3
Free Cash flow	(52.4)	(29.7)	26.7	67.6	64.5
FCF per share (p)	(7.1)	(4.0)	3.6	9.2	8.7
Acquisitions	(37.0)	(1.4)	0.0	0.0	0.0
Disposals	N/A	N/A	N/A	N/A	N/A
Shares issued					
Net cash flow	25.1	(27.8)	(31.6)	2.9	(5.1)
Overdrafts / borrowings	1,533.5	235.6	238.2	240.6	241.9
Cash & equivalents	121.0	93.2	95.3	97.2	98.4
Net (Debt)/Cash, pre-IFRS 16	(1,412.5)	(1,499.7)	(1,531.3)	(1,528.4)	(1,533.5)
NAV AND RETURNS	**2023**	**2024**	**2025E**	**2026E**	**2027E**
Net asset value	1,928.6	1,893.7	1,919.8	1,954.8	1,986.1
NAV/share (p)	259.6	254.8	258.3	263.1	267.3
EPRA NTAV	2,359.0	2,267.5	2,218.1	2,269.8	2,304.8
NTAV/share (p)	317.5	305.2	298.5	305.4	310.2
Average equity	1,947.7	1,911.2	1,906.7	1,937.3	1,970.4
Post-tax ROE (%)	1.6%	4.4%	5.2%	5.2%	0.0%
METRICS	**2023**	**2024**	**2025E**	**2026E**	**2027E**
Net rental income growth	11.8%	14.1%	15.0%	8.5%	6.6%
Adj EBITDA growth	15.6%	16.7%	10.6%	16.3%	6.4%
Adjusted earnings growth	4.4%	(6.1%)	3.1%	6.9%	1.3%
EPRA earnings growth	40.1%	21.5%	13.3%	12.0%	10.3%
EPRA EPS growth	40.2%	21.7%	13.3%	12.0%	10.3%
Dividend growth	10.8%	13.5%	12.5%	7.5%	7.5%
EBITDA margin	53.3%	53.7%	54.0%	58.1%	58.9%
VALUATION	**2023**	**2024**	**2025E**	**2026E**	**2027E**
EV/Sales (x)	11.7	10.8	10.6	10.4	10.2
EV/EBITDA (x)	44.0	37.7	34.1	29.3	27.6
EV/NOPAT (x)	25.6	32.7	27.8	21.8	21.3
PER (x)	41.4	34.1	30.1	26.8	24.3
Dividend yield	3.0%	3.4%	3.9%	4.1%	4.5%
FCF yield	(3.2%)	(1.8%)	1.6%	4.2%	4.0%

*Source: Company information and Progressive Equity Research estimates. *REIT basis*

Progressive EQUITY RESEARCH

20 January 2025

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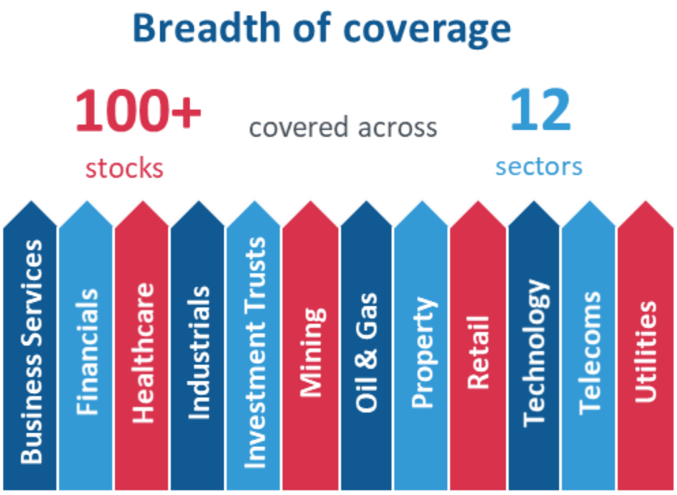

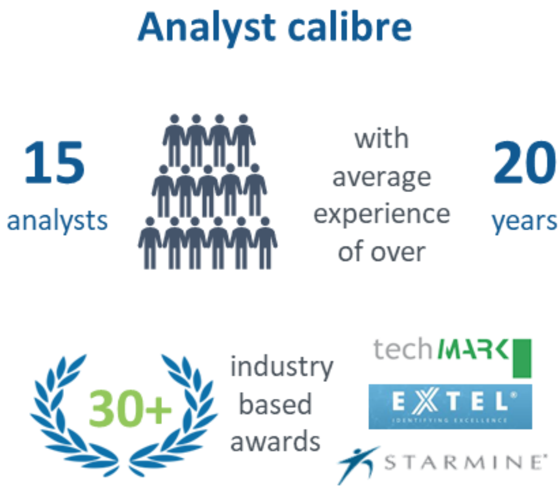

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