

Equity valuation of GE Capital Real Estate

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ABSTRACT

This is a case study designed for a classroom exercise. The purpose of the case is to demonstrate the method of comparables approach in equity valuation. Students will follow a series of steps to estimate the equity value of GE Capital Real Estate, which was liquidated in a series of transactions in 2015 and 2016. For this, they will use six comparable firms in the real estate industry. In addition, they will also arrive at an equity value using an alternate approach that is simpler and will serve as a check of robustness of the prior estimate.

Keywords: GE, Real estate, Method of Comparables, Equity valuation, Case study



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INTRODUCTION

In the first half of 2015, GE announced a strategic shift. They had decided to significantly shrink the size of one of their divisions, GE Capital. GE Capital has had its own separate divisions, primarily in the form of consumer loans, real estate, commercial lending, and mortgages. The plan, titled the GE Capital Exit Plan, was announced on April 10, 2015, and was detailed in GE's 10-Q filing for March 31, 2015¹. It involved disposing off several assets, one of which was their real estate division.

In their 2015 Letter to Shareholders, GE announced reported agreements to sell \$34 Billion of their Real Estate portfolio², which involved most of that division's assets. This resulted in an after-tax net loss of \$2 billion from the disposal of their real estate holdings in 2015³. The real estate business had revenues of \$2.969 billion and earnings of \$1.003 billion in 2014⁴. The goal of this exercise is to arrive at a valuation of GE Capital Real Estate's equity at the end of 2014 (just before the disinvestment was announced) using a group of publicly-traded real estate corporations as comparables.

GE Capital Real Estate, headquartered in Stamford, CT, was a commercial real estate entity operating under the umbrella of GE Capital from the 1970s. Among other services, it provided financing and servicing solutions for commercial properties such as office buildings, shopping centers, hotels; and residential properties such as rental apartments. It had operations globally and was a significant component of GE Capital, accounting for 13% of the latter's 2014 profits⁵.

COMPARABLES

The following are firms in the real estate industry that are to be used as comparables for the analysis. The short description of each firm was obtained from their respective websites listed in the References section.

Brookfield Property Partners (NYSE: BPY)

“Brookfield Property Partners is a diversified global real estate company that owns, operates and develops one of the largest portfolios of office, retail, multifamily, industrial, hospitality, triple net lease and self-storage assets. Brookfield Property Partners' portfolio features some of the world's best-known commercial properties. It is headquartered in Hamilton, Bermuda.”

Source: Brookfield Property Partners Overview

¹ *General Electric Co.* (Form 10-Q). (2015, May 4)

² Form 10-K section of *GE 2015 annual report*, page 32

³ *Ibid.*, page 68

⁴ *Ibid.*, page 150

⁵ Page 10 of *GE 2014 Form 10-K*

Cousins Properties Incorporated (NYSE: CUZ)

“Cousins Properties Incorporated is a fully integrated, self-administered and self-managed real estate investment trust (REIT) based in Atlanta, Georgia. When it comes to strategy, Cousins keeps it simple: assemble a portfolio of trophy assets in high-growth Sun Belt markets, capture value embedded in operating portfolio and execute attractive investment opportunities, all while maintaining a conservative balance sheet.”

Source: About us | Cousins Properties

Sun Communities, Incorporated (NYSE: SUI)

“Sun Communities, Inc. is a fully integrated real estate investment trust, which together with its affiliates and predecessors, has been in the business of acquiring, operating, developing and expanding manufactured home and RV communities since 1975. Our trusted position in the market, our prime locations throughout the United States and Canada, and our outstanding organizational management make Sun Communities the best choice in active living. Sun Communities is headquartered in Southfield, MI.”

Source: About us | Sun Communities, Inc.

Vornado Realty Trust (NYSE: VNO)

“Vornado Realty Trust is a preeminent owner, manager and developer of office and retail assets. Vornado’s portfolio is concentrated in the nation’s key market — New York City — along with the premier asset in both Chicago and San Francisco. Vornado is also the real estate industry leader in sustainability policy. It is headquartered in New York City, NY.”

Source: About us | Vornado Realty Trust

Washington REIT (NYSE: WRE)

“Washington REIT is a value-creation focused owner and operator of high-quality Office, Retail and Multifamily assets in the Washington Metro Area. We have over five decades of operating history exclusively in the Washington, DC area and pride ourselves on being a local sharp-shooter in one of our nation’s key gateway markets. Washington REIT is headquartered in Washington, D.C.”

Source: About us | Washington REIT

W.P. Carey Incorporated (NYSE: WPC)

“W. P. Carey Inc. (NYSE: WPC) is a leading, internally-managed net-lease REIT that provides real estate-based financing solutions for companies primarily in the U.S. and Europe. In addition to its owned portfolio of diversified global real estate, W. P. Carey manages a series of non-traded publicly-registered and private investment programs with assets under management of approximately \$13.0 billion. W. P. Carey is headquartered in New York City, NY.”

Source: Our firm | W. P. Carey Inc.

DATA

Data for the six firms listed above are provided in the Appendix. Table 1 shows the stock price and number of shares outstanding on December 31, 2014. Tables 2, 3, and 4 provide condensed versions of the income statements, balance sheets, and statements of cash flows for the 12 months ending on December 31, 2014. All financial data were obtained from Yahoo! Finance⁶, except for the number of shares outstanding, which was obtained from Google Finance⁷ for Brookfield Property Partners, and from Bloomberg Professional database for the remaining firms.

DISCUSSION

Please answer the following questions⁸ by referring to the financial statements when appropriate:

1. At the end of day on Dec 31, 2014, GE (i.e. the parent company) had a closing stock price of \$25.27 and 10,057,380,000 shares outstanding. Why can't this and other publicly available information be used to accurately estimate the market value of GE Capital Real Estate's equity directly?
2. This case study uses relative valuation. An alternative method to estimate equity value is to use the discounted cash flow approach with expected cash flows for the firm's equity holders. What is the difficulty in employing the discounted cash flow approach in this context for GE Capital Real Estate?
3. The first step in relative valuation involves identifying a group of comparable firms that are in the same industry as the firm that is being valued and have similar characteristics. Discuss whether the six real estate firms listed above are reasonable comparables for GE Capital Real Estate. You may want to look up these companies for more details.
4. The second step in relative valuation requires a valuation metric, or a multiple. The most commonly used multiple in equity valuation is the P/E ratio, defined as the ratio of the stock price to the earnings per share for the most recent four quarters. Discuss some of the advantages and disadvantages of using the P/E ratio. What are other alternatives?
5. Calculate the P/E ratio for each of the six comparable firms. Then find the average. This will give us the multiple for GE Capital Real Estate.
6. The third step in relative valuation is an initial estimate of GE Capital Real Estate's equity value. Use the multiple from step 5 and GE Capital Real Estate's 2014 earnings (provided in the Introduction section) to find the estimate.
7. The final step involves refining the initial estimate. Discuss the appropriateness of including all six of these firms as comparables based on their:
 - a. Size (Assets & Sales)
 - b. Geographic distribution of assets
 - c. Components of ROE – Profit Margin, Asset Turnover, Assets/Equity ratio

⁶ Source: <https://finance.yahoo.com>

⁷ Source: <https://www.google.com/finance>

⁸ Note to instructors: Please contact the author for solutions to the numerical questions at sacharya@murraystate.edu

8. One simple approach to refine the initial estimate is to omit firm(s) whose P/E ratios are wildly different from the rest of the group. Furthermore, Brookfield Property Partners is incorporated outside the United States and is therefore not subject to the same SEC filing requirements as the other firms. As a result, their financial statements may not be strictly comparable with the rest of the firms that are incorporated in the United States (see page 6 of Brookfield Property Partners' 2014 Annual report for additional details). Eliminate this and any other firm(s) whose P/E ratio is significantly different than the others and repeat steps 5 & 6. This is the final estimate.
9. According to GE's 10-K report for the year ending on Dec 31, 2015, they closed most of their real estate business for about \$32 Billion. In addition, they sold their remaining real estate assets in 2016 but they didn't disclose the proceeds from those sales in their next 10-K report. Let's attempt to arrive at a rough estimate of the value of those assets that were sold in 2016. From the operations that were discontinued in 2015, they could generate \$2.969 billion in revenues in the prior year. These assets were sold for \$32 billion. From the operations that were discontinued in 2016, they could generate \$0.911 billion in revenues⁹. What would be your estimate for the value of those latter assets? Assume that the ratio of revenues to market value of assets (i.e. the asset turnover) is the same.
10. The procedure in the previous step provides us with an estimate of the market value of GE Capital Real Estate's assets (by including both the 2015 and 2016 values). Next, you need to arrive at an estimate of their liabilities. GE did not provide the value of liabilities for its real estate division separately. They did provide book values of assets and liabilities for all their discontinued operations, which included their real estate business. For 2015, the assets of all discontinued operations were listed as \$120.951 billion while the liabilities of all discontinued operations were listed as \$46.487 billion¹⁰. Make two assumptions here: (i) the same ratio of liabilities to assets remains valid for the real estate component; and (ii) while these are book values, the same ratio holds true for market values as well. Using these assumptions, what would your estimate for GE Capital Real Estate's liabilities be?
11. Use the two steps above to arrive at an alternate estimate of the market value of GE Capital Real Estate's equity. How does this compare to your earlier estimate from step 8 using comparables?

REFERENCES

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⁹ Form 10-K section of *GE 2015 annual report*, page 150

¹⁰ *Ibid.*, page 149

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Our firm | W. P. Carey Inc. (n.d.). Retrieved July 28, 2017, from <http://www.wpcarey.com/Our-Firm/About-WPC>



APPENDIX

Table – 1: Stock Data for December 31, 2014

	BPY	CUZ	SUI	VNO	WRE	WPC
<i>Stock Price</i>	\$22.87	\$11.42	\$60.46	\$86.12	\$27.66	\$70.10
<i>Total Common Shares Outstanding (Millions)</i>	254.08	216.51	48.57	187.89	67.82	104.04

Table – 2: Income Statements for the year ending December 31, 2014

<i>(all values in millions of \$)</i>	BPY	CUZ	SUI	VNO	WRE	WPC
<i>Total Revenue</i>	4,473.00	177.56	469.80	2,312.51	288.64	908.45
<i>Cost of Revenue</i>		76.96	189.14	953.61	103.70	192.80
<i>Gross Profit</i>	4,473.00	100.60	280.66	1,358.90	184.94	715.65
<i>Operating Expenses</i>						
<i>Selling General and Administrative</i>	833.00	23.51	73.47	169.27	19.07	149.92
<i>Non Recurring</i>		4.78	0.84	18.44	5.71	57.53
<i>Others</i>	148.00	62.26	133.73	481.30	96.01	237.12
<i>Operating Income or Loss</i>	1,732.00	10.05	72.63	689.89	64.15	271.07
<i>Income from Continuing Operations</i>						
<i>Total Other Income/Expenses Net</i>	3,756.00	12.54	37.77	215.35	0.83	-14.23
<i>Earnings Before Interest and Taxes</i>	6,854.00	22.58	109.20	845.39	64.97	406.90
<i>Interest Expense</i>	1,258.00	20.98	76.98	412.76	59.79	178.12
<i>Income Before Tax</i>	5,596.00	1.60	32.22	432.63	5.19	228.78
<i>Income Tax Expense</i>	1,176.00	-0.02	0.22	9.28	0.12	17.61
<i>Minority Interest</i>	21,708.00	58.68	29.69	743.96	2.67	139.85
<i>Net Income From Continuing Ops</i>	5,786.00	12.89	28.51	423.35	5.07	211.17
<i>Non-recurring Events</i>						
<i>Discontinued Operations</i>		40.12		585.68	106.53	34.90
<i>Net Income</i>	4,420.00	52.00	28.51	864.85	111.64	239.83

Table – 3: Balance Sheets as of December 31, 2014

(all values in millions of \$)	BPY	CUZ	SUI	VNO	WRE	WPC
Current Assets						
<i>Cash & Cash Equiv.</i>	1,282.00	5.04	83.46	1,374.68	26.13	448.09
<i>Net Receivables</i>	4,060.00	68.67	174.86	897.27	59.75	557.27
<i>Inventory</i>			8.86			
Total Current Assets	5,342.00	73.71	267.18	2,271.95	85.87	1,005.36
<i>Long Term Investments</i>	10,356.00	100.50		1,960.79		816.23
<i>Property Plant and Equipment</i>	43,619.00	2,294.95	2,568.16	13,660.73	1,906.75	4,833.07
<i>Goodwill</i>						692.42
<i>Intangible Assets</i>		163.24		225.16		993.82
<i>Other Assets</i>	4,017.00	34.93	102.35	2,656.93	115.69	300.33
<i>Deferred Long Term Asset Charges</i>				382.43		
Total Assets	65,575.00	2,667.33	2,937.69	21,157.98	2,108.32	8,648.48
Current Liabilities						
<i>Accounts Payable</i>	1,753.00	76.24	35.08	447.75	54.32	393.92
<i>Short/Current Long Term Debt</i>	3,127.00		123.65		71.43	3,590.20
Total Current Liabilities	4,880.00	76.24	158.73	447.75	125.75	3,984.13
<i>Long Term Debt</i>	23,879.00	792.34	1,662.53	9,530.34	1,160.34	498.35
<i>Other Liabilities</i>	5,878.00	102.01	176.27	1,876.84		175.07
<i>Deferred Long Term Liability Charges</i>	2,639.00	23.28		475.90		94.13
<i>Minority Interest</i>	21,708.00		29.69	743.96	2.67	139.85
Total Liabilities	58,984.00	993.87	2,027.23	13,074.77	1,288.76	4,891.52
Stockholders' Equity						
<i>Misc. Stocks Options Warrants</i>			32.33	1,337.78		6.07
<i>Common Stock</i>		220.08	0.49	7.49	0.68	0.10
<i>Retained Earnings</i>		-180.76	-863.55	-1,505.39	-365.52	-497.73
<i>Treasury Stock</i>		-86.84				
<i>Capital Surplus</i>		1,720.97	1,741.15	6,873.03	1,184.40	4,293.45
<i>Other Stockholder Equity</i>				93.27		-44.94
Total Stockholder Equity	6,591.00	1,673.46	878.13	6,745.43	819.56	3,750.89
<i>Net Tangible Assets</i>		1,510.21	878.13	6,520.27	819.56	2,064.66

Table – 4: Statements of Cash Flows for the year ending December 31, 2014

<i>(all values in millions of \$)</i>	BPY	CUZ	SUI	VNO	WRE	WPC
<i>Net Income</i>	4,420.00	52.00	28.51	864.85	111.64	239.83
<i>Operating Activities, Cash Flows</i>						
<i>Depreciation</i>	148.00	141.63	132.06	536.62	99.60	247.76
<i>Adjustments To Net Income</i>	-3,423.00	-60.61	-15.89	-314.20	-100.16	-92.94
<i>Changes In Accounts Receivables</i>		-0.64	-15.30	-8.28		-23.71
<i>Changes In Liabilities</i>		9.02	10.40	47.75	-4.62	15.72
<i>Changes In Inventories</i>			-11.14			
<i>Changes In Other Operating Activities</i>	-662.00			-135.61	-23.31	6.19
<i>Total Cash Flow From Operating Activities</i>	483.00	142.40	133.32	1,135.31	83.12	399.09
<i>Investing Activities, Cash Flows</i>						
<i>Capital Expenditures</i>	-5,221.00	-710.74	-604.46	-1,034.75	-237.80	-942.83
<i>Investments</i>	-1,986.00	23.00	-10.69	71.51	-60.95	22.24
<i>Other Cash flows from Investing Activities</i>	2,377.00	226.13	64.44	388.78	190.86	280.36
<i>Total Cash Flows From Investing Activities</i>	-5,000.00	-461.62	-550.71	-574.47	-107.88	-640.23
<i>Financing Activities, Cash Flows</i>						
<i>Dividends Paid</i>	-1,797.00	-67.09	-121.38	-850.19	-83.73	-368.55
<i>Sale Purchase of Stock</i>	711.00	227.07	571.18	45.73	30.70	284.07
<i>Net Borrowings</i>	3,741.00	162.25	46.29	858.81	-34.30	421.98
<i>Other Cash Flows from Financing Activities</i>	1,800.00	-4.00		-225.00	-2.42	5.64
<i>Total Cash Flows From Financing Activities</i>	4,455.00	318.24	496.09	54.34	-89.75	343.14
<i>Effect Of Exchange Rate Changes</i>	-24.00		-0.07			-20.84
<i>Change In Cash and Cash Equivalents</i>	-62.00	-0.98	78.71	615.19	-114.52	81.16