

## Solid discount unjustified

### Recommendation: Buy

We issue Buy recommendation for PHN with a Target Price of PLN21.1. PHN is a Treasury-controlled commercial and residential developer. We think that the bonds issue completed in May secured PLN160mn for commercial projects which to date have not been implemented on the expected scale. For example, the Company finished the selection of the general contractor and will soon start the construction of the Skysawa office building – its flagship project. In addition, we estimate that the Company will recognize its profit from residential projects in 2019–21P. We still think that c. 75% discount to book value and 70% discount to foreign peers is unjustified considering the expected profits from development projects, leverage ratio below industry average and c. 3.7% dividend yield in 2019E.

**Investment plan.** The Company plans to start the construction of 111.9k sqm of office and hotel space in 2019 (the current resource is c. 309k sqm), with estimated capex of c. PLN1bn. The Company has already signed an agreement on the construction of its flagship project – Skysawa office building in Warsaw (targeted 40k sqm GLA). We estimate the revaluation at c. PLN244-324mn.

**Residential projects.** In 2018, the Company did not recognize a significant result on the sale of apartments due to the fact that its residential projects are still in progress. At the end of 2019, the Company plans to complete the construction of the first stage of the Vis-a-Vis Wola project, and apartments in the Yacht Park project in Gdynia. We assess the sale of apartments positively, so recognizing profits from the above-mentioned projects seems highly likely. For example, the Company sold over 90% from Vis-a-Vis Wola, and over 40% from Yacht Park. In 2019E–21E, we expect the Company to recognize a total profit from the residential segment of PLN62mn.

**Dividend.** PHN regularly pays dividend. The Company plans to maintain its dividend policy assuming pay-out of up to 40% of net profit. In 2018, the dividend amounted to PLN0.28 per share, and in 2019E it will amount to PLN0.41 (3.7% DY).

**Discount to peers.** PHN is trading at a 70% discount to foreign peers. Part of that discount may be justified, due to lower ROE generated by PHN compared to peers. However, we think that the Company deserves a lower discount due to (1) low leverage, (2) regular dividend payout, (3) revaluation potential from planned office projects.

**Risk factors.** (1) potential dilution due to planned issue of shares, (2) high sensitivity to interest rates (negative impact of interest rate increase), (3) weakening of the EUR/PLN exchange rate, (4) partly non-modern office resource.

**Valuation.** We value PHN using SOTP valuation. We value properties generating rental revenue with the discounted cash flow method. We adopt a 50% discount to the book value of properties in need of optimization. We value development projects/land at book value at a 10% discount. For assets held for sale, we assume a 25% discount to book value. Investment project implementation offers an upside potential. On the other hand, the planned issue of shares may negatively affect valuation.

### PHN: Financial summaries

PLNmn	2017	2018	2019E	2020E	2021E	2022E
Revenue	159	169	193	345	306	185
EBITDA	38	67	69	91	84	74
EBIT	37	65	68	90	83	72
Net profit	31	48	38	56	49	37
P/E (x)	23.7	11.9	13.7	9.3	10.7	14.3
P/BV (x)	0.38	0.29	0.26	0.25	0.25	0.25
DY	1.6%	2.2%	3.7%	2.8%	4.1%	3.6%

Source: Company data, Santander Brokerage Poland, 2017-2018 multiples calculated on historical share price average

PHN	Buy
Price (PLN, June 24, 2019)	11.2
Target price (PLN, 12M)	21.1
Market cap. (PLNmn)	520
Free float (%)	30.3
Number of shares (PLNmn)	46.8
Average daily turnover 3M	0.1

### Analyst

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**Fig. 1. PHN: SOTP valuation summary**

PLNmn	Book value (PLNmn)	NOI (PLNmn)	Yield/ Applied discount	Implied value (PLNmn)
Rent generating properties	1275	91.6	10%	916
Properties for optimization	233		50%	117
Developments/land	909		10%	818
Properties for sale	124		25%	93
<b>Total:</b>	<b>1944</b>			<b>1944</b>
Debt (as at 1Q19)	792			792
Cash (as at 1Q19)	101			101
Reserves and other (as at 1Q19)	238			238
<b>Implied value (PLNmn)</b>				<b>1015</b>
<b>Implied value per share (PLN)</b>				<b>21.1</b>

Source: Company data, Santander Brokerage Poland

**Fig. 2. PHN: Comparable valuation summary**

Comparable valuation	P/BV	Book value of PHN per share as at 1Q19 (PLN)	Implied valuation of PHN per share (PLN)
Median for WSE-listed real estate companies	0.68		<b>29.5</b>
Median for foreign real estate companies	0.86	43.4	<b>37.3</b>
Median for WSE-listed residential developers	0.76		<b>33.0</b>
<b>Average:</b>			<b>33.3</b>

Source: Company data, Santander Brokerage Poland

**Fig. 3. PHN: Income statement forecasts**

PLNmn	2016	2017	2018	2019E	2020E	2021E	2022E
<b>Net sales</b>	<b>175</b>	<b>159</b>	<b>169</b>	<b>193</b>	<b>345</b>	<b>306</b>	<b>185</b>
COGS	-96	-76	-83	-95	-221	-190	-79
<b>Gross profit</b>	<b>79</b>	<b>83</b>	<b>86</b>	<b>98</b>	<b>124</b>	<b>117</b>	<b>106</b>
SG&A	31	31	32	34	34	34	34
Other operating income, net	-3	-15	12	4	0	0	0
<b>EBITDA</b>	<b>46</b>	<b>38</b>	<b>67</b>	<b>69</b>	<b>91</b>	<b>84</b>	<b>74</b>
<b>Operating profit</b>	<b>45</b>	<b>37</b>	<b>65</b>	<b>68</b>	<b>90</b>	<b>83</b>	<b>72</b>
Net financial income (costs) and other	-15	-9	-7	-21	-20	-22	-27
<b>Profit before tax</b>	<b>30</b>	<b>28</b>	<b>58</b>	<b>47</b>	<b>69</b>	<b>61</b>	<b>45</b>
Income tax	0	-2	-11	-9	-13	-12	-9
<b>Net profit</b>	<b>31</b>	<b>31</b>	<b>48</b>	<b>38</b>	<b>56</b>	<b>49</b>	<b>37</b>

Source: Company data, Santander Brokerage Poland

**Fig. 4. PHN: Balance sheet forecasts**

PLNmn	2016	2017	2018	2019E	2020E	2021E	2022E
<b>Current assets</b>	<b>216</b>	<b>238</b>	<b>286</b>	<b>300</b>	<b>221</b>	<b>198</b>	<b>171</b>
cash	76	104	114	129	49	27	10
<b>Fixed assets</b>	<b>2465</b>	<b>2405</b>	<b>2497</b>	<b>2502</b>	<b>2676</b>	<b>2779</b>	<b>2978</b>
<b>Total assets</b>	<b>2681</b>	<b>2643</b>	<b>2783</b>	<b>2802</b>	<b>2896</b>	<b>2978</b>	<b>3149</b>
<b>Current liabilities</b>	<b>104</b>	<b>100</b>	<b>315</b>	<b>315</b>	<b>315</b>	<b>315</b>	<b>315</b>
bank debt	536	486	379	379	429	479	629
<b>Long-term liabilities</b>	<b>583</b>	<b>530</b>	<b>420</b>	<b>420</b>	<b>470</b>	<b>520</b>	<b>670</b>
bank debt	25	20	150	150	150	150	150
<b>Equity</b>	<b>1994</b>	<b>2013</b>	<b>2048</b>	<b>2067</b>	<b>2111</b>	<b>2143</b>	<b>2164</b>
<b>Total liabilities</b>	<b>2681</b>	<b>2643</b>	<b>2783</b>	<b>2802</b>	<b>2896</b>	<b>2978</b>	<b>3149</b>

Source: Company data, Santander Brokerage Poland

**Fig. 5. PHN: Cash flow statement forecasts**

<b>PLNmn</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019E</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>
<b>CF from operations</b>	<b>32</b>	<b>70</b>	<b>83</b>	<b>59</b>	<b>78</b>	<b>73</b>	<b>65</b>
<b>CF from investment</b>	<b>-281</b>	<b>10</b>	<b>-57</b>	<b>-5</b>	<b>-175</b>	<b>-105</b>	<b>-200</b>
<b>CF from financing</b>	<b>199</b>	<b>-52</b>	<b>-16</b>	<b>-40</b>	<b>18</b>	<b>10</b>	<b>107</b>
dividends	-20	-12	-13	-19	-15	-21	-19
<b>Net change in cash</b>	<b>-50</b>	<b>28</b>	<b>10</b>	<b>14</b>	<b>-80</b>	<b>-22</b>	<b>-27</b>

Source: Company data, Santander Brokerage Poland

**Rys. 6. PHN: Margins**

<b>PLNmn</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019E</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>
Gross margin	45%	52%	51%	51%	36%	38%	58%
EBITDA margin	26%	24%	39%	36%	26%	27%	40%
EBIT margin	26%	23%	39%	35%	26%	27%	39%
Net margin	18%	20%	28%	20%	16%	16%	20%
Rental gross margin	50%	54%	53%	56%	55%	55%	58%
Housing gross margin	-	-	-	18%	18%	18%	-

Source: Company data, Santander Brokerage Poland

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EBIT - earnings before interest and tax

EBITDA - earnings before interest, taxes, depreciation, and amortization

P/E - price-earnings ratio

EV - enterprise value (market capitalisation plus net debt)

PEG - P/E to growth ratio

EPS - earnings per share

CPI - consumer price index

WACC - weighted average cost of capital

CAGR - cumulative average annual growth

P/CE - price to cash earnings (net profit plus depreciation and amortisation) ratio

NOPAT - net operational profit after taxation

FCF - free cash flows

BV - book value

ROE - return on equity

P/BV - price-book value

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**SOTP valuation** - different assets of a company are being valued according to different valuation methods, and the sum of these valuations represents the final valuation of the company. SOTP valuation advantages / disadvantages are identical to advantages and disadvantages of the specific valuation methods used.

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