POLSKI HOLDING NIERUCHOMOSCI

Reuters: PHN.WA Bloomberg: PHN PW

CEE Equity Research

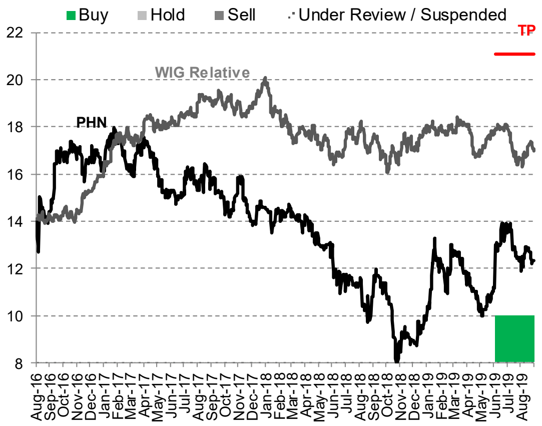
Real Estate, Poland

25 Sep 2019, 08:05 CET

Discount to NAV

PHN **Buy (maintained)**

Price (PLN, Sep 23, 2019)	11.8
Target price (PLN, 12M)	21.1
Market cap. (PLNmn)	552
Free float (%)	30.3
Number of shares (PLNmn)	46.8
Average daily turnover 3M	0.1



The chart measures performance against the WIG index.

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WSE's Analytical Coverage Support Programme

We maintain our Buy recommendation for PHN shares with a Target Price of PLN21.1. We think that the PLN160mn bonds issue gave a boost to commercial projects that had not been implemented on the expected scale to date. PHN initiated the construction of its flagship Skysawa office building (c. 40k GLA), which may lead to the first revaluation gain in 2H19E. The company has also secured a building permit for the Intraco Prime building (14k GLA), a milestone step in the development process, we think. We still believe that a c. 70% discount to book value is unjustified considering the expected 2020E earnings expansion and leverage ratio below industry average.

2Q19 results review. 2Q19 profits came in above our expectations. Surprisingly, PHN recognized a PLN5mn JV profit and a PLN7.4mn revaluation gain. On the other hand, PLN1.5mn net other operating costs, and relatively high financial costs, came in as a negative surprise.

Financial forecasts. We are raising our mid-run EBIT forecast as we include contributions from recently acquired office buildings for EUR30.8mn (located in Wialnow, deal with Polnord) and higher than expected 1H19 EBIT. We have also increased our financial costs estimate due to the debt-financed purchase of the aforementioned buildings and higher than expected financial costs in 1H19. Overall, our 2019E net profit forecast goes up by 23%, and remains unaltered in 2020E and beyond.

Residential business to boost 2020E earnings. The company plans to complete the construction of the first stage of the Vis-a-Vis Wola project and Yacht Park project in 2019E. We assess the sale volume positively (c. 100%/50% units sold respectively). We expect the company to recognize a total profit from the residential segment of PLN62mn in 2H19E-21E. We see an upside risk to our projection, due to the conservative nature of our 18% gross margin estimate.

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

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 2019 it amounted to PLN0.41.

Discount to NAV. PHN is trading at a 70% discount to its NAV. 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.

Valuation. Our Target Price remains intact. 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	199	353	315	194
Revaluation	-19	14	9	0	0	0
EBIT	37	65	80	103	96	85
Net profit	31	48	47	56	49	36
P/E (x)	23.7	11.9	12.2	10.1	11.6	15.9
P/BV (x)	0.38	0.29	0.28	0.28	0.27	0.27
DY	1.6%	2.2%	3.4%	3.1%	3.7%	3.3%

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

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Santander

Forecasts' changes

Fig. 1. PHN: Forecasts changes

PLNmn	2019E			2020E			2021E		
	New	Previous	*Change*	New	Previous	*Change*	New	Previous	*Change*
Sales	199	193	*3%*	353	345	*2%*	315	306	*3%*
EBITDA	82	68	*20%*	104	90	*16%*	97	83	*17%*
EBIT	80	69	*17%*	103	91	*13%*	96	84	*14%*
Net profit	47	38	*23%*	56	56	*1%*	49	49	*0%*

Source: Santander Brokerage Poland

SOTP valuation

Fig. 2. PHN: SOTP valuation summary

PLNmn	Book value (PLNmn)	NOI (PLNmn)	Yield/ Applied discount	Implied value (PLNmn)
Rent generating properties	1265	98	10%	980
Properties for optimization	233		50%	116
Developments/land	920		10%	828
Properties for sale	124		25%	93
Total:	2542			2018
Debt (as at 2Q19)	915			915
Cash (as at 2Q19)*	259			240
Reserves and other (as at 2Q19)	312			312
Implied value (PLNmn)				**1020**
Implied value per share (PLN)				**21.1**

Source: Company data, Santander Brokerage Poland, adjusted for dividend paid in 3Q19

Fig. 3. PHN: SOTP valuation summary

PLN	New	Previous	Change
SOTP valuation per share/Target Price	21.1	21.1	0%

Source: Santander Brokerage Poland

Comparable valuation

Fig. 4. PHN: Comparable valuation summary

Comparable valuation	P/BV	Book value of PHN per share as at 2Q19 (PLN)	Implied valuation of PHN per share (PLN)
Median for WSE-listed real estate companies	0.68		**29.9**
Median for foreign real estate companies	0.86	43.9	**37.8**
Median for WSE-listed residential developers	0.76		**33.4**
Average:			**33.7**

Source: Company data, Santander Brokerage Poland

Valuation summary

Fig. 5. PHN: Valuation changes

PLN per share	New	Previous	*Change*
SOTP valuation	**21.1**	21.1	*0%*
Comparable valuation	**33.7**	33.3	*1%*
Weighted valuation*	**21.1**	21.1	*0%*

*Source: Santander Brokerage Poland, * 100% SOTP*

Financials in details

Fig. 6. PHN: Income statement forecasts

PLNmn	2017	2018	2019E	2020E	2021E
Net sales	159	169	199	353	315
COGS	-76	-83	-93	-217	-185
Gross profit	83	86	106	137	130
SG&A	31	32	35	34	34
Other operating income, net	-15	12	10	0	0
EBITDA	38	67	82	104	97
Operating profit	37	65	80	103	96
Net financial income (costs)	-9	-7	-23	-33	-35
Profit before tax	28	58	57	69	61
Income tax	-2	-11	-10	-13	-12
Net profit	31	48	47	56	49

Source: Company data, Santander Brokerage Poland

Fig. 7. PHN: Balance sheet forecasts

PLNmn	2017	2018	2019E	2020E	2021E
Current assets	238	286	245	310	284
Fixed assets	2405	2497	2667	2840	2944
Total assets	2643	2783	2911	3149	3227
Current liabilities	100	315	415	565	565
bank debt	486	379	379	429	479
Long-term liabilities	530	420	420	470	520
bank debt	20	150	250	400	400
Equity	2013	2048	2076	2114	2142
Total liabilities and equity	2643	2783	2911	3149	3227
Net debt	402	414	556	691	767

Source: Company data, Santander Brokerage Poland

Fig. 8. PHN: Cash flow statement forecasts

PLNmn	2017	2018	2019E	2020E	2021E
CF from operations	70	83	62	91	86
CF from investment	10	-57	-162	-175	-105
CF from financing, incl.	-52	-16	58	149	-7
dividends	-12	-13	-19	-18	-21
Net change in cash	28	10	-42	65	-26

Source: Company data, Santander Brokerage Poland

Fig. 9. PHN: Margins

PLNmn	2016	2017	2018	2019E	2020E	2021E	2022E
Gross margin	45%	52%	51%	53%	39%	41%	62%
EBITDA margin	26%	24%	39%	41%	29%	31%	45%
EBIT margin	26%	23%	39%	40%	29%	30%	44%
Net margin	18%	20%	28%	24%	16%	16%	19%
Rental gross margin	50%	54%	53%	60%	60%	60%	62%
Housing gross margin	-	-	-	18%	18%	18%	-

Source: Company data, Santander Brokerage Poland

Fig. 10. PHN: Quarterly results review

PLNmn	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19	y/y	q/q
Sales	40.4	40.4	43.8	43.0	43.1	43.0	6%	0%
Rental business	38.6	39.6	41.3	40.5	41.6	40.5	2%	-3%
Residential business	0.0	0.0	0.1	0.5	0.0	0.1	n.m.	n.m.
Other	1.8	2.2	2.4	2.0	1.5	2.4	n.m.	n.m.
Gross profit	21.1	22.3	23.4	19.2	24.8	24.1	8%	-3%
Rental business	20.6	22.1	22.9	19.0	24.8	24.2	10%	-2%
Residential business	0.0	0.0	0.1	0.0	0.0	0.1	-	-
Other	0.5	0.2	0.4	0.2	0.0	-0.1	n.m.	n.m.
Revaluation gain/loss	2.5	14.7	-10.9	7.4	1.5	7.4	n.m.	n.m.
EBITDA	17.4	25.8	7.9	15.3	20.2	21.1	-18%	4%
EBITDA margin	*43.1%*	*63.9%*	*18.0%*	*35.6%*	*46.9%*	*49.1%*	*-14.8*	*2.2*
EBIT	17.1	25.5	7.6	15.0	19.9	20.8	-18%	5%
EBIT margin	*42.3%*	*63.1%*	*17.4%*	*34.9%*	*46.2%*	*48.4%*	*-14.7*	*2.2*
Adj EBIT*	14.6	10.8	18.5	7.6	18.4	13.4	24%	-27%
Net profit	12.7	20.0	5.2	9.9	12.7	14.8	-26%	17%
Net profit margin	*31.4%*	*49.5%*	*11.9%*	*23.0%*	*29.5%*	*34.4%*	*-15.1*	*5.0*

Source: Company data, Santander Brokerage Poland, adjusted for revaluation gain/loss

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The discounted cash flows (DCF) valuation method is based on expected future discounted cash flows. One advantage of the DCF valuation method is that it takes into account all cash streams reaching Issuer and the cost of money over time. Some disadvantages of the DCF valuation method are that a large number of parameters and assumptions need to be estimated; and the valuation is sensitive to changes in those parameters.
The comparative valuation method is based on the economic rule of "one price". Some advantages of the comparative valuation method are that the analyst need only estimate a small number of parameters; the valuation is based on current market conditions; the relatively large accessibility of indicators for companies being compared; and that there is an extensive knowledge of the comparative method among investors. Some disadvantages of valuation by the comparative method are the considerable sensitivity of the results of the valuation on the choice of companies to the comparative group; the method can lead to a simplification of the picture of the company which in turn can lead to omitting certain important factors (e.g. growth dynamics, extra-operational assets, corporate governance, the repeatability of results, differences in applied accounting standards); and the uncertainty of the effectiveness of a market valuation of companies being compared.
The mid-cycle multiple valuation is based on long-term average valuation multiples of a sector or a peer group. The methodology aims to calculate a fair, through the cycle value of the company. Among its shortfalls is that at peaks and/or troughs of the cycle, the implied fair value may deviate substantially from the market's value of an analysed stock as well as the methods' reliance on the quality of external data (we usually use Bloomberg or Damodaran databases). Simplicity and average through-cycle value allowing to capture over- as well as under-valuation of a given stock are the main advantages of this methodology.
The dividend discount model (DDM) valuation is based on the net present value of the future dividends that are expected to be paid out by the company. Some advantages of the DDM valuation method are that it takes into account real cash flows to equity-owners and that the methodology is used in respect to companies with long dividend payout history. Main disadvantage of the DDM valuation method is that dividend payouts are based on a large number of parameters and assumptions, including dividend payout ratio.
Residual income method is conceptually close to the discounted cash flows method (DCF) for non-financial stocks, the difference being that it is based on expected residual income (returns over COE) rather than expected future cash flows. One advantage of this valuation method is that it captures the excess of profit potentially available to shareholders and the cost of money over time. Main disadvantage of the valuation method is that a large number of parameters and assumptions need to be estimated; and the valuation is sensitive to changes in those parameters.
The warranted equity method (WEV) is based on the formula P/BV = (two year forward ROE less sustainable growth rate)/(Cost of equity less sustainable growth rate) which allows estimating a fair value (FV) of a given stock in two years' time. Subsequently the FV is discounted back to today. The main advantage of the WEV method is that it is a transparent one and based on relatively short term forecasts, hence substantially reducing the margin of forecasting error. The main disadvantage in our view is that the model is based on the principle that stock price should converge towards its fair value implied by company's ROE and COE.
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.
Liquidation value method – liquidation value is the estimated amount of money that an asset or company could be quickly sold for, such as if it were to go out of business. Then, the estimated assets value is adjusted for liabilities and liquidation expenses. One advantage of this valuation method is its simplicity. This method does not account for intangible assets as goodwill, which is the main disadvantage.

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Based on the provisions of the agreement with Giełda Papierów Wartościowych w Warszawie S.A., which Santander Brokerage is a party, within the next 12 months Santander Brokerage Poland will receive remuneration for the preparation of recommendations regarding the Issuer, as part of the "Pilot Support Program for Analytical Coverage".
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