POLSKI HOLDING NIERUCHOMOSCI

Reuters: PHN.WA Bloomberg: PHN PW

CEE Equity Research

Real Estate, Poland

14 Apr 2020, 08:05 CET

Attractive despite worsened macro

WSE's Analytical Coverage Support Programme

We maintain our Buy recommendation. PHN is trading at a 80% discount to its NAV. Part of that discount may be justified, due to lower ROE generated by PHN compared to peers and worsened macro outlook. However, we think that the Company deserves a lower discount due to (1) low leverage, (2) regular dividend payout, and (3) revaluation from planned office projects. Progress in construction of its flagship Skysawa office building, may lead further revaluation gain in 2020E. We also expect earnings growth from residential business due to scheduled completions/handovers this year.

Solid 4Q19 earnings. The company's 4Q19 earnings were helped by PLN38.6mn revaluation gain, due to progress in construction of pipeline projects and land plot revaluation. The company recognized profit from residential business, due to completed construction of Vis-a Vis Wola residential project. On the other hand, rental profit decreased 21% q/q, due to higher refurbishment costs. Overall, the company recognized PLN25mn net profit vs. PLN9.9mn in 4Q18.

Completed acquisitions. The company issued 4.2mn shares in 4Q19 in exchange for a non-cash contribution in the form of State-owned companies: 1) c. 98% stake in Chemobudowa Krakow and 2) 85% stake in Centrum Biurowe Plac Grunwaldzki (CBPG). The company has disclosed previously that Chemobudowa (general construction company) generates c. PLN170-180mn sales annually, but no other details have been provided. CBPG holds office property in Katowice offering 17k sqm GLA.

Financial forecasts. We are raising our sales forecast as we include contributions from recently acquired general contractor Chemobudowa and the office property. Though, we expect minor earnings contribution, due to estimated low margin generation by both entities (profit close to nil recognized by Chemobudowa in 4Q19). We see high development potential in Chemobudowa's land bank, though, it might take time to unlock the value, due to worsened macro environment.

Residential business to boost 2020E earnings. PHN initiated handovers of 213 residential units in 4Q19 (48) of which we expect 165 to be transferred in FY20E (all units had been already sold). We expect completion and handovers of the second stage of Vis-à-Vis as of 4Q20E (253 units). We also expect handovers of 135 units in Yacht Park project as of 3Q20E (almost 100 units already sold).

Dividend. PHN regularly pays dividend. The Company plans to maintain its dividend policy (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. We estimate flattish y/y dividend in 2020E, implying 4.0% yield.

Risk factors: (1) economic slowdown might depress demand on office space and delay scheduled pipeline developments, (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.

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. Shares dilution trimmed our Target Price to PLN18.5.

PHN: Financial summaries

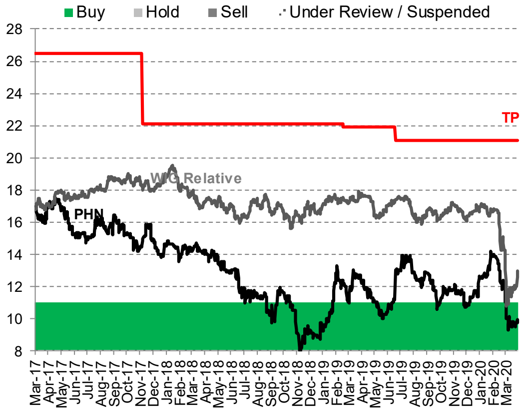
PLNmn	2017	2018	2019	2020E	2021E	2022E
Revenue	159	169	209	430	414	196
Revaluation	-19	14	57	0	0	0
EBIT	37	65	117	103	100	84
Net profit	31	48	68	56	53	35
P/E (x)	23.7	11.9	7.1	9.3	9.1	13.7
P/BV (x)	0.38	0.29	0.22	0.23	0.21	0.21
DY	1.6%	2.2%	4.0%	4.0%	4.4%	4.2%

Source: Company data, Santander Brokerage Poland, 2017-2019 multiples calucalated on historical share price average

PHN	Buy (maintained)
12M Target Price	PLN18.5
Price (PLN, Apr 9, 2020)	10.3
Market cap. (PLNmn)	526
Free float (%)	28
Number of shares (mn)	51.1
Average daily turnover 3(PLNmn)	0.1

What has changed

- Sale contribution from recently acquired Chemobudowa and Centrum Biurowe Plac Grunwaldzki
- EPS dilution due to new shares issue



The chart measures performance against the WIG index.

Main shareholders	% of votes
Treasury	72.2
Aviva pension fund	9.1
Nationale-Nederlanden mutual fund	5.6

Source: www.gpw.pl

Company description

PHN is residential and office space developer and holder of yielding office and retail properties.

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Forecasts' changes

Fig. 1. PHN: Forecasts changes

PLNmn	2020E			2021E			2022E		
	New	Previous	*Change*	New	Previous	*Change*	New	Previous	*Change*
Sales	430	353	*22%*	414	315	*32%*	196	194	*1%*
EBITDA	103	104	*-1%*	100	97	*3%*	84	87	*-3%*
EBIT	105	103	*2%*	102	96	*7%*	86	85	*1%*
Net profit	56	56	*0%*	53	49	*8%*	35	36	*-2%*

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	1 433	98	10%	981
Properties for optimization	237		50%	118
Developments/land	1 212		10%	1 091
Properties for sale	58		25%	43
Total:	2 939			2 233
Debt (as at 4Q19)	990			990
Cash (as at 4Q19)	210			210
Reserves and other (as at 2Q19)	510			510
Implied value (PLNmn)				**943**
Implied value per share (PLN)				**18.5**

Source: Company data, Santander Brokerage Poland

Fig. 3. PHN: SOTP valuation summary

PLN	New	Previous	Change
SOTP valuation per share/Target Price	18.5	21.1	-12%

Source: Santander Brokerage Poland

Comparable valuation

Fig. 4. PHN: Comparable valuation summary

Comparable valuation	P/BV	Book value of PHN per share as at 4Q19 (PLN)	Implied valuation of PHN per share (PLN)
Median for WSE-listed real estate companies	0.76	44.7	**33.9**
Median for foreign real estate companies	0.61		**27.3**
Average:			**30.6**

Source: Bloomberg, Santander Brokerage Poland

Valuation summary

Fig. 5. PHN: Valuation changes

PLN per share	New	Previous	*Change*
SOTP valuation	18.5	21.1	*-12%*
Comparable valuation	30.6	33.7	*-9%*
Weighted valuation*	**18.5**	21.1	*-12%*

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

4Q19 Results Review

PHN's gross profit increased 36% y/y, though it declined 5% q/q. Rental profit decreased 21% q/q, due to higher q/q refurbishment costs. On the other hand, PHN recognized first profit from residential business, due to completed construction and initiated handovers of Vis-a Vis Wola residential projects. The company handed over to clients 48 residential units in 4Q19 of the avg. revenue of PLN458k per unit, whereas the gross margin settled at 19.3% (above our 18% estimate).

Administration costs in 4Q19 increased to PLN11.8mn from 9M19 quarterly avg. of PLN9.1mn. Quarterly earnings were helped by PLN38.6mn gain form property revaluation, thanks to progress in construction of pipeline projects and land plot revaluation. Moreover, PHN recognized PLN3.2mn net other operating income. Overall, the company recognized PLN25mn net profit, vs. PLN9.9mn in 4Q18 and PLN15.5mn in 3Q19.

1Q20E Results Preview

We expect strong 1Q20E results, due to estimated 151 residential units handovers of Vis-à-vis project vs. 48 in 4Q19 and nil in 1Q19. We estimate lower q/q refurbishment costs in 1Q20 lifting q/q rental profit. We do not expect any revaluation gain, though revaluation of Skysawa office property is likely due to progress in construction works. Overall, we project PLN20.3mn net profit in 1Q20E vs. PLN24.9mn in 4Q19 (high contribution of revaluation gain) and PLN12.6mn in 1Q19.

Fig. 6. PHN: 4Q19 Results Review and 1Q20E Results Preview

PLNmn	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19	3Q19	4Q19	1Q20E	*y/y*	*q/q*
Sales	40.4	40.4	43.8	43.0	43.1	43.0	48.0	75.0	129.3	*200%*	*72%*
Rental business	38.6	39.6	41.3	40.5	41.6	40.5	45.5	44.3	44.3	*6%*	*0%*
Residential business	0.0	0.0	0.1	0.5	0.0	0.1	0.1	22.1	71.0	*n.m.*	*221%*
Construction and Other	1.8	2.2	2.4	2.0	1.5	2.4	2.4	8.6	14.0	*n.m.*	*63%*
Gross profit	21.1	22.3	23.4	19.2	24.8	24.1	27.6	26.5	34.0	*37%*	*28%*
Rental business	20.6	22.1	22.9	19.0	24.8	24.2	27.4	21.7	25.7	*4%*	*18%*
Residential business	0.0	0.0	0.1	0.0	0.0	0.0	0.1	4.2	13.5	*n.m.*	*221%*
Construction and Other	0.5	0.2	0.4	0.2	0.0	-0.1	0.1	0.6	0.2	*n.m.*	*n.m.*
Revaluation gain/loss	2.5	14.7	-10.9	7.4	1.5	7.4	9.9	38.6	0.0	*n.m.*	*n.m.*
EBITDA	17.4	25.8	7.9	15.3	20.2	21.0	32.1	45.3	27.0	*34%*	*-40%*
EBITDA margin	*43.1%*	*63.9%*	*18.0%*	*35.6%*	*46.9%*	*48.8%*	*66.9%*	*60.4%*	*20.9%*	*-26.0*	*-39.5*
EBIT	17.1	25.5	7.6	15.0	19.9	20.7	31.8	45.0	25.0	*26%*	*-44%*
EBIT margin	*42.3%*	*63.1%*	*17.4%*	*34.9%*	*46.2%*	*48.1%*	*66.3%*	*60.0%*	*19.4%*	*-26.8*	*-40.6*
Adj EBIT*	14.6	10.8	18.5	7.6	18.4	13.3	21.9	6.4	25.0	*36%*	*291%*
Net profit	12.7	20.0	5.2	9.9	12.6	14.6	15.5	24.9	20.3	*61%*	*-19%*
Net profit margin	*31.4%*	*49.5%*	*11.9%*	*23.0%*	*29.2%*	*34.0%*	*32.3%*	*33.2%*	*15.7%*	*-13.5*	*-17.5*

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

Financials in details

Fig. 7. PHN: Income statement forecasts

PLNmn	2017	2018	2019	2020E	2021E
Net sales	159	169	209	430	414
COGS	-76	-83	-106	-293	-280
Gross profit	83	86	103	137	134
SG&A	31	32	39	34	34
Other operating income, net	-15	12	54	0	0
EBITDA	38	67	119	105	102
Operating profit	37	65	117	103	100
Net financial income (costs)	-9	-7	-21	-34	-35
Profit before tax	28	58	97	70	65
Income tax	-2	-11	-28	-13	-12
Net profit	31	48	68	56	53

Source: Company data, Santander Brokerage Poland

Fig. 8. PHN: Balance sheet forecasts

PLNmn	2017	2018	2019	2020E	2021E
Current assets	238	286	662	526	454
Fixed assets	2 405	2 497	3 121	3 294	3 397
Total assets	2 643	2 783	3 783	3 820	3 852
Current liabilities	100	315	627	627	627
bank debt	486	379	789	789	789
Long-term liabilities	530	420	875	875	875
bank debt	20	150	201	201	201
Equity	2 013	2 048	2 282	2 319	2 351
Total liabilities and equity	2 643	2 783	3 783	3 820	3 852
Net debt	402	414	706	842	914

Source: Company data, Santander Brokerage Poland

Fig. 9. PHN: Cash flow statement forecasts

PLNmn	2017	2018	2019	2020E	2021E
CF from operations	70	83	-8	92	90
CF from investment	10	-57	-162	-175	-105
CF from financing, incl.	-52	-16	421	-53	-56
dividends	-12	-13	-19	-19	-23
Net change in cash	70	83	-8	92	90

Source: Company data, Santander Brokerage Poland

Fig. 10. PHN: Margins

PLNmn	2016	2017	2018	2019	2020E	2021E	2022E
Gross margin	45%	52%	51%	49%	32%	32%	60%
EBITDA margin	26%	24%	39%	57%	24%	25%	44%
EBIT margin	26%	23%	39%	56%	24%	24%	43%
Net margin	18%	20%	28%	32%	13%	13%	18%
Rental gross margin	50%	54%	53%	57%	58%	58%	60%
Housing gross margin	-	-	-	19%	19%	19%	-

Source: Company data, Santander Brokerage Poland

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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
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In preparing this document Santander Brokerage Poland applied at least one of the following valuation methods: discounted cash flows (DCF), comparative, mid-cycle, dividend discount model (DDM), residual income, warranted equity method (WEV), SOTP valuation, liquidation value.
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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