POLSKI HOLDING NIERUCHOMOSCI

Santander Biuro Maklerskie

Reuters: PHN.WA Bloomberg: PHN PW

CEE Equity Research

Real Estate, Poland

21 September 2020, 08:05 CET

Nearing Skysawa pre-lease to drive revaluation?

WSE's Analytical Coverage Support Programme

We stay positive on PHN keeping Buy rating, though we cut Target Price to PLN18.0, due to dividend adjustment. 2Q20 results came in disappointing, due to properties' write-offs. Eased social restrictions in Poland and V-shape recovery of economic activity QTD makes us believe that further assets' write-offs in the coming quarters are unlikely. We also believe in nearing pre-lease of Skysawa office space, which could imply positive property revaluation. PHN keeps trading at a 80% discount to its NAV, only partially justified with its lower ROE compared to peers, we think.

2Q20 earnings depressed by properties' write-off. PHN recognized PLN70.7mn properties' write-offs implying heavy net loss of PLN54.2mn in 2Q20. Write-offs were driven by yield growth and/or ERV decrease, we estimate. Eased social restrictions in Poland and V-shape recovery of economic activity QTD makes us believe that further assets' write-offs in the coming quarters are unlikely.

Residential handovers likely in 2H20E/1H21E. PHN has already sold c. 100% residential units of both Vis-à-vis II (213 units) and Yacht Park (213 units) projects, with works completion and handovers scheduled on 2H20E/1H21E. Construction works and sales initiation at Retkinia (166) and Mloda Bialoleka (174) projects is nearing with handovers scheduled on 2022E.

Skysawa construction in line with schedules. Construction works of Skysawa flagship project go in line with the schedule. Lockdown has delayed negotiations with tenants, but perfect location could attract not only Treasury-controlled tenants, we think. We also think that pre-lease agreements are just a matter of time, which could initiate asset revaluation and gain recognition in P&L account. Potential revaluations from Skysawa or Intraco Prime office developments represent an upside to our forecasts and valuation.

Good performing logistic assets, bad performing construction business. PHN recently acquired the remaining 50% stake in warehouse project in Pruszkow from its JV partner, which we like, due to high demand on logistic space and the asset occupancy close to 100%. On the other hand, we do not appreciate the late-2019 purchase of Chemobudowa contractor in the light of its negative EBITDA in 1H20. We think that potential business synergies are probably still ahead.

Financial forecasts. We cut our 2020E earnings forecast, due to weaker than expected 1H20 results including higher write-offs and administrative costs. Delays in initiating works at Mloda Bialoleka residential projects shifts our earnings estimates onto 2022E from 2021E previously. We also increase our sales forecast for Chemobudowa, due to above-expected revenues in 1H20.

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.

PHN: Financial summaries

PLNmn	2017	2018	2019	2020E	2021E	2022E
Revenue	159	169	209	561	387	387
Revaluation	-19	14	57	-60	0	0
EBIT	37	65	117	32	74	84
Net profit	31	48	68	9	41	38
P/E (x)	23.7	11.9	7.8	61.9	12.9	11.2
P/BV (x)	0.27	0.26	0.24	0.24	0.23	0.23
DY	1.6%	2.2%	3.6%	4.8%	0.7%	2.9%

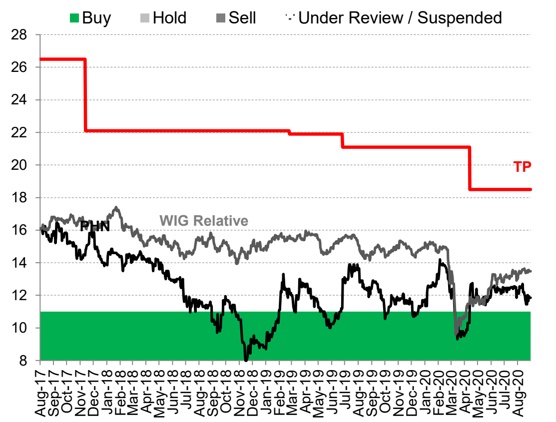
Source: Company data, Santander Brokerage Poland, 2017-2019 multiples calucalated on historical share price average

PHN	Buy (maintained)
12M Target Price	PLN18.0

Price (PLN, Sep 18, 2020)	11.5
Market cap. (PLNmn)	587
Free float (%)	28
Number of shares (mn)	51.1
Average daily turnover (PLNmn)	0.1

What has changed

- Higher than expected net loss in 2Q20 due to properties' write-offs and higher administrative costs
- Decreased 2020E financial forecast due lower than expected 1H20 results
- Upped sales forecast from construction business on better than expected sales in 1H20
- Shift in handovers of Mloda Bialoleka residential units into 2022E from 2021E previously due to prolonged initiation of construction works (administrative procedures)
- Decreased exit yield applied to valuation of yielding assets to 8.5% from 10% due to risk free rate contraction



The chart measures performance against the WIG index.

Main shareholders	% of votes
Treasury	72.2
Aviva pension fund	9.1
Nationale-Nederlanden pension 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	561	430	*30%*	387	414	*-7%*	387	276	*40%*
Revaluations	-60	0	*n.m.*	0	0	*n.m.*	0	0	*n.m.*
EBIT	32	105	*-69%*	74	102	*-28%*	84	86	*-2%*
Net profit	9	56	*-83%*	41	53	*-23%*	38	35	*10%*

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	1447	85	8.5%	994
Properties for optimization	231		50%	115
Developments/land	1225		10%	1103
Properties for sale	58		25%	43
Total:	2961			2 233
Debt (as at 2Q20)	1001			990
Cash (as at 2Q20)	274			210
Dividend paid in 3Q20	28			28
Reserves and other (as at 2Q19)	577			510
Implied value (PLNmn)				**924**
Implied value per share (PLN)				**18.0**

Source: Company data, Santander Brokerage Poland

Fig. 3. PHN: SOTP valuation summary

PLN	New	Previous	Change
SOTP valuation per share/Target Price	18.0	18.5	-3%

Source: Santander Brokerage Poland

Comparable valuation

Fig. 4. PHN: Comparable valuation summary

Comparable valuation	P/BV	Book value of PHN per share as at 2Q20 (PLN)	Implied valuation of PHN per share (PLN)
Median for WSE-listed real estate companies	0.63	43.1	**27.2**
Median for foreign real estate companies	0.85		**36.6**
Average:			**31.9**

Source: Bloomberg, Santander Brokerage Poland

Valuation summary

Fig. 5. PHN: Valuation changes

PLN per share	New	Previous	*Change*
SOTP valuation	18.0	18.5	*-3%*
Comparable valuation	31.9	30.6	*4%*
Weighted valuation*	**18.0**	**18.5**	***-3%***

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

2Q20 Results Review

- PHN reported a net loss of PLN54.2mn in 2Q20 vs. our forecast of net loss of PLN2.7mn;
- Properties write-offs of PLN70.7mn depressed quarterly earnings (PLN15mn write-off expected). The company observed lower demand on office space in 2Q20, renegotiated leasing agreements with tenants of retails space, and saw slight delays in tenants' payments;
- Rental sales and gross profit came in flattish q/q and higher y/y;
- Residential sales decreased to PLN5.8mn from PLN78.5mn in 1Q20 due to low handovers volume. Gross margin in this segment decreased to 12% from 17% in 1Q20;
- Construction sales increased q/q. Gross margin in this segments stabilised q/q at c. 6%;
- Administrative costs settled flattish q/q;
- Net other operating income stood at PLN1.9mn;
- Net financials stood at PLN-8mn;
- The company recognize tax shield of PLN7.4mn;
- Operating CF stood at PLN-5.4mn in 2Q20 (PLN47.2mn in 2Q19).

Fig. 6. PHN: 2Q20 Results Review

PLNmn	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	*y/y*	*q/q*	2Q20E
Sales	43.1	43.0	48.0	75.0	164.5	**100.7**	*134%*	*-39%*	80.0
Rental business	41.6	40.5	45.5	44.3	46.6	**46.2**	*14%*	*-1%*	44.0
Residential business	0.0	0.1	0.1	22.1	78.5	**5.8**	*n.m.*	*-93%*	4.0
Construction	-	-	-	-	37.1	**46.6**	*n.m.*	*26%*	32.0
Other	1.5	2.4	2.4	8.6	2.3	**2.1**	*n.m.*	*n.m.*	0.0
Gross profit	24.8	24.1	27.6	26.5	40.2	**27.1**	*12%*	*-33%*	27.1
Rental business	24.8	24.2	27.4	21.7	25.6	**25.6**	*6%*	*0%*	24.2
Residential business	0.0	0.0	0.1	4.2	13.4	**0.7**	*n.m.*	*n.m.*	0.8
Construction	-	-	-	-	2.2	**2.8**	*n.m.*	*n.m.*	1.9
Other	0.0	-0.1	0.1	0.6	-1.0	**-2.0**	*n.m.*	*n.m.*	0.3
Revaluation gain/loss	1.5	7.4	9.9	38.6	11.0	**-70.7**	*n.m.*	*n.m.*	-15.0
EBITDA	20.2	21.0	32.1	45.3	36.6	**-53.9**	*n.m.*	*n.m.*	0.0
EBITDA margin	*46.9%*	*48.8%*	*66.9%*	*60.4%*	*22.2%*	***-53.5%***	-102.4	-75.8	*0.1%*
EBIT	19.9	20.7	31.8	45.0	36.3	**-54.2**	*n.m.*	*n.m.*	-0.3
EBIT margin	*46.2%*	*48.1%*	*66.3%*	*60.0%*	*22.1%*	***-53.8%***	-102.0	-75.9	*-0.3%*
Adj EBIT*	18.4	13.3	21.9	6.4	25.3	**16.5**	*24%*	*-35%*	14.7
Net profit	12.6	14.6	15.5	24.9	29.2	**-54.3**	*n.m.*	*n.m.*	-2.7
Net profit margin	*29.2%*	*34.0%*	*32.3%*	*33.2%*	*17.8%*	***-53.9%***	-87.9	-71.7	*-3.4%*

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

Financials in details

Fig. 7. PHN: Income statement forecasts

PLNmn	2018	2019	2020E	2021E	2022E
Net sales	169	209	561	387	387
COGS	-83	-106	-419	-265	-262
Gross profit	86	103	142	122	125
SG&A	32	39	49	48	48
Other operating income, net	12	54	-60	0	0
EBITDA	67	119	34	76	86
Operating profit	65	117	32	74	84
Net financial income (costs)	-7	-21	-23	-30	-36
Profit before tax	58	97	18	51	47
Income tax	-11	-28	-9	-10	-9
Net profit	48	68	9	41	38

Source: Company data, Santander Brokerage Poland

Fig. 8. PHN: Balance sheet forecasts

PLNmn	2018	2019	2020E	2021E	2022E
Current assets	286	662	538	472	495
Fixed assets	2497	3121	3235	3338	3536
Total assets	2783	3783	3773	3809	4030
Current liabilities	315	627	627	627	826
bank debt	379	789	789	789	789
Long-term liabilities	420	875	875	875	875
bank debt	150	201	201	201	400
Equity	2048	2282	2272	2309	2331
Total liabilities and equity	2783	3783	3773	3809	4030
Net debt	414	706	830	896	1073

Source: Company data, Santander Brokerage Poland

Fig. 9. PHN: Cash flow statement forecasts

PLNmn	2018	2019	2020E	2021E	2022E
CF from operations	83	-8	94	73	77
CF from investment	-57	-162	-175	-105	-200
CF from financing, incl.	-16	421	-43	-34	146
dividends	-13	-19	-28	-4	-17
Net change in cash	10	251	-124	-66	23

Source: Company data, Santander Brokerage Poland

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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.
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