

Top of the Props

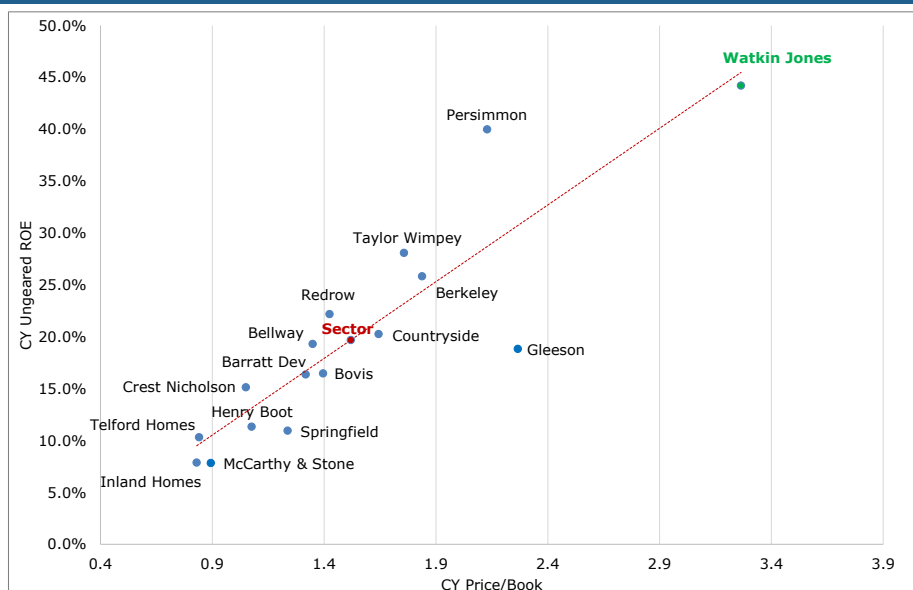
4th April 2019

Stock picking is never easy. Many investors employ a smorgasbord of different styles, including technical, momentum, growth and value, with some even trusting their hard earned cash to the 'dart board'. However shrewd property owners tend to be far more rigorous - focusing instead on long term returns. In fact most, before pumping leverage into the equation, want to know their expected ungeared ROIs – which, after stripping out the distortive effects of debt finance, provide a useful yardstick of a project's 'pure intrinsic worth'.

Well-oiled machine delivering best in class returns

On this score **Watkin Jones**, a UK developer/manager of large scale, multi occupancy accommodation – **ranks as the best 'money making machine' out of the entire UK property universe** (see below). Derived from sustainable secular tailwinds (eg student & Build-to-Rent), a forward funded model, high asset turns, low cost base and leading industry expertise.

Ungeared Return on Equity vs Price:Book valuation



Source: Equity Development. $Ungeared\ ROE = (EBIT - tax - minorities) / (net\ assets +/-\ net\ debt/cash)$

So how are things progressing?

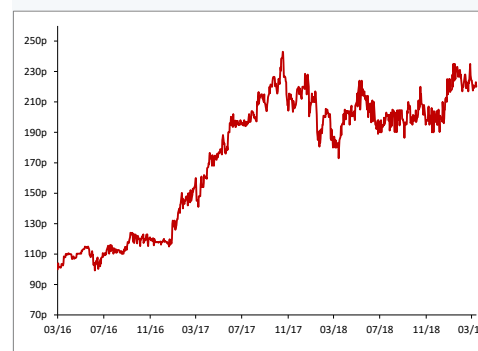
Well after posting record results for the past umpteen years, one would have imagined it was going to be a challenge to 'go one better', especially in light of the wider economic uncertainty. No so. This morning the company said that **trading for the 6 months ending March 2019 was "good" and importantly "in line with its expectations"**.

In fact, it was pleasing to hear that not only was WJG's bread-and-butter PBSA (>70% of gross profits) powering along at a fair rate of knots - sporting a **"secure development pipeline of >7,500 beds across 17 sites"** (worth circa £650m). But also the group's new growth engines of **BTR, property management and** (to a lesser extent) **house building were making great strides too**.

Company Data

EPIC	AIM:WJG
Price (last close)	222p
52 week Hi/Lo	249p/178p
Market cap	£567m
ED valuation/share	250p
Daily volume	300k

Share Price (p)



Source: Web Financial

Company Description

Watkin Jones is a tier 1 developer & manager of large scale, multi occupancy accommodation, focusing on purpose built student accommodation (PBSA) and residential build to rent (BTR).

Both areas are expanding, supported by strong fundamentals – enabling the firm to leverage its reputation & industry expertise, along with operating a forward sale, low risk, cashflow positive and capital light model.

Residential property & agency lettings businesses are also set to become growth engines.

Next news: Interims 21st May 2019

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PBSA delivery pipeline (beds – Jan'19)

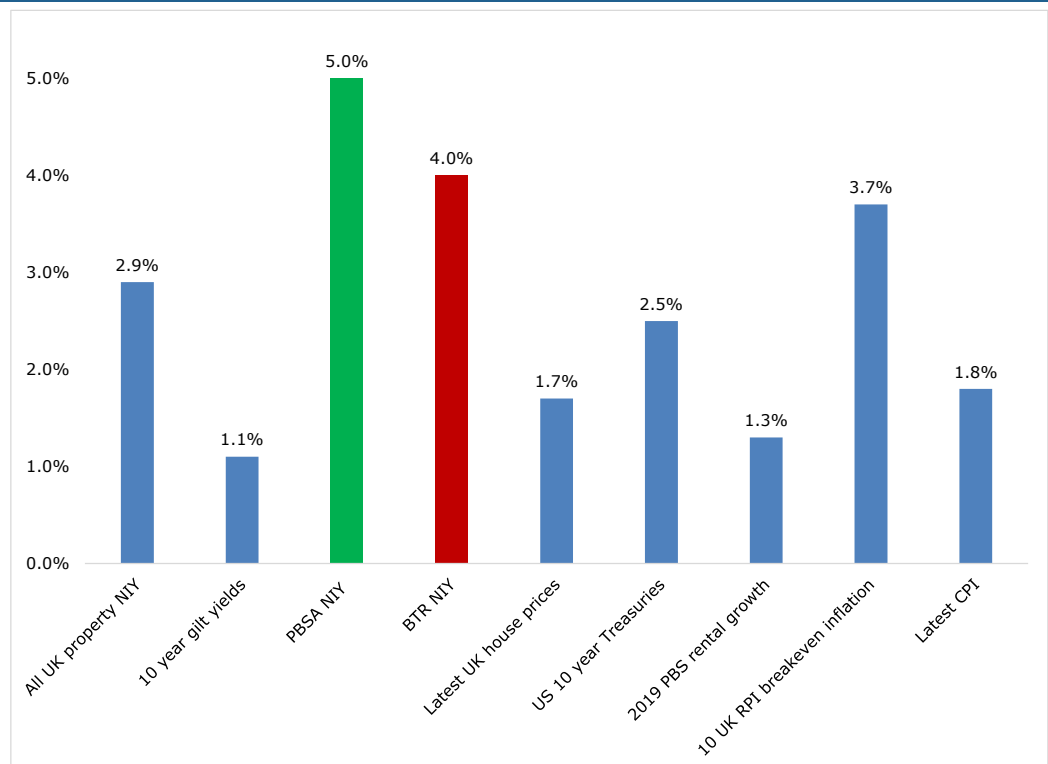


Source: Company. NB: sales/profits track 'cost to complete' contract accounting not just deliveries. Secure = Beds forward sold and/or with planning permission.

Improving asset yields vs sovereign bonds

Additionally from a macro perspective, yields of late on WJG's core asset classes have become more attractive (see below) to investors vs traditional 'safe havens' like government bonds (eg German bunds & JGBs at 0%). Where several central banks have walked back their previous 'relatively hawkish' stances on interest rates and quantitative tightening.

PBSA and BTR generating positive real-returns



Source: Source: Bank of England, ED estimates and various websites. NIY - Net Initial Yields

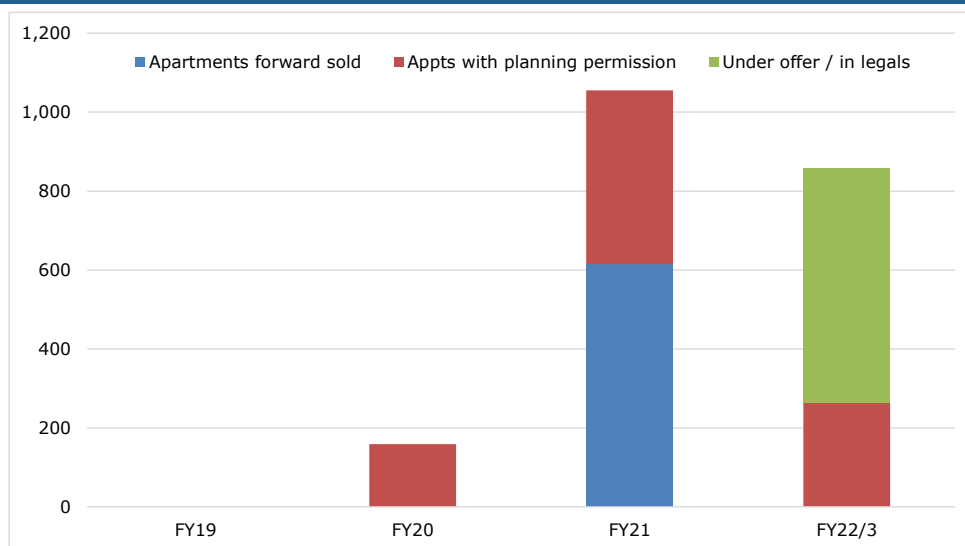
BTR goes from strength-to-strength

Picking through today’s numbers in more detail - of the 17 PBSA schemes, 11 (5,334 beds) have been forward sold, with **all 6 slated for completion in FY19 (2,723 beds) being on track** for the start of the 2019/20 academic year.

Elsewhere, **institutional investors continue to descend on the nascent yet “burgeoning” BTR market**. Here WJG acquired a “prime site for 336 units in Woking”, along with obtaining planning consent for another 166 in Sutton (Surrey). Hence generating a total owned pipeline of >1,200 apartments, including 3 with planning (415 units) and a further 3 (800 apartments) for which approval is being progressed.

On top, the group is also developing 315 BTR apartments in Reading for M&G Real Estate and has commenced work on 300 more in Wembley for Singaporean investors. Altogether providing excellent visibility to achieve its goal of building 1,500 such units between FY20-23.

Total BTR delivery pipeline (apartments – Jan’19)



Source: ED estimates. NB: sales/profits track ‘cost to complete’ contract accounting not just deliveries

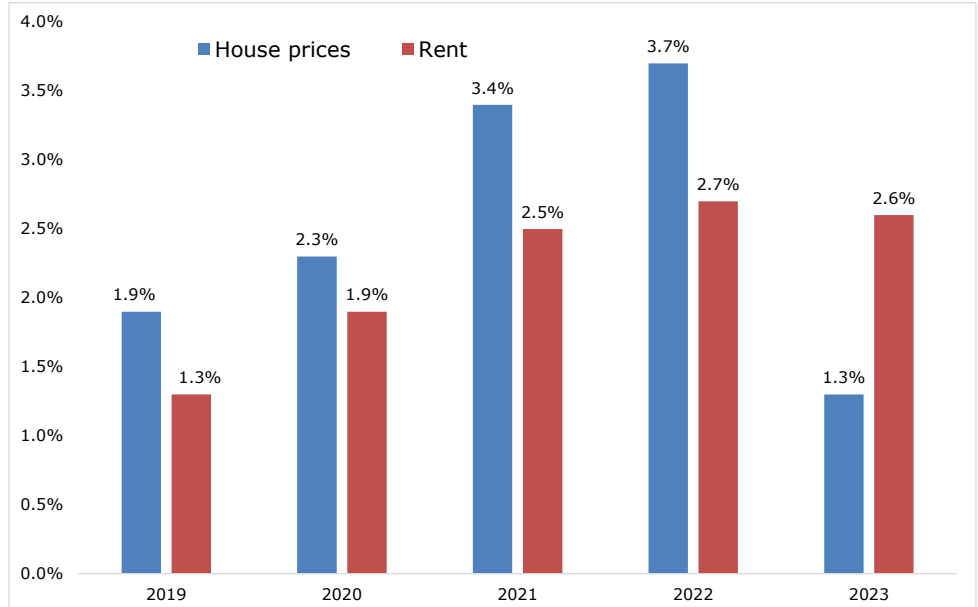
Fresh achieves high quality recurring revenues

But that’s not all. **The Fresh lettings business continues to “perform well”**, with 15,421 units under management across 56 schemes, of which 52% were constructed by 3rd parties. Better still, this is set to increase to 21,018 across 73 schemes by FY22, thus underpinning our expectations.

Last but not least, **Residential** also enjoyed a **“robust level of sales activity in H1’19”**, reflecting the relative strength of its geographical exposure to the North West. More broadly too, the UK housing sector is being assisted by a robust employment picture, rising wages, generous government support (Help-to-Buy), low interest rates and the availability of competitive mortgages.

Moreover we think the private rented sector (PRS) should remain supply constrained, with modestly improving rental growth and house price rises pencilled in for the next 5 years (see below).

Stable residential property market

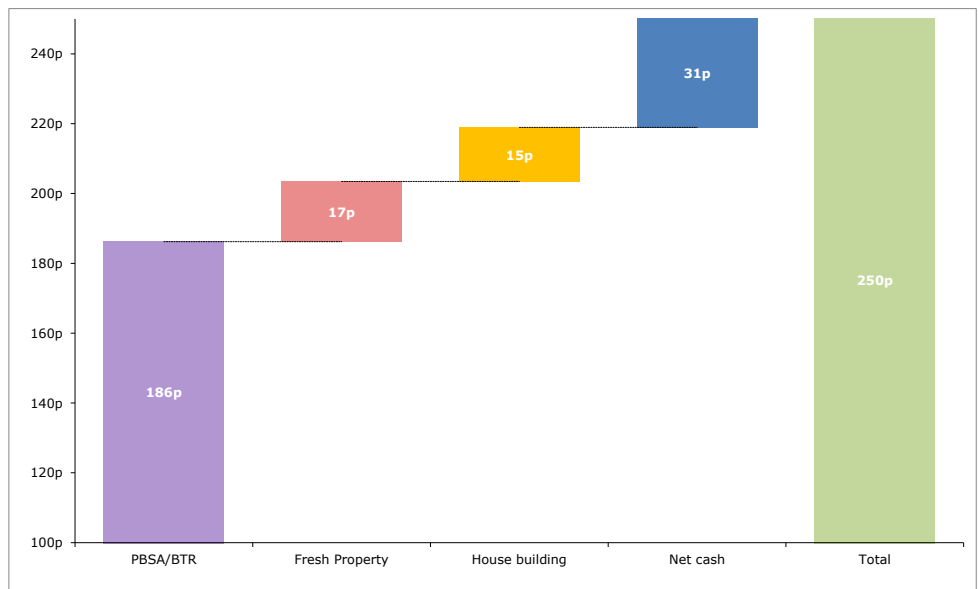


Source: ONS, CBRE

Valuation nudged up to 250p/share

Consequently, **we make no change to our forecasts, but lift the SOTP valuation to 250p/share** (from 240p) based on the natural roll-forward of the discount rate and de-risking of the FY19 numbers. In our opinion, **WJG continues to trade at a deserved premium to peers in light of its superior cash generation, asset efficiency, sales visibility and risk profile.**

Sum of the parts valuation (pence/share)



Source: Equity Development

CEO Richard Simpson commenting **"The Group's continued good trading performance underlines the strength of the Watkin Jones business model, even during times of broader uncertainty.**

*Leveraging our development and property management expertise into the attractive purpose built student accommodation and build to rent sectors, which are well supported by institutional investor demand, continues to deliver solid returns for the Group and its shareholders. **We are making good progress in the financial year and remain confident in the Group's medium term prospects**.*

Finally, another big advantage of PBSA/BTR, is that by moving more students/young professionals into institutionally owned/managed accommodation. This then frees up traditional Buy-to-Let & other rented properties, which can be renovated and re-provisioned to provide much-needed housing to families in areas that may be short of affordable places to live. A win-win situation for councils, developers and the government alike.

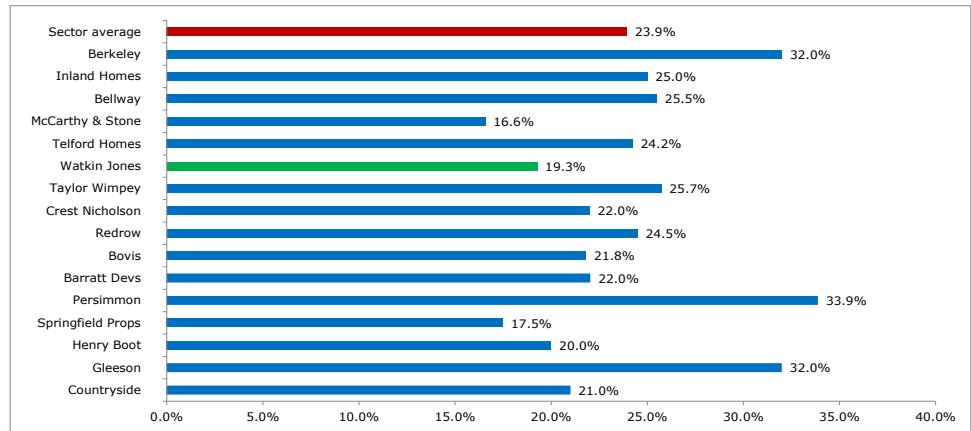
Summary financial projections

Watkin Jones (continuing) (Sept yearend)	2015 Act £'ms	2016 Act £'ms	2017 Act £'ms	2018 Act £'ms	2019 Est £'ms	2020 Est £'ms	2021 Est £'ms	2022 Est £'ms	2023 Est £'ms	2024 Est £'ms
Turnover										
Student (PBSA) accommodation	228.2	237.2	256.1	312.7	285.0	295.0	300.0	300.0	300.0	300.0
Build to Rent (BTR)	0.0	0.0	1.2	3.8	60.0	90.0	125.0	170.0	210.0	250.0
Residential development	15.9	26.3	18.1	30.0	38.0	40.0	45.0	50.0	55.0	60.0
Fresh property management		2.8	6.1	7.3	7.0	8.1	8.9	9.7	10.7	11.8
Other / construction	0.2	0.7	20.4	9.3	0.0	0.0	0.0	0.0	0.0	0.0
Total	244.2	267.0	301.9	363.1	390.0	433.1	478.9	529.7	575.7	621.8
Group revenue growth % YoY	73.5%	9.3%	13.1%	20.3%	7.4%	11.0%	10.6%	10.6%	8.7%	8.0%
Student (PBSA) accommodation		3.9%	8.0%	22.1%	-8.9%	3.5%	1.7%	0.0%	0.0%	0.0%
Build to Rent (BTR)				209.5%	1494.0%	50.0%	38.9%	36.0%	23.5%	19.0%
Residential development	-12.6%	65.3%	-31.3%	65.8%	26.8%	5.3%	12.5%	11.1%	10.0%	9.1%
Fresh property management			116.6%	19.2%	-4.1%	15.0%	10.0%	10.0%	10.0%	10.0%
Student (PBSA) accommodation	41.5	48.6	56.6	60.7	55.6	55.1	54.0	54.0	54.0	54.0
Build to Rent (BTR)	0.0	0.0	0.7	1.0	7.8	11.7	16.3	22.1	27.3	32.5
Residential development	2.7	3.0	3.0	4.4	7.6	8.0	9.0	10.0	11.0	12.0
Fresh property management	0.0	1.7	3.8	4.5	4.2	4.8	5.3	5.8	6.4	7.1
Other	-0.1	0.5	-0.5	1.8	0.0	0.0	0.0	0.0	0.0	0.0
Group gross profit	44.0	53.8	63.5	72.4	75.2	79.6	84.6	91.9	98.7	105.6
Group % margin	18.0%	20.2%	21.0%	20.0%	19.3%	18.4%	17.7%	17.4%	17.1%	17.0%
Student (PBSA) accommodation	18.2%	20.5%	22.1%	19.4%	19.5%	18.7%	18.0%	18.0%	18.0%	18.0%
Build to Rent (BTR)			56.3%	27.1%	13.0%	13.0%	13.0%	13.0%	13.0%	13.0%
Residential development	16.6%	11.5%	3.8%	14.6%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%
Fresh property management		58.9%	49.4%	61.8%	60.0%	60.0%	60.0%	60.0%	60.0%	60.0%
Admin	-10.6	-14.6	-20.8	-22.8	-23.5	-24.9	-26.1	-27.4	-28.4	-29.5
Distribution / other	-1.0	-1.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Adjusted EBIT	32.5	37.9	42.7	49.6	51.7	54.7	58.5	64.6	70.3	76.1
% margin	13.3%	14.2%	14.1%	13.7%	13.3%	12.6%	12.2%	12.2%	12.2%	12.2%
EBITDA (incl JV profits)	33.6	41.5	45.2	52.0	53.1	56.1	59.9	66.1	71.8	77.7
% margin	13.8%	15.6%	15.0%	14.3%	13.6%	13.0%	12.5%	12.5%	12.5%	12.5%
Profit from JVs	1.2	3.0	1.4	1.1	0.0	0.0	0.0	0.0	0.0	0.0
Net interest	-0.7	-1.0	-0.9	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7
Adj profit before Tax	32.9	39.8	43.3	50.1	51.0	54.0	57.7	63.8	69.6	75.4
Effective tax rate	-19.1%	-20.5%	-17.3%	-18.6%	-19.0%	-18.0%	-17.0%	-17.0%	-17.0%	-17.0%
Adjusted EPS (pence)	10.4	12.4	14.0	16.0	16.2	17.3	18.7	20.7	22.6	24.4
EPS growth rate	138.5%	19.2%	13.1%	13.8%	1.3%	7.1%	8.2%	10.6%	8.9%	8.3%
Net assets per share (p)	44	40	49	60	68	77	86	96	108	120
Net tangible assets per share (p)	44	34	44	54	62	71	80	91	102	114
Dividend (p)		4.0	6.6	7.6	8.1	8.7	9.4	10.4	11.3	12.2
Valuation benchmarks										
P/E ratio	21.3	17.9	15.8	13.9	13.7	12.8	11.8	10.7	9.8	9.1
P/E ratio (excluding Sept'18 net cash)				11.9	11.8	11.0	10.2	9.2	8.4	7.8
Price/Tangible book	5.0	6.5	5.1	4.1	3.6	3.1	2.8	2.4	2.2	1.9
Price/Book	5.0	5.5	4.5	3.7	3.3	2.9	2.6	2.3	2.1	1.9
EV/EBIT	15.0	12.8	11.4	9.8	9.4	8.9	8.3	7.5	6.9	6.4
Return on Equity (EPS/NA)	23.5%	30.8%	28.4%	26.6%	23.8%	22.6%	21.8%	21.5%	21.0%	20.4%
Dividend yield		1.8%	3.0%	3.4%	3.6%	3.9%	4.2%	4.7%	5.1%	5.5%
Net cash / (debt)	39.1	32.2	41.0	80.2	90.5	101.5	113.5	126.8	141.2	156.8
Net cash / share (p)	15.3	12.6	16.1	31.4	35.4	39.7	44.4	49.6	55.2	61.3
Sharecount (Ks)	255,269	255,269	255,269	255,269	255,369	255,469	255,569	255,669	255,769	255,869
Shareprice	222									

Source: Company historic data, Equity Development estimates.

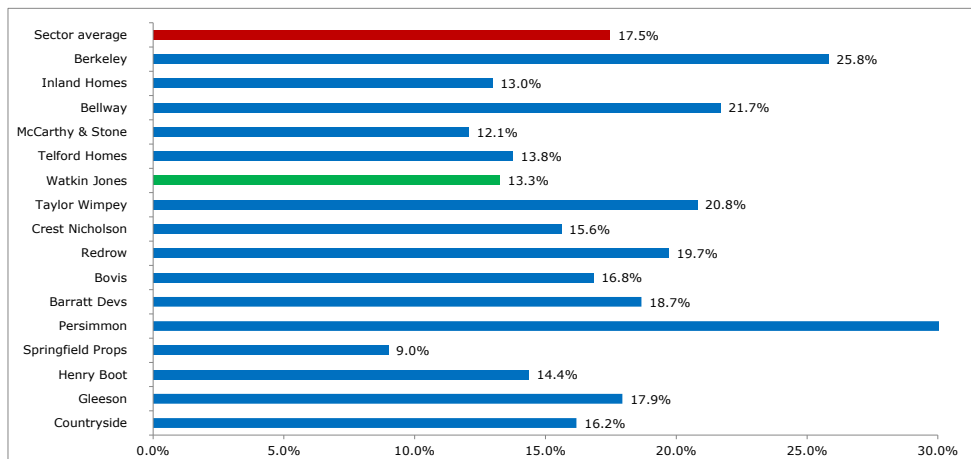
Appendices - sector valuation metrics and KPIs

Current Year gross profit margins



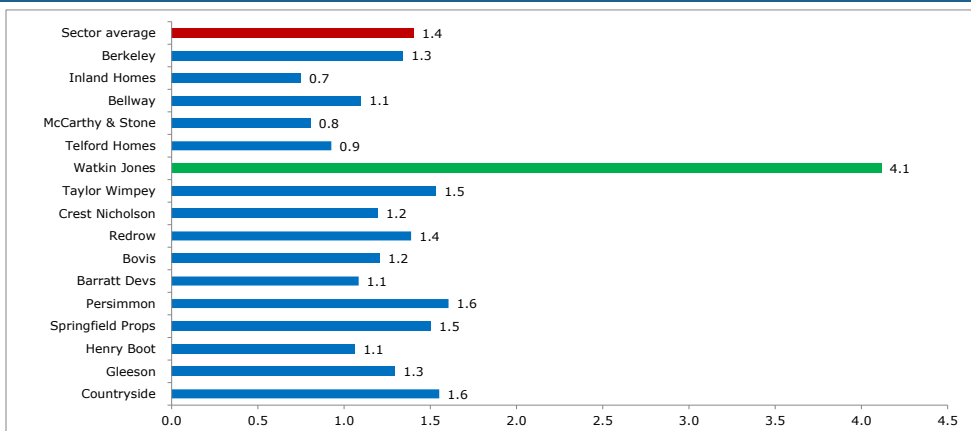
Source: Equity Development : arithmetic average for sector

CY EBIT margins



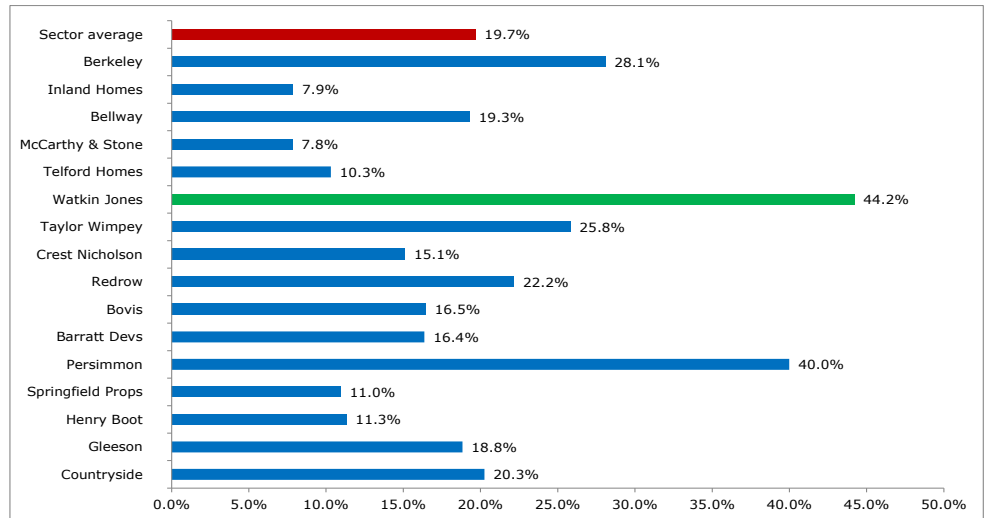
Source: Equity Development, arithmetic average for sector

CY ungeared net asset turns



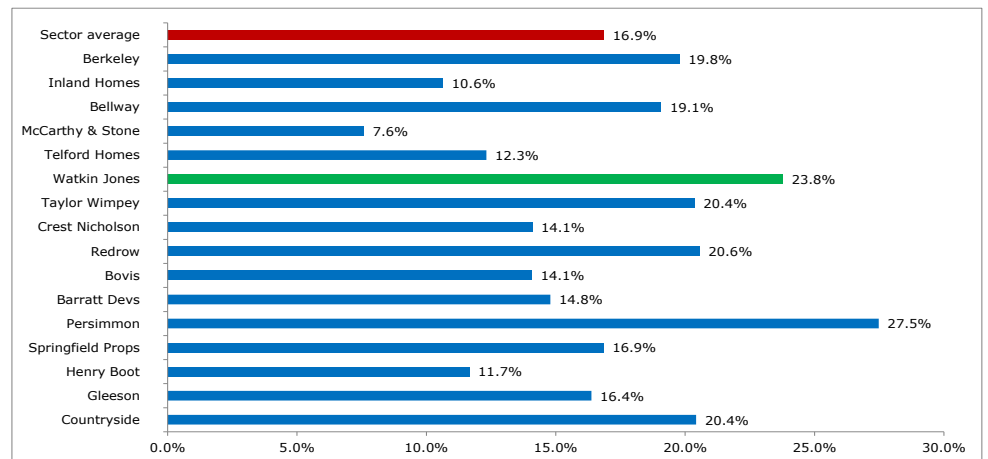
Source: Equity Development : arithmetic average for sector

CY ungeared ROE



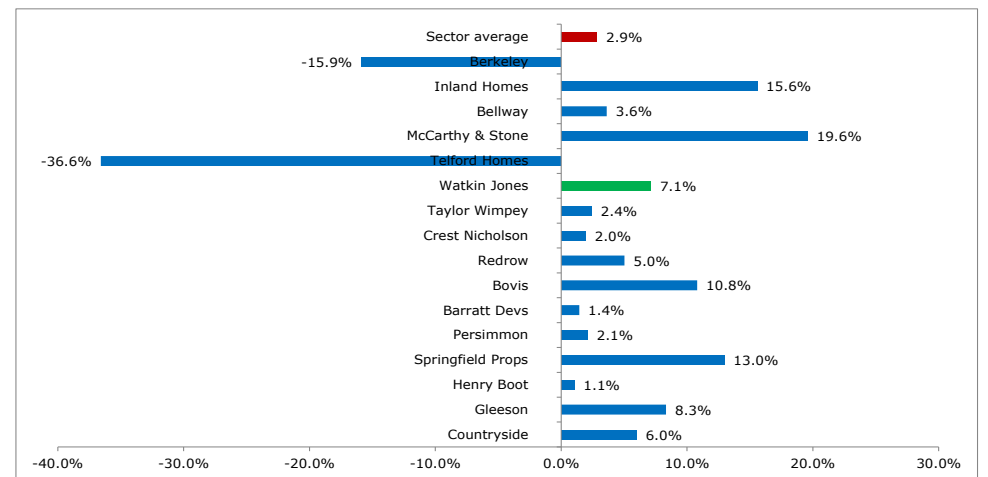
Source: Equity Development, arithmetic average for sector

CY ROE (reported)



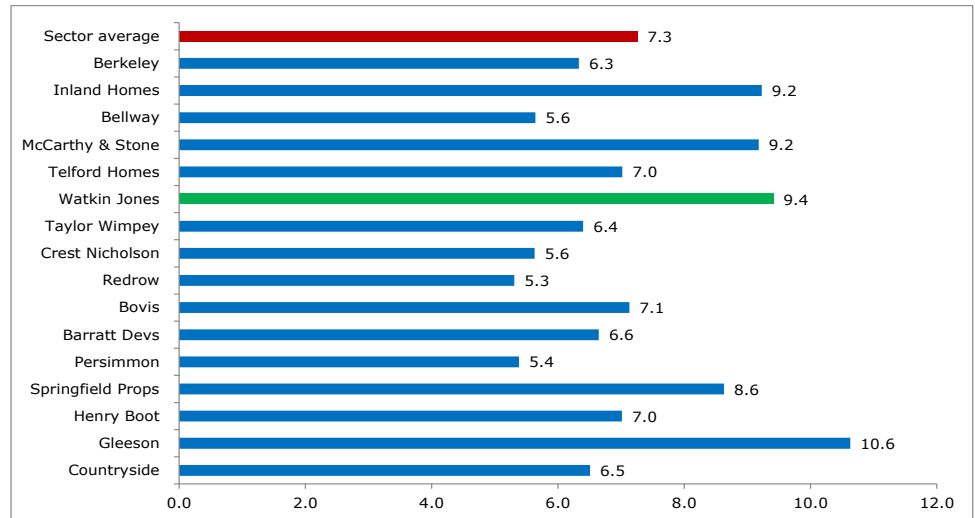
Source: Equity Development, arithmetic average for sector

CY + 1 EPS growth rates



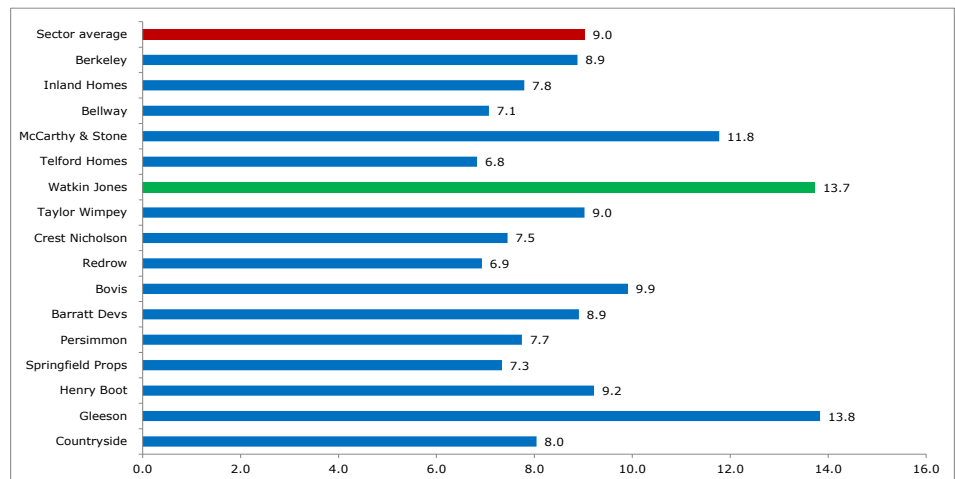
Source: Equity Development : arithmetic average for sector

CY EV/EBIT multiples vs peers



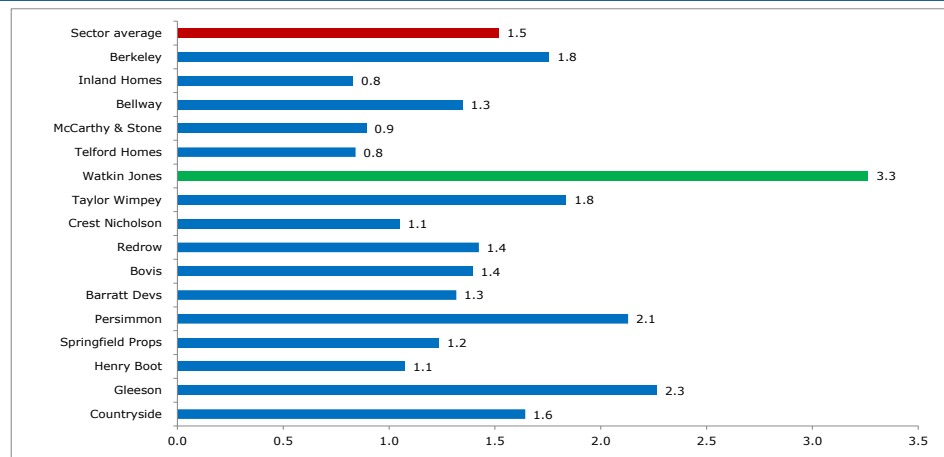
Source: Equity Development : arithmetic average for sector

CY PER multiples vs peers



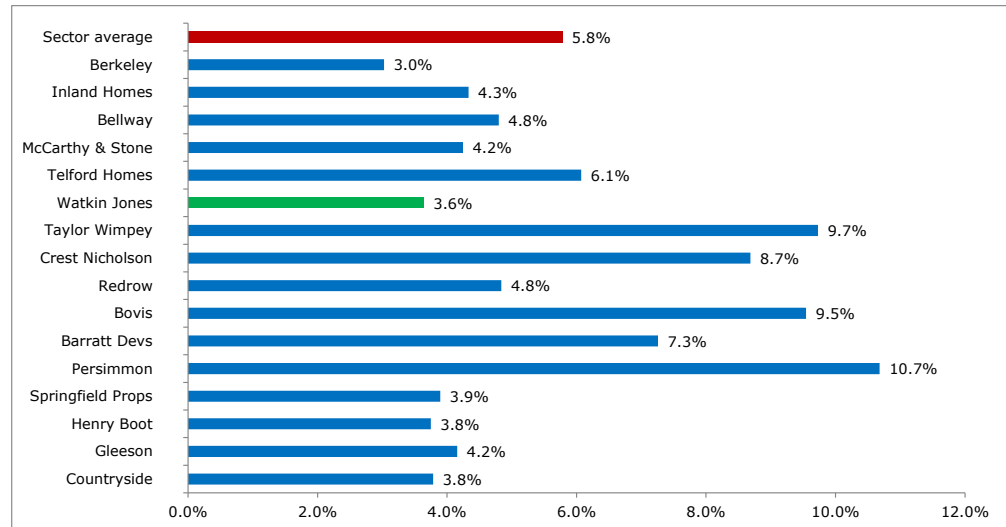
Source: Equity Development : arithmetic average for sector

CY Price : Book



Source: Equity Development, arithmetic average for sector

CY dividend yield vs peers



Source: Equity Development : arithmetic average for sector

Key risks

- Impact of a substantial jump in UK interest rates and/or a recession. This seems unlikely though, given that even the most pessimistic economic forecasts are for >1.5% GDP growth through to 2022.
- Protracted delays in obtaining planning consent, which traditionally has plagued the whole sector.
- Availability of skilled labour and associated resources at desired cost levels.
- Foreign exchange fluctuations could impact demand from international investors, from say Singapore, Hong Kong and China.
- Being relatively small in BTR, Watkin Jones could get squeezed by larger rivals, partners and customers.
- Future access to funding at commercial rates, perhaps in the unlikely event of another banking crisis.
- Generic risks of retention/recruitment of key staff, etc.
- Acquiring land at affordable rates.
- Withdrawal of government support for house-building (eg H2B, FTBs, stamp duty, etc).
- Brexit, and other possible legislative changes, say concerning building regulations, affordable housing, ground rents, etc
- Less demand from institutional money, if for example bond/gilt yields were to rise materially.



Investor Access

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