# Watkin Jones plc

## Time to be patient

2nd April 2020

Storms eventually blow over, even CAT 5 hurricanes like COVID-19, which has grounded airlines, cruise ships & travel firms worldwide. Together with forcing many others to close, namely pubs, restaurants, hotels and more recently construction sites.

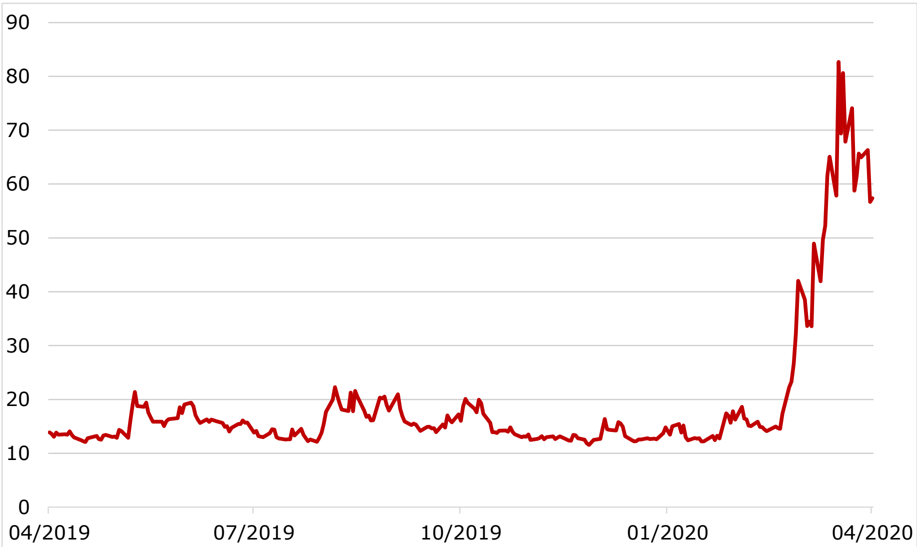
Last week came news that Watkin Jones was also temporarily suspending all non-essential work at its PBSA, BtR and housebuilding sites, in line with the rest of the industry. Nevertheless, sporting **gross cash of £71m** (net £35m, post site specific loans) as at March 2020, and a further **£31m of undrawn credit facilities**, we are confident that **the group will emerge from this crisis in a stronger competitive position**.

Additionally it has **forward sold all of its 2020 developments**, and **8 out of ten of those scheduled for 2021**. Thus providing robust cashflow/earnings visibility, despite near term revenue recognition being pushed to the right due to business interruption and social distancing measures.

## Ok, but how does the rest of 2020 pan out?

Well, the honest answer is nobody knows. Hence why the equity/bond markets are in such flux, while the VIX (ie investor fear gauge, see below) is trading at nose-bleed levels. However, after a great deal of digging into the pandemic, our base case is not quite so bleak.

**CBOE Volatility Index**




*Source: Equity Development, CBOE*

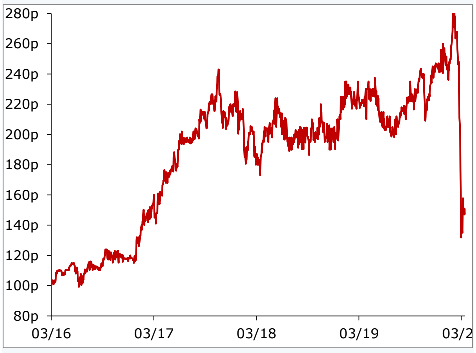
Indeed given the amount of expertise being thrown at the problem, we are hopeful that an effective anti-viral will be found by the autumn. With the aim of reducing fatality/hospitalisation rates, so that global healthcare systems are not overwhelmed. Alongside permitting lockdown restrictions to be lifted, and economies to breathe again.

Similarly, an effective vaccine should arrive in circa 12-18 months' time (or earlier). At which point, the world can get back to a semblance of normality.

**Company Data**

| | |
|---|---|
| EPIC | AIM:WJG |
| Price (previous close) | 146p |
| 52 week Hi/Lo | 260p/200p |
| Market cap | £373m |
| ED valuation/share | Withdrawn |
| Net cash March 2020 | £35m |
| Sharecount | 255.7m |
| Daily volume | 750k |

**Share Price (p)**




*Source: Share Cast*

**Company Description**

Watkin Jones is the **UK's leading developer and manager of 'residential for rent'**, with a focus 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.

The residential property & agency lettings business (Fresh) is also set to become a growth engine.

**Next news**: Interims May 2020


**Paul Hill (Analyst)**
0207 065 2690
paul.hill@equitydevelopment.co.uk

## So what does this mean for the PBSA & BtR sectors?

Here **Watkin Jones is already cutting discretionary spend and future investment**, albeit mindful not to harm operational capability. Further evaluating fiscal support programs, and **temporarily suspending the dividend** until "*disruption caused by COVID-19 is better understood*".

Additionally, there are **other buttons to push if things were to significantly deteriorate**. Not least, potentially furloughing underutilised staff, postponing investment and/or possibly accessing coronavirus related government loans. The exec directors, will not receive an annual pay increase either, meanwhile the non-execs have waived 20% of their fees.

## On track for strong 1st half & in-line with consensus

The frustrating thing is that **trading was actually "*strong*"** up to this point, **with H1'20 results set to be "*in line with expectations*"**. **All divisions performed well** (again), with COVID-19 only starting to impact right at the end of the period.

Likewise good progress was made expanding the pipeline and forward selling assets to institutional clients, including:

1. The forward sale of a 348 bed PBSA scheme at Wilder Street, Bristol, for delivery in FY21.
2. Agreement, with planning consent, to increase the forward sold PBSA development at Kelaty House, Wembley by 100 beds.
3. Secured two further PBSA sites in Bristol (291 beds) and Bath (300 beds).
4. Secured two further significant BtR sites in Birmingham (565 apartments) and Bath (323 apartments).

That said, **the Board have sensibly withdrawn FY20 guidance**, until there's greater clarity **–** and we've retracted our forecasts too. But believe at 146p, **the stock is attractively priced** for patient risk tolerant investors - trading on a trailing PER of 8.7x (see below) compared to typical sector multiples pre COVID-19 of between 10x–15x.

**Range of sector valuation benchmarks pre COVID-19**

| | **Watkin Jones 2019 Trailing** | **Typical industry multiples pre COVID-19 crisis** | |
|---|---|---|---|
| | | **Low** | **High** |
| Return on equity | 24.2% | 10.0% | 20.0% |
| PER | 8.7 | 10.0 | 15.0 |
| PER (ex net cash) | 6.9 | 10.0 | 15.0 |
| EV/EBIT | 5.7 | 8.0 | 12.0 |
| Dividend yield | 5.7% | 3.0% | 7.0% |
| Price Book | 2.1 | 1.3 | 2.5 |

*Source: Equity Development*

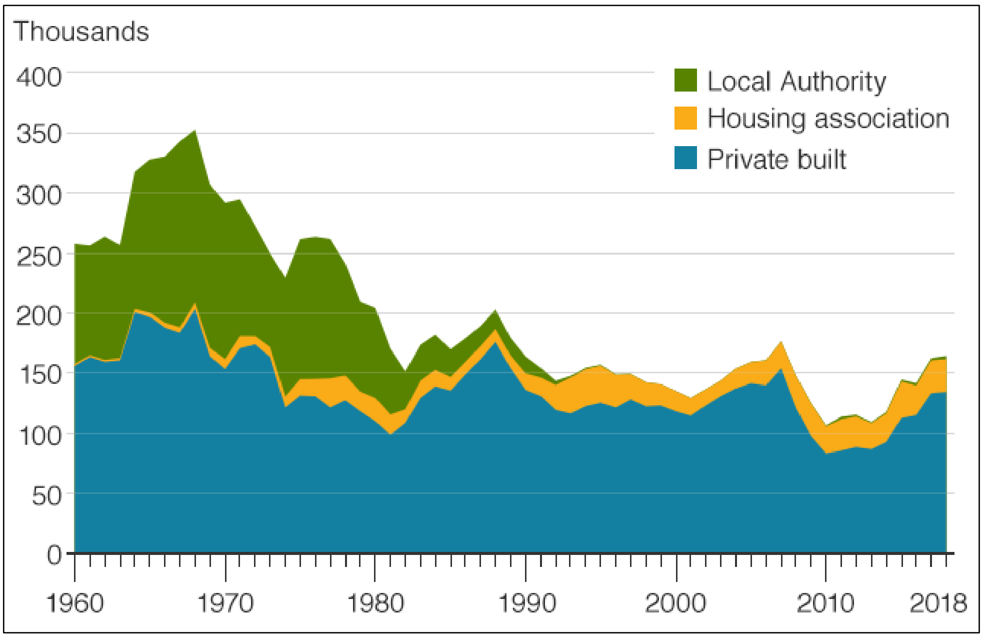
**Longer term, the secular drivers underpinning the UK PBSA, BtR & Housing markets remain intact**.

## UK's chronic lack of housing isn't going away

The Conservatives have promised at least another 1m new homes over the next 5 years (target 300k/yr) – with BtR playing a central role. Not only alleviating the acute lack of rental properties, but also enabling people to move easily between jobs (re mobility), regenerating inner-city areas and upgrading dilapidated accommodation.

At the end of Sept'19, there were 148,046 such homes in the UK at varying stages of construction, up 19.8% from LY (source: British Property Federation) – & worth in aggregate c. £10.6bn.

**Chronic shortage of new homes being built in the UK**



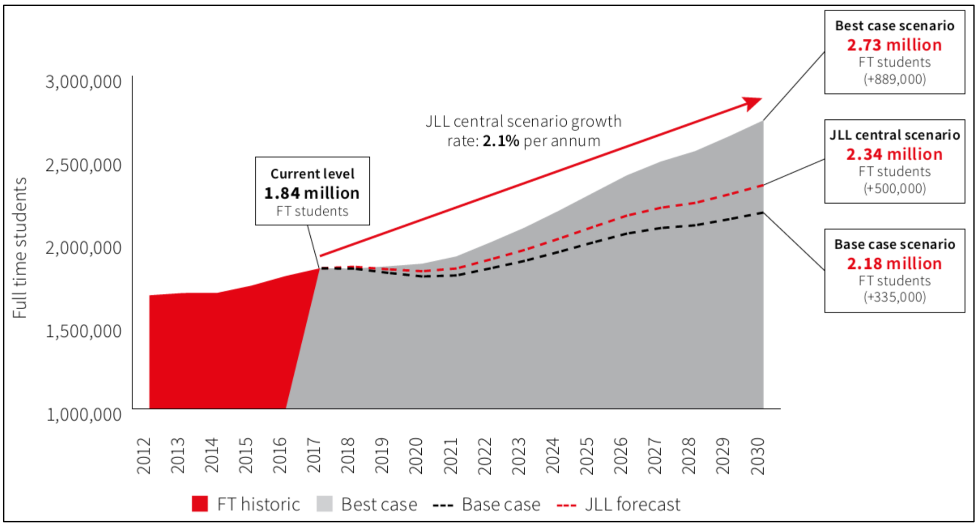

*Source: BBC*

Ultimately though, Savills reckon BtR could tip £542bn - corresponding to 1.7m homes, or approx. 1/3rd of the country's private rented sector (PRS). The vast majority of which are owned by buy to let (BTL) landlords, who are being squeezed by tax hikes (eg stamp duty) and stricter building regulations.

## It's little different with student accommodation

Elsewhere, Jones Lang LaSalle predict there will be 500k more full time students by 2030 (see base case below) – mirroring a rise in 18-year olds from 2021, a moderate lift in participation rates and ongoing demand from overseas. The government is aiming to attract 600k international students by 2030 vs 458.5k in 2017/18 (+31%).

## Full time student demand forecasts




*Source: Jones Lang LaSalle (Dec'19)*

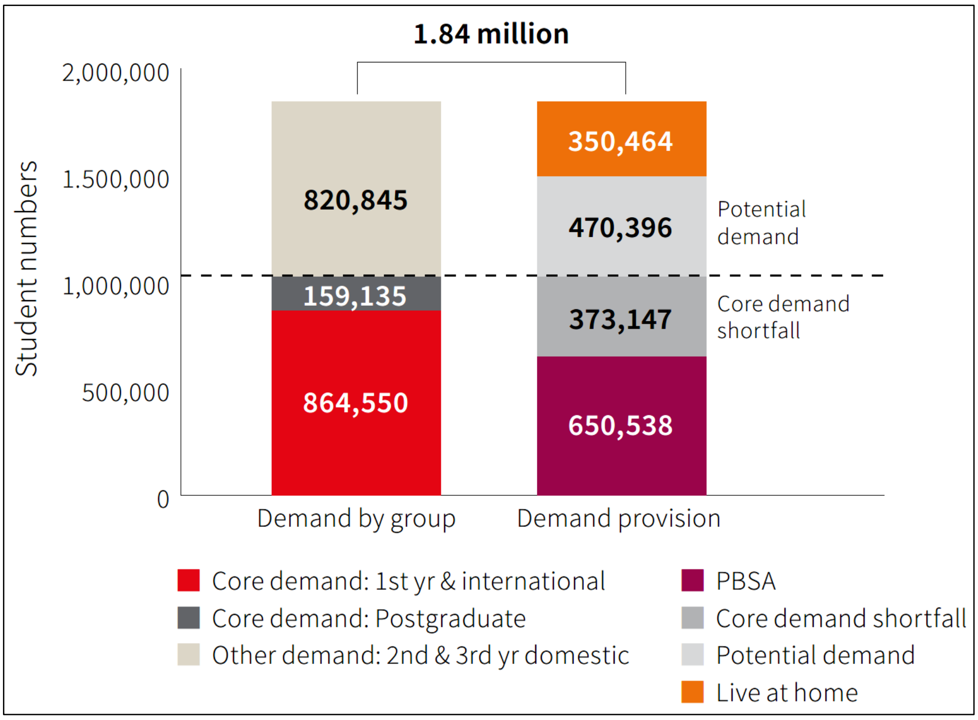
## University population set to rise 2.1% CAGR to 2030

But that's not all. There are **more people opting for post-graduate courses** (up >1/3rd in 10 years), augmented by **many 2nd & 3rd year undergrads now choosing PBSA** in preference to traditional digs.

Granted, COVID19 may deter some students (particularly foreign) from taking up places in Sept'20. Yet equally, one could argue that if there are fewer jobs around, this will encourage more under 21s to choose higher education to advance their career prospects.

Besides, there's still a **significant demand vs supply imbalance for PBSA** anyway. For instance, there are only 650k beds (see above) - split 50:50 university vs corporately owned - compared to 1.1m full time students living away from home, and 864.6k 1st year undergraduates & international students.

## PBSA supply/demand imbalance

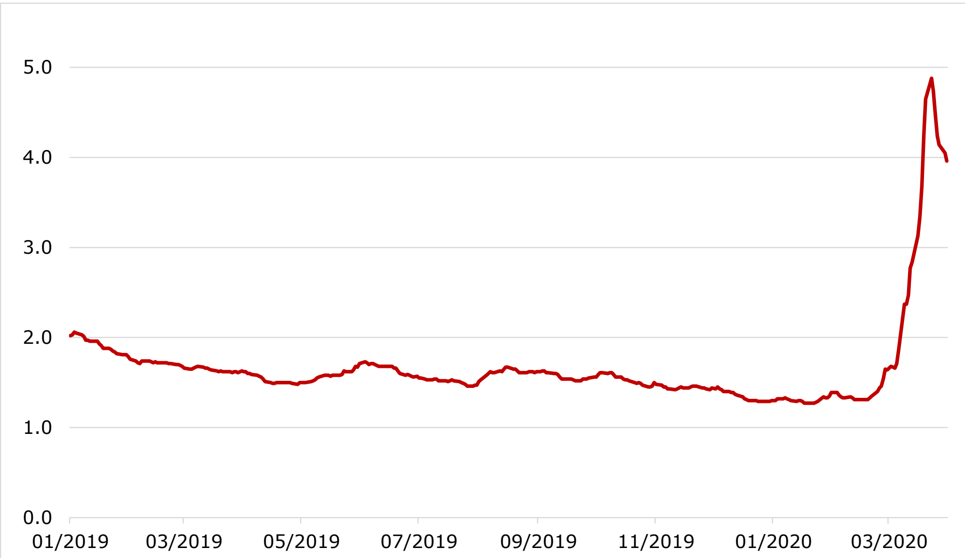



*Source: Jones Lang LaSalle (Dec'19)*

## Institutional investors still needs to deploy capital

In terms of capital availability, the recent spike in corporate bond yields (see below) might cause institutions to briefly pause putting new money to work. Albeit as central banks pour $trillions of liquidity into the financial system - spearheaded by the US Federal Reserve going 'all in on QE infinity' (ie Helicopter money, Chinook style) – then it should (in theory) enable borrowing costs to settle down.

## BBB US Corporate Index Option-Adj'd Spread (% vs Treasuries)




*Source: Equity Development*

## Watkin Jones helps industry fix cladding issue

Lastly - reflecting new government guidance (published 20/01/20) on the suitability of cladding (re Grenfell) - Watkin Jones (as an act of goodwill) has offered to split the initial cost of any historical remediation work that might be required.

At this early stage, the expense is predicted to be between £12m-£15m over the next 2-3 years. Some of which may be recoverable from sub-contractors and/or consultants. A one off charge will raised at the year end.

## Summary financial projections

| **Watkin Jones (continuing)**<br>(Sept yearend) | **2015 Act**<br>**£'ms** | **2016 Act**<br>**£'ms** | **2017 Act**<br>**£'ms** | **2018 Act**<br>**£'ms** | **2019 Act**<br>**£'ms** |
|---|---|---|---|---|---|
| **Turnover** | | | | | |
| Student (PBSA) accommodation | 228.2 | 237.2 | 256.1 | 312.7 | 246.1 |
| Build to Rent (BTR) | 0.0 | 0.0 | 1.2 | 3.8 | 73.6 |
| Residential development | 15.9 | 26.3 | 18.1 | 30.0 | 38.1 |
| Fresh property management | | 2.8 | 6.1 | 7.3 | 7.5 |
| Other / construction | 0.2 | 0.7 | 20.4 | 9.3 | 9.5 |
| **Total** | **244.2** | **267.0** | **301.9** | **363.1** | **374.8** |
| ***Group revenue growth % YoY*** | *73.5%* | *9.3%* | *13.1%* | *20.3%* | *3.2%* |
| *Student (PBSA) accommodation* | | *3.9%* | *8.0%* | *22.1%* | *-21.3%* |
| *Build to Rent (BTR)* | | | | *209.5%* | *1856.5%* |
| *Residential development* | *-12.6%* | *65.3%* | *-31.3%* | *65.8%* | *27.0%* |
| *Fresh property management* | | | *116.6%* | *19.2%* | *2.2%* |
| Student (PBSA) accommodation | 41.5 | 48.6 | 56.6 | 60.7 | 51.6 |
| Build to Rent (BTR) | 0.0 | 0.0 | 0.7 | 1.0 | 13.2 |
| Residential housing | 2.7 | 3.0 | 3.0 | 4.4 | 7.7 |
| Fresh property management | 0.0 | 1.7 | 3.8 | 4.5 | 4.6 |
| Other | -0.1 | 0.5 | -0.5 | 1.8 | -0.3 |
| **Group gross profit** | **44.0** | **53.8** | **63.5** | **72.4** | **76.8** |
| ***Group % margin*** | ***18.0%*** | ***20.2%*** | ***21.0%*** | ***20.0%*** | ***20.5%*** |
| *Student (PBSA) accommodation* | *18.2%* | *20.5%* | *22.1%* | *19.4%* | *21.0%* |
| *Build to Rent (BTR)* | | | *56.3%* | *27.1%* | *18.0%* |
| *Residential housing* | *16.6%* | *11.5%* | *3.8%* | *14.6%* | *20.3%* |
| *Fresh property management* | | *58.9%* | *49.4%* | *61.8%* | *61.5%* |
| Admin | -10.6 | -14.6 | -20.8 | -22.8 | -24.5 |
| Distribution / other | -1.0 | -1.4 | 0.0 | 0.0 | 0.0 |
| **Adjusted EBIT** | **32.5** | **37.9** | **42.7** | **49.6** | **52.3** |
| ***% margin*** | ***13.3%*** | ***14.2%*** | ***14.1%*** | ***13.7%*** | ***14.0%*** |
| **EBITDA (incl JV profits)** | **33.6** | **41.5** | **45.2** | **50.9** | **53.7** |
| *% margin* | *13.8%* | *15.6%* | *15.0%* | *14.0%* | *14.3%* |
| Profit from JVs | 1.2 | 3.0 | 1.4 | 1.1 | 0.3 |
| Net interest | -0.7 | -1.0 | -0.9 | -0.7 | -0.3 |
| **Adj profit before Tax** | **32.9** | **39.8** | **43.3** | **50.1** | **52.3** |
| *Effective tax rate* | *-19.1%* | *-20.5%* | *-17.3%* | *-18.6%* | *-18.5%* |
| **Adjusted EPS (pence)** | **10.4** | **12.4** | **14.0** | **16.0** | **16.7** |
| *EPS growth rate* | *138.5%* | *19.2%* | *13.1%* | *13.8%* | *4.6%* |
| *Net assets per share (p)* | *44* | *40* | *49* | *60* | *69* |
| *Net tangible assets per share (p)* | *44* | *34* | *44* | *54* | *63* |
| ***Dividend (p)*** | | ***4.0*** | ***6.6*** | ***7.6*** | ***8.4*** |
| ***Valuation benchmarks*** | | | | | |
| *P/E ratio* | *14.0* | *11.8* | *10.4* | *9.1* | *8.7* |
| *P/E ratio (excluding net cash)* | | | | *7.2* | *6.9* |
| *Price/Tangible book* | *3.3* | *4.3* | *3.3* | *2.7* | *2.3* |
| *Price/Book* | *3.3* | *3.6* | *3.0* | *2.4* | *2.1* |
| *EV/EBIT* | *9.1* | *7.8* | *6.9* | *6.0* | *5.7* |
| *Return on Equity (y/e adj earnings/NA)* | *23.5%* | *30.8%* | *28.4%* | *26.6%* | *24.2%* |
| *Dividend yield* | | *2.7%* | *4.5%* | *5.2%* | *5.7%* |
| **Net cash/(debt)** | **39.1** | **32.2** | **41.0** | **80.2** | **76.8** |
| Net cash / share (p) | 15.3 | 12.6 | 16.1 | 31.4 | 30.1 |
| Sharecount (Ks) | 255,269 | 255,269 | 255,269 | 255,269 | 255,382 |
| **Shareprice** | **146p** | | | | |

*Source: Equity Development*

Note: FY19 exceptional charge of £2.6m relates to compensation to CEO for forfeited incentives held with former employer, £2.2m of which was a share based non-cash expense.

## Key risks

- COVID-19 related delays and disruption.
- 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.
- Foreign exchange fluctuations could impact demand from international investors, from say Singapore, Hong Kong and China.
- 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. Availability of skilled labour and associated resources at desired cost levels.
- 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

**Hannah Crowe**
Direct: 0207 065 2692
Tel: 0207 065 2690
hannah@equitydevelopment.co.uk

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More information is available on our website

www.equitydevelopment.co.uk

Equity Development, 15 Eldon Street, London, EC2M 7LD. Contact: info@equitydevelopment.co.uk 0207 065 2690