WATKIN JONES

HOME CONSTRUCTION

4 October 2022

WJG.L

152p

Market Cap: £389.9m

SHARE PRICE (p)

12m high/low	277p/149p

Source: LSE Data (priced as at prior close)

KEY DATA

Net (Debt)/Cash	£75.0m *(at 30/09/22)*
Enterprise value	£314.9m
Index/market	AIM
Next news	FY results, Jan 2023
Shares in Issue (m)	256.2
Chairman	Alan Giddins
CEO	Richard Simpson
CFO	Sarah Sergeant

COMPANY DESCRIPTION

Watkin Jones develops large-scale residential-for-rent properties in the build-to-rent & student accommodation markets.

www.watkinjones.com

WATKIN JONES IS A RESEARCH CLIENT OF PROGRESSIVE

ANALYSTS

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Strong rental market offset by margin pressure

Residential-for-rent developer and manager Watkin Jones has confirmed in today's trading statement a strong operational performance in the second half of the year to 30 September 2022, with investor demand for rental assets remaining strong and good visibility going into FY23E. However, the group said it had encountered some pricing and margin softness as its institutional investors faced increased funding costs. We have reduced our estimates for FY22E and FY23E but remain confident in the longer-term prospects, driven by strong demand from tenants, which has boosted rents.

- **Strong demand, but pricing pressure.** Investor demand for residential-for-rent assets has remained strong, with three build-to-rent (BTR) schemes and three purpose-built student accommodation (PBSA) schemes forward sold in H2, bringing the total for FY22E to £0.9bn, from £0.3bn in H1. While in H1 build-cost inflation was offset by increasing asset values, WJG saw pricing and margin softness on sales in the second half, with purchasers facing increased funding costs. Two forward sales that were planned to close in September have been impacted by the recent market volatility and are now planned to transact in FY23E. While H2 was materially stronger than H1, the Board now expects FY22E underlying operating profit to be c.10% below market expectations
- **Our forecasts.** We have cut our FY22E EBIT from £60m to £54m and, taking a prudent stance, for FY23E from £80m to £55m. Our adjusted PBT goes from £55m to £49m for FY22E and from £75m to £50m for FY23E. Our dividend expectations are unchanged.
- **Long-term rental demand opens up opportunities.** We believe that both the BTR and student accommodation markets offer substantial long-term growth opportunities, driven by the rising demand among tenants and the attractive income characteristics for institutional investors, for which WJG's forward-funding model offers lower risk for both parties. The group's £95m net cash could offer major opportunities in the land market.
- **Unique capital-light, low-risk model.** WJG develops BTR, PBSA and urban regeneration assets, forward-funded by institutions, which in our view reduces risk and cyclicality with low capital tie-up. The accommodation management division has relatively sustainable revenues (page 4).

FYE SEP (£M)	2019	2020	2021	2022E	2023E
Revenue	374.8	354.1	430.2	421.3	545.4
Fully Adj PBT	50.4	45.8	51.1	49.0	50.0
Fully Adj EPS, dil (p)	16.1	14.7	16.3	15.5	15.8
Dividend per share (p)	8.4	7.4	8.2	8.7	7.9
PER (x)	9.5x	10.4x	9.3x	9.8x	9.6x
Dividend yield (%)	5.5%	4.8%	5.4%	5.7%	5.2%
EV/EBITDA (x)	4.9x	5.2x	4.8x	4.9x	4.9x

Source: Company Information and Progressive Equity Research estimates.

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Key assumptions in forecast changes

- **Revenue.** We have reduced our revenue estimate for FY22E by £140m, from £561m to £421m, to reflect the slippage of the two forward sales that were expected to complete in September in the Student accommodation and BTR divisions, with most of the reduction coming in Student accommodation. For FY23E, we have cut our revenue estimate by £114m from £659m to £545m. This reflects the delayed forward sales from FY22E, offset by our prudent view of potentially slower deal flow on the basis of economic uncertainty continuing in the medium term.
- **Margins.** We have trimmed our margin for Student accommodation from 17.0% to 15.0% for FY22E and maintained our estimate of 17% in FY2023E. For BTR, we had forecast 15.0% and then 17.0%, but have raised FY22E to 17.0%, to reflect strong H2 performance, and cut FY23E to 13.0%.
- **Profit on sale.** The group also achieved a strong financial outcome on the previously flagged sale of the two leasehold assets, which we have disclosed separately as an £18.0m profit.
- **Other.** We have not changed our assumptions for the two other divisions, but have raised our admin costs by £1.3m and £2.6m for the two years, respectively.
- **Interest and tax.** There are now changes to our interest cost assumptions. We have cut the rate of Corporation tax for FY23E from 22% (six-month effect) to 19% following the reversal of the planned rise to 25% in the 'mini-budget'. This adds 3.8% to our adjusted EPS figure.
- **Net cash.** Pre-IFRS16 net cash was recorded as c.£75m for FY22E in the statement; we have assumed £80m for FY23E on the basis that there could be significant opportunities for investment in land and work in progress.

Figure 1: Watkin Jones – FY and HY divisional performance (£m unless stated)

Year-end September	2018	2019	2020	2021	2022E	2023E	H1 2021	H2 2021	H1 2022	H2E 2022E
Revenue										
Student accommodation	312.7	246.1	226.0	259.9	180.0	300.0	104.8	155.1	78.3	101.7
Change (%)	*22.1%*	*-21.3%*	*-8.2%*	*15.0%*	*-30.7%*	*66.6%*	*-13.3%*	*47.4%*	*-25.3%*	*-34.4%*
Build-to-rent	3.8	77.4	94.0	138.6	195.0	204.8	59.1	79.5	93.8	101.2
Change (%)	*na*	*na*	*21.4%*	*47.4%*	*40.7%*	*5.0%*	*43.3%*	*50.6%*	*58.7%*	*27.4%*
Affordable-led Homes	30.0	34.3	26.3	22.7	24.9	28.7	10.7	12.0	5.4	19.5
Change (%)	*65.8%*	*14.4%*	*-23.4%*	*-13.7%*	*10.0%*	*15.0%*	*-45.6%*	*80.2%*	*-49.4%*	*62.8%*
Accommodation management	7.3	7.5	7.6	7.8	10.0	12.0	3.8	3.9	4.1	5.9
Change (%)	*19.2%*	*2.2%*	*1.7%*	*2.3%*	*28.8%*	*20.0%*	*-8.0%*	*14.7%*	*7.4%*	*49.5%*
Corporate	9.3	9.5	0.3	1.3	11.4	-	0.1	1.3	11.4	-
Group revenue	**363.1**	**374.8**	**354.1**	**430.2**	**421.3**	**545.4**	**178.4**	**251.8**	**193.0**	**228.3**
Change (%)	*20.3%*	*3.2%*	*-5.5%*	*21.5%*	*-2.1%*	*29.4%*	*-3.9%*	*49.5%*	*8.2%*	*-9.3%*
Gross profit										
Student accommodation	60.7	54.9	54.3	50.5	27.0	51.0	25.2	25.2	13.0	14.0
Margin (%)	*19.4%*	*22.3%*	*24.0%*	*19.4%*	*15.0%*	*17.0%*	*24.1%*	*16.3%*	*16.6%*	*13.8%*
Build-to-rent	1.0	13.8	14.9	29.8	33.2	26.6	12.4	17.4	12.0	21.2
Margin (%)	*27.1%*	*17.8%*	*15.8%*	*21.5%*	*17.0%*	*13.0%*	*21.0%*	*21.9%*	*12.8%*	*20.9%*
Affordable-led Homes	4.4	7.2	4.0	2.6	3.0	3.4	1.5	1.1	0.6	2.4
Margin (%)	*14.6%*	*20.9%*	*15.4%*	*11.3%*	*12.0%*	*12.0%*	*14.0%*	*8.9%*	*11.1%*	*12.2%*
Accommodation management	4.5	4.6	4.5	4.1	5.0	7.0	2.2	1.9	2.7	2.3
Margin (%)	*61.8%*	*61.5%*	*59.8%*	*52.6%*	*50.0%*	*58.3%*	*58.4%*	*47.0%*	*65.9%*	*39.0%*
Corporate	1.8	(0.3)	(1.8)	(2.1)	-	-	0.0	(2.1)	1.6	(1.6)
Gross profit	**72.4**	**80.0**	**75.9**	**84.8**	**68.1**	**88.0**	**41.3**	**43.5**	**29.9**	**38.2**
Margin (%)	*20.0%*	*21.4%*	*21.4%*	*19.7%*	*16.2%*	*16.1%*	*23.2%*	*17.3%*	*15.5%*	*16.7%*
AM admin[1]	(3.2)	(3.2)	(3.4)	(4.2)	(5.1)	(5.7)	na	na	na	na
Group admin	(19.6)	(21.3)	(20.8)	(23.3)	(27.0)	(27.3)	(12.3)	(15.3)	(15.3)	(16.8)
Profit on sale of l-hold properties	-	-	-	18.0	-	-	-	-	-	18.0
EBIT, group only	**49.6**	**55.6**	**51.7**	**57.3**	**54.0**	**55.0**	**29.1**	**28.2**	**14.6**	**21.4**
Share in op profit of JVs	1.1	0.3	0.2	(0.1)	-	-	-	(0.1)	-	-
Total operating profit	**50.8**	**55.9**	**51.9**	**57.2**	**54.0**	**55.0**	**29.1**	**28.1**	**14.6**	**21.4**
Exceptionals	4.3	(2.6)	(20.4)	-	(28.0)	-	-	-	(28.0)	-
Net interest	(0.7)	(5.4)	(6.1)	(6.0)	(5.0)	(5.0)	(3.2)	(2.8)	(3.2)	(1.8)
PBT	**54.3**	**47.9**	**25.3**	**51.1**	**21.0**	**50.0**	**25.8**	**25.3**	**(16.6)**	**19.6**
Add back exceptionals	(4.3)	2.6	20.4	-	28.0	-	-	-	28.0	-
Adj PBT	**50.1**	**50.4**	**45.8**	**51.1**	**49.0**	**50.0**	**25.8**	**25.3**	**11.4**	**19.6**
EBITDA	**50.9**	**64.8**	**61.1**	**65.9**	**63.8**	**64.8**	**33.4**	**32.6**	**18.8**	**27.0**
Adj EPS, dil (p)	**16.0**	**16.1**	**14.7**	**16.3**	**15.5**	**15.8**	**8.1**	**-**	**3.6**	**-**
DPS (p)	**7.6**	**8.35**	**7.35**	**8.2**	**8.7**	**7.9**	**2.6**	**5.6**	**2.9**	**5.3**
Net debt, post-IFRS 16	80.2	(60.7)	(39.6)	(4.9)	(50.0)	(39.6)	(100.0)	(4.9)	(99.2)	(50.0)
Net cash, pre-IFRS 16		**88.4**	**94.8**	**124.3**	**75.0**	**80.4**	**31.7**	**124.3**	**26.8**	**75.0**

Source: Company Information and Progressive Equity Research estimates. [1] FY only

WJG in brief: low-risk, capital-light, in growth markets

Unique model addresses growing rental market, with low exposure to development risk and capital tie-up

The group, admitted to AIM in 2016, in our view offers a unique low-risk, capital-light development and asset management model for private and student rental. It develops BTR and PBSA schemes, largely forward-funded by institutional investors, which acquire sites from WJG with the benefit of planning and then pay for the works monthly as development progresses, thus reducing capital tie-up for WJG. The group also provides an accommodation management service through its Fresh Property Group (FPG) business, which manages both WJG and third-party developed assets, and operates a more traditional housebuilding business focused on the North West, with the intention signalled to pivot this into affordable housing. We believe the group should benefit from continuing growth opportunities in new student accommodation, has 'early mover advantage' in BTR, and this is all tied together by FPG in what we have defined as a 'virtuous circle'. For more details, see our 9 June 2020 initiation, *Build-to-rent 'comes of age'*.

Key current themes: addressing growing rental markets

- **Institutional investment resilient.** Institutional investors have underpinned the group's capital-light growth model by acquiring developments on a forward-sale basis, in which they pay for the land and the development works as they progress. Despite the repricing referred to in the statement due to higher funding costs, demand has remained robust for both BTR and PBSA because of long-term visibility of rental income.
- **Build-to-Rent.** As we argued in our initiation note, we expect long-term growth in BTR, fuelled by demand from renters, either economically or for 'life-style', and from investors, attracted by income prospects while other sources of yield are diminishing.
- **Student demand remains high despite Covid challenges.** Despite worries that Brexit and Covid may deter university entries, particularly from overseas students, UCAS registered a new record in the number of applications from both home and abroad. While remote teaching by universities and uncertainty during the pandemic could reduce the number of students choosing to study away from home in the current year, in our view it remains the preference of the majority to study at their university of choice, and so we expect lettings to recover to normal levels post-Covid.
- **Opportunities in land market – boosted by strong balance sheet.** Any slowdown in investment decisions could, in our view, open up new opportunities for WJG to buy land at reduced prices, given the group's net cash of c. £75m. We believe WJG could exploit significant opportunities from landowners in challenged sectors such as retail and leisure. We believe WJG could benefit from recent changes to planning rules, allowing vacant office and retail properties to be fast-tracked for residential use.
- **House building arm pivoting into the affordable homes market.** The largely stand-alone Residential division, which historically operated a private-focused housebuilding model mainly in the North West of England, is piloting a move into affordable housing, which will operate through a capital-light forward-sale model. This will be led by affordable housing and include BTR as well as private housing for sale. The group has announced its first affordable homes site.
- **Fresh accommodation management: tying the group together.** We see Fresh as not only providing a stable income stream from its regular management fees but also using its insight and 'brand' to tie together student accommodation, BTR and possibly co-living as graduates move into work.

Financial Summary: Watkin Jones

Year end: September (£m unless shown)

PROFIT & LOSS	**2019**	**2020**	**2021**	**2022E**	**2023E**
Revenue	374.8	354.1	430.2	421.3	545.4
Adj EBITDA	64.8	61.1	65.9	63.8	64.8
Adj EBIT	55.6	51.7	57.3	54.0	55.0
Reported PBT	47.9	25.3	51.1	21.0	50.0
Fully Adj PBT	50.4	45.8	51.1	49.0	50.0
NOPAT	41.1	37.6	41.9	39.7	40.5
Reported EPS (p)	15.2	8.2	16.4	4.6	15.8
Fully Adj EPS (p)	16.1	14.7	16.3	15.5	15.8
Dividend per share (p)	8.4	7.4	8.2	8.7	7.9
CASH FLOW & BALANCE SHEET	**2019**	**2020**	**2021**	**2022E**	**2023E**
Operating cash flow	38.9	54.9	76.3	(8.8)	46.8
Free Cash flow	23.8	38.0	61.3	(23.3)	32.0
FCF per share (p)	9.3	14.9	23.9	(9.1)	12.5
Acquisitions	0.2	0.8	0.1	0.0	0.0
Net cash flow	9.0	18.9	1.8	(45.1)	10.4
Overdrafts / borrowings	176.3	174.1	141.2	141.2	141.2
Cash & equivalents	115.7	134.5	136.3	91.2	101.6
Net (Debt)/Cash, pre-IFRS 16	88.4	94.8	124.3	75.0	80.4
IFRS 16 Lease liabilities	(149.0)	(134.5)	(129.3)	(125.0)	(120.0)
Net (Debt)/Cash post-IFRS 16	(60.7)	(39.6)	(4.9)	(50.0)	(39.6)
NAV AND RETURNS	**2019**	**2020**	**2021**	**2022E**	**2023E**
Net asset value	161.1	167.8	184.8	174.8	193.7
NAV/share (p)					
Net Tangible Asset Value	147.3	154.6	172.1	162.6	182.1
NTAV/share (p)					
Average equity	157.1	164.5	176.3	179.8	184.2
Post-tax ROE (%)	28.1%	23.6%	12.0%	23.3%	6.4%
METRICS	**2019**	**2020**	**2021**	**2022E**	**2023E**
Revenue growth	3.2%	(5.5%)	21.5%	(2.1%)	29.4%
Adj EBITDA growth	27.2%	(5.7%)	7.9%	(3.2%)	1.6%
Adj EBIT growth	12.1%	(7.1%)	10.8%	(5.6%)	1.8%
Adj PBT growth	0.8%	(9.3%)	11.7%	(4.1%)	2.0%
Adj EPS growth	0.7%	(8.5%)	11.2%	(5.3%)	2.0%
Dividend growth	9.9%	(12.0%)	11.6%	6.1%	(9.1%)
Adj EBIT margins	14.8%	14.6%	13.3%	12.8%	10.1%
VALUATION	**2019**	**2020**	**2021**	**2022E**	**2023E**
EV/Sales (x)	0.8	0.9	0.7	0.7	0.6
EV/EBITDA (x)	4.9	5.2	4.8	4.9	4.9
EV/NOPAT (x)	7.7	8.4	7.5	7.9	7.8
PER (x)	9.5	10.4	9.3	9.8	9.6
Dividend yield (%)	5.5%	4.8%	5.4%	5.7%	5.2%
FCF yield	6.1%	9.8%	15.7%	(6.0%)	8.2%

Source: Company information and Progressive Equity Research estimates

Progressive
EQUITY RESEARCH

4 October 2022

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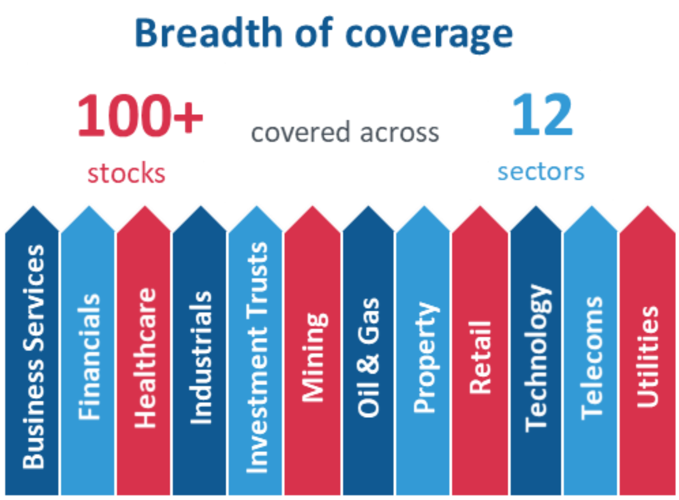

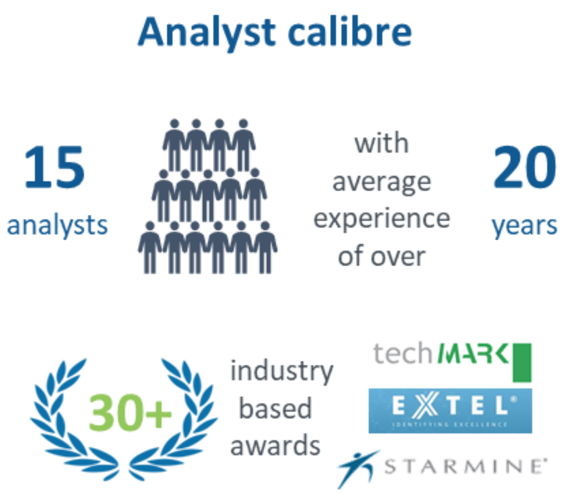

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