Progressive EQUITY RESEARCH

WATKIN JONES (WJG.L)

HOME CONSTRUCTION

July 2024

52.2p - Market Cap: £133.7m

SHARE PRICE (p)

12m high/low	58p/32p

Source: LSE Data

KEY DATA

Net (Debt)/Cash	£44.0m *(at 31/03/24)*
Enterprise value	£89.7m
Index/market	AIM
Next news	FY trading update, Oct
Shares in Issue (m)	256.2

TOP TEN SHAREHOLDERS

Octopus Investments	12.0%
Gresham House Plc	6.6%
M&G Investment Management	5.6%
Watkin Jones 1992 Trust	5.5%
Fidelity International	5.3%
Polar Capital	5.3%
abrdn Investment Mgt	5.0%
Investec Wealth	4.4%
Hargreaves Lansdown	3.9%
Close Brothers	3.8%

www.watkinjones.com

WATKIN JONES IS A RESEARCH CLIENT OF PROGRESSIVE

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Long-term growth fuelled by 'Generation Rent'

Company description

Watkin Jones (WJG) offers a unique low-risk, capital-light development and asset management model for private and student rental. It develops build-to-rent (BTR) and purpose-built student accommodation (PBSA) schemes, largely forward-funded by institutional investors, thus reducing capital tie-up for WJG. It owns very few rental assets of its own.

These institutions acquire sites from WJG once planning has been granted; WJG simultaneously agrees fixed-price contracts with subcontractors, reducing inflation risk, and the institutions subsequently pay for construction monthly as development progresses.

WJG also provides an accommodation management service through its Fresh Property Group (FPG) business, which manages both WJG and third-party assets. WJG is pivoting its more traditional private-led housebuilding business, focused on the North West, into an affordable-led mixed-tenure housing developer, which we believe provides synergies with BTR and improved attractions to planning authorities.

Investment case summary

WJG has a unique model, focused on institutional demand for rental income in a strongly growing market:

- Institutions are attracted by the growth in demand for BTR, due to high house prices and lifestyle changes. The attraction of PBSA is the security of income, given fixed academic terms and relative lack of supply in top university towns.
- WJG has a well-established track record with institutional investors for delivering rental assets on schedule and within budget. The cash-rich group's forward-funding model reduces risk and requires little capital to be tied up.

In our view, WJG benefits from demand for its projects outstripping supply and from high barriers to entry for new rivals, given its reputation with institutions.

FYE SEP (£M)	2020	2021	2022	2023	2024E
Revenue	354.1	430.2	407.1	413.2	401.3
Fully Adj PBT	45.8	51.1	48.8	-2.9	11.5
Fully Adj EPS, dil (p)	14.7	16.3	14.8	-0.6	3.4
Dividend per share (p)	7.4	8.2	7.4	1.4	0.0
PER (x)	3.6x	3.2x	3.6x	N/A	15.8x
Dividend yield (%)	13.8%	15.4%	13.9%	2.6%	N/A
EV/EBITDA (x)	1.5x	1.4x	1.5x	12.9x	3.7x

Source: Company Information and Progressive Equity Research estimates

Investor criteria – how Watkin Jones measures up…

What investors look for	What Watkin Jones offers
Large and growing market with diverse revenue streams	The greatest growth potential is in BTR due to huge demand and under-supply of new rental, which is dominated by 'buy-to-let'. PBSA demand could shift to redevelopment of on-campus accommodation.
Recurring (or repeat) business from blue-chip customers, or otherwise reliable revenue base	Most of WJG's institutional investors are 'repeat customers', due to the group's experience and track record. FPG provides a steady 'service' income profile.
Defensible position with barriers to entry	The group's reputation, expertise, economies of scale and relationships with planners and supply chains all provide significant barriers to entry.
Strong margins, cash generation and dividends	Margins are de-risked by supply chains signing fixed-price contracts simultaneously with institutions agreeing the value of contracts. Cashflow is enhanced by WJG's low working capital requirements.
Positioned for acquisitive growth	The group has not made any significant acquisitions, given its substantial organic growth potential and broad in-house capabilities.
Strong ESG credentials – as a business or via products/services	Three commitments: 'Future planet' (environmental performance of the business and developments), 'Future people' (staff welfare and development) and 'Future places' (creating communities that support lives of people in and around WJG's homes).
Credible, strategic and experienced management team	The Board and management are highly experienced in the rental development market. The company has a long track record (originally dating to 1791, formed by the Jones family), and in 1999 started focusing its development model on student housing, evolving a forward-funding model in this area and in private rental.

Business model

WJG is entirely focused on the UK, predominantly for delivery and management of new-build rental accommodation.

It has four divisions: PBSA, BTR, FPG and Affordable-led Housing. A split of revenue by geography is shown on page 5:

- PBSA builds forward-funded student accommodation, comprising bedrooms and communal facilities in multi-storey blocks in town centres.
- BTR operates a similar model, providing one- and two-bedroom apartments for private rental, mainly for singles and couples, and is exploring 'Co-living'.
- FPG manages properties for WJG's institutional and third-party owners.
- Affordable-led, previously a 'traditional' housebuilder, is refocusing on mixed-tenure homes, which ties up less capital and faces less cyclical risk, potentially partnering with BTR and PBSA.

FPG offers steady income, service to owners and intelligence for future projects, while Affordable-led can bring planning advantages in partnership with BTR.

Together, the four businesses provide low-risk growth in a 'virtuous circle' of inter-divisional synergies and development opportunities with only modest capital requirements. The group's experience and well-established reputation with institutions present significant entry barriers to potential rivals.

Illustration of product offering

Source: Progressive Equity Research / company information

Market dynamics

There is a huge structural under-supply of purpose-built homes for rent, with demand growing due to lack of affordability in the sales market and a dwindling buy-to-let sector.

There are three core end markets, with differing dynamics:

- BTR offers long-term growth opportunities, underpinned by under-supply and facing less cyclical risk than the sales market. UK rentals are dominated by buy-to-let, where landlords are being forced to sell due to tax changes. Although various market entrants have tried to replicate the model of the huge US 'multi-family' development sector in recent years, they have had limited market penetration and, arguably, have over-estimated demand for 'up-market' facilities. WJG's BTR offering is focused on mid-income renters.
- The overall market for PBS is steadier and demand from students greatly exceeds supply in top university towns, supporting security of rental income for institutional investors.
- There is huge under-supply of various affordable family housing tenures, with growing political pressure to expand provision and significant appetite from institutions to invest in what they see as secure long-term income.

We also expect steady growth in demand from third-party rental property owners for FPG's services, due to its strong track record and branding. For WJG as a whole, there is very little risk to the private housing sales cycle.

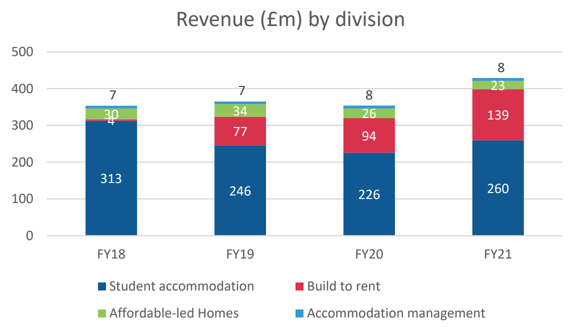
If there are serious disruptions in the financial markets, WJG carries little exposure since ongoing contracts are agreed with owners and supply chains. It carries very little inventory (eg no exposure to falling rents and no 'land banks' as in the case of a housebuilder, which could need to be written down).

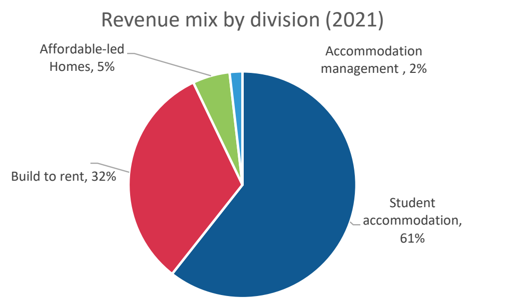
Customer examples

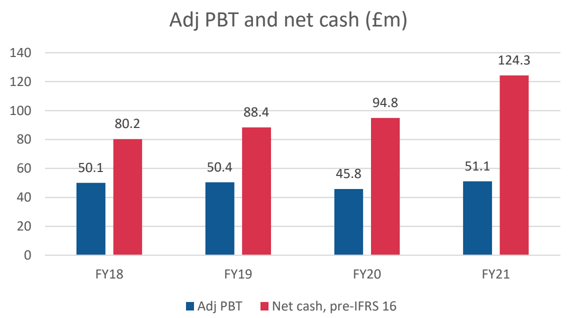
WJG's main customers are institutional investors, which forward-fund PBSA and BTR developments. They may also become involved in funding Affordable-led developments, along with local authorities and housing associations.

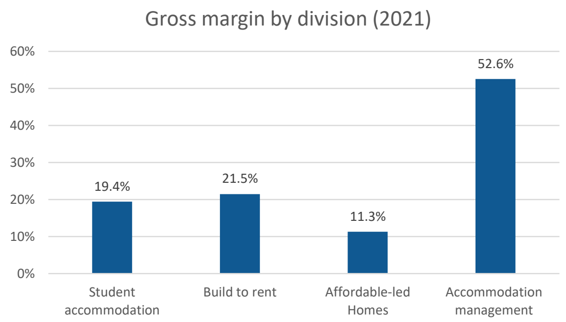
Source: Progressive Equity Research / company information

Financial performance









Source: Progressive Equity Research / company information

Business catalysts

- A lowering of inflation assumptions could lead to further settling in bond yields, which could attract institutional investors back into the market after a hiatus following the 'mini-budget'.
- Reduced availability and affordability of mortgages for first-time buyers could further increase demand for BTR.
- The widely reported shortage of affordable housing should increase demand for the Affordable-led division.
- Positive newsflow, such as new agreements for the three development divisions, planning approvals and further mandates for Fresh.

Executive Management Team and Chair

Alan Giddins

Chairman

Alan has been Managing Partner and Global Head of Private Equity at 3i Group and a member of its Executive Committee. Prior to joining 3i, he spent 13 years in investment banking advising a broad range of quoted companies. He is currently chair of FTSE 250 group Hill & Smith Holdings and a non-exec director and investment committee member of Big Society Capital.

Alex Pease

CEO

Alex joined Watkin Jones in 2010 and was appointed Chief Investment Officer in 2021. In July 2023, Alex took up the Interim CEO role and in November was appointed Chief Executive Officer. Prior to Watkin Jones, Alex spent six years in the Savills Residential Investment team where he specialised in brokerage, consultancy and valuation across all residential asset classes. He is a chartered surveyor (MRICS).

Simon Jones

CFO

Sarah was appointed CFO Designate in October 2021, assuming the full role in November 2021. She was previously CFO of the UK & Ireland region at Compass Group, the FTSE 100 food and support services company. Her senior finance and operational roles in 13 years at Compass included Group Financial Controller, M&A Director and CFO, Asia Pacific. She is a chartered accountant.

Key risks and challenges

Areas of concern	Management mitigation
Demand risk: BTR	BTR is counter-cyclical compared to the sales market and is being driven by structural under-supply. WJG has targeted sites with at least 100,000 professional employees within each proposed catchment areas and assumed rent projections at no more than 35% of local income.
Demand risk: PBSA	Any decline in overseas students could be mitigated by greater demand from UK students, given the greater security and conditions of PBSA over traditional 'homes of multiple occupation' (HMOs).
Client and supply chain risk	Land prices and fixed-price construction subcontracts are calculated and signed 'back to back' as part of forward-funding development agreements with clients, minimising risk of cost over-runs. WJG has well-established partnerships with its supply chain.
Financial markets turbulence	Turbulence in financial markets, especially gilt yields, can lead institutions to reconsider their investment decisions. Where this involves re-pricing, WJG can seek to mitigate this by changing the price it offers for land.
Cladding	After revised government guidance in January 2020, WJG has worked with the owners of certain of its developed properties to remediate cladding, and has made what it believes to be suitable cost provisions.

Financial Summary: Watkin Jones

Year end: September (£m unless shown)

PROFIT & LOSS	**2020**	**2021**	**2022**	**2023**	**2024E**
Revenue	354.1	430.2	407.1	413.2	401.3
Adj EBITDA	61.1	65.9	63.1	7.1	25.0
Adj EBIT	51.7	57.3	54.7	0.2	15.0
Reported PBT	25.3	51.1	18.4	(42.5)	10.2
Fully Adj PBT	45.8	51.1	48.8	(2.9)	11.5
NOPAT	42.5	47.0	42.6	0.1	11.2
Reported EPS (p)	8.2	16.4	5.2	(12.7)	2.9
Fully Adj EPS (p)	14.7	16.3	14.8	(0.6)	3.4
Dividend per share (p)	7.4	8.2	7.4	1.4	0.0
CASH FLOW & BALANCE SHEET	**2020**	**2021**	**2022**	**2023**	**2024E**
Operating cash flow	54.9	76.3	(19.6)	(17.2)	14.0
Free Cash flow	38.0	61.3	(15.3)	(16.5)	7.7
FCF per share (p)	14.9	23.9	(6.0)	(6.4)	3.0
Acquisitions	0.8	0.1	0.0	0.0	0.0
Net cash flow	18.9	1.8	(25.5)	(38.4)	7.7
Overdrafts / borrowings	174.1	141.2	77.4	73.7	73.7
Cash & equivalents	134.5	136.3	110.8	72.4	80.1
Net (Debt)/Cash, pre-IFRS 16	94.8	124.3	82.6	43.9	51.6
IFRS 16 Lease liabilities	(134.5)	(129.3)	(49.1)	(45.2)	(45.2)
Net (Debt)/Cash post-IFRS 16	(39.6)	(4.9)	33.5	(1.3)	6.4
NAV AND RETURNS	**2020**	**2021**	**2022**	**2023**	**2024E**
Net asset value	167.8	184.8	176.5	128.8	137.4
NAV/share (p)	65.5	72.1	68.8	50.2	53.1
Net Tangible Asset Value	154.6	172.1	164.3	117.2	125.1
NTAV/share (p)	60.3	67.2	64.1	45.7	48.8
Average equity	164.5	176.3	180.9	153.5	133.1
Post-tax ROE (%)	12.8%	23.8%	7.4%	(21.2%)	5.5%
METRICS	**2020**	**2021**	**2022**	**2023**	**2024E**
Revenue growth	(5.5%)	21.5%	(5.4%)	1.5%	(2.9%)
Adj EBITDA growth	(5.7%)	7.9%	(4.3%)	(88.7%)	251.8%
Adj EBIT growth	(7.1%)	10.8%	(4.5%)	(99.7%)	8709.4%
Adj PBT growth	(9.3%)	11.7%	(4.6%)	(105.9%)	(501.1%)
Adj EPS growth	(8.5%)	11.2%	(9.7%)	(104.4%)	(616.9%)
Dividend growth	(12.0%)	11.6%	(9.8%)	(81.1%)	(100.0%)
Adj EBIT margins	14.6%	13.3%	13.4%	0.0%	3.7%
VALUATION	**2020**	**2021**	**2022**	**2023**	**2024E**
EV/Sales (x)	0.3	0.2	0.2	0.2	0.2
EV/EBITDA (x)	1.5	1.4	1.5	12.9	3.7
EV/NOPAT (x)	2.2	2.0	2.2	930.3	8.2
PER (x)	3.6	3.2	3.6	N/A	15.8
Dividend yield (%)	13.8%	15.4%	13.9%	2.6%	N/A
FCF yield	28.0%	45.0%	(11.2%)	(12.1%)	5.6%

Source: Company information and Progressive Equity Research estimates

Progressive Equity Research

July 2024

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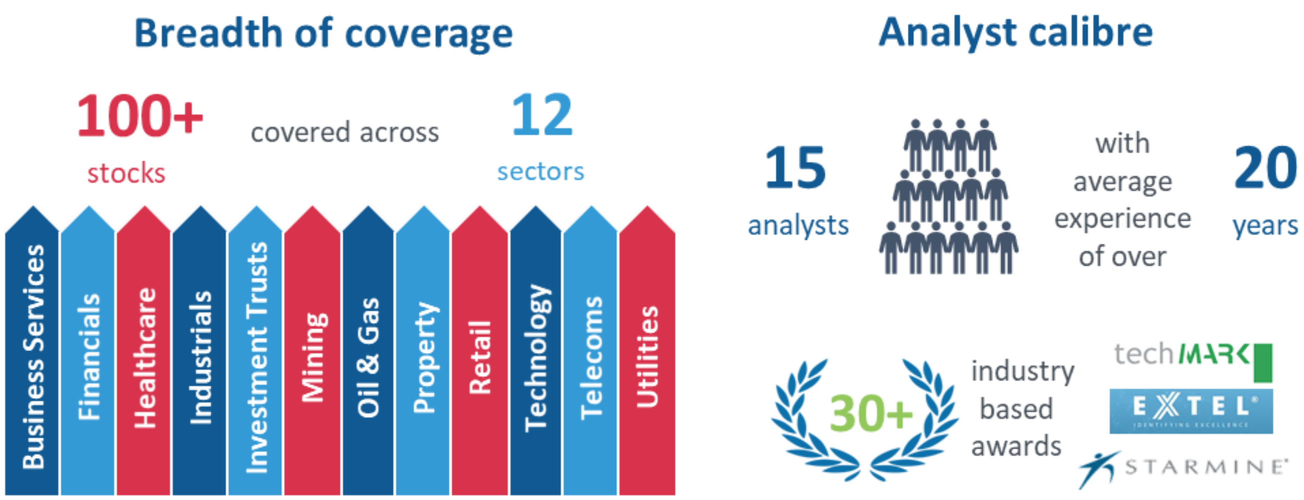

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