Progressive EQUITY RESEARCH

WATKIN JONES
HOME CONSTRUCTION

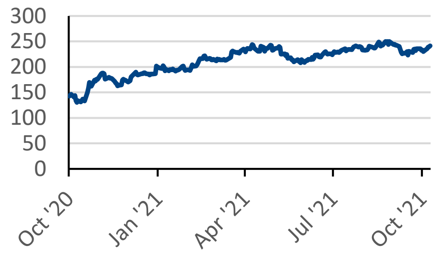
2 November 2021

WJG.L

242p

Market Cap: £618.7m

SHARE PRICE (p)



12m high/low	250p/130p

Source: LSE Data

KEY DATA

Net (Debt)/Cash	£125.3m *(at 30/09/21)*
Enterprise value	£493.4m
Index/market	AIM
Next news	FY results, Jan
Shares in Issue (m)	256.2
Chairman	Alan Giddins
CEO	Richard Simpson
CFO	Philip Byrom

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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Profit 'in-line' and cash 'beat' in FY21E update

Residential-for-rent developer and manager Watkin Jones has confirmed in today's trading update that operating profit for the year to September 2021 will be in line with expectations, but that year-end net cash of £125m is £40m ahead of our estimates. We are not changing our FY22E P&L estimates but have increased our net cash in line with the 'beat' for FY21E. The statement precedes today's Capital Markets Day at which WJG will highlight its sustainability and affordable homes strategies against what we see as a backdrop of increasingly supportive build-to-rent and student markets.

- **'In-line' profits.** Operating profit for FY21E is expected to be in line with expectations despite a shortfall in forecast revenue due to the forward sale of one site completing shortly after the year-end. Pre-IFRS 16 net cash is estimated at £125m, up from £95m the previous year and our previous estimate of £85m. We have maintained our FY21E operating profit and PBT estimates at £54.8m and £50.0m, respectively, but have cut revenue to the Group's new forecast of £430m from our estimate of £480m.
- **FY22E PBT unchanged, cash increased.** We have not changed our FY22E revenue and PBT estimates ahead of the FY21 results, which gives an EPS of 17.4p, but we have nudged the dividend from 8.5p to 8.7p to reflect WJG's policy of paying a dividend 2.0x covered by adjusted earnings.
- **Robust delivery, growing pipeline.** All five build-to-rent (BTR) and seven purpose-built student accommodation (PBSA) developments scheduled for delivery in FY21E were completed and handed over and all 13 in build are on track. Despite inflationary pressures, overall build costs are being closely managed and remain in line with WJG's forecasts. Since the 6 September update, new forward sales agreements worth £227m have been added to the forward sold pipeline. The secured pipeline for BTR and PBSA now has a future revenue value to WJG of c.£1.75bn.
- **Growth in Fresh and affordable housing.** The Fresh accommodation management division has lifted student beds and BTR apartments under management by 10.1% to 22,210. The pilot project to refocus Residential to a more capital-light affordable homes model is proceeding well.
- **Unique capital light, low risk model.** WJG develops sites that are forward-funded by institutional investors. This, in our view, reduces occupation risk and cyclicality, with low capital tie-up; the accommodation management division has relatively sustainable revenues and provides significant consumer insight for its PBSA and BTR development activities (page 5).

FYE SEP (£M)	2018	2019	2020	2021E	2022E
Revenue	363.1	374.8	354.1	429.8	549.6
Fully Adj PBT	50.1	50.4	45.8	50.0	55.0
Fully Adj EPS (p)	16.0	16.1	14.7	15.8	17.4
Dividend per share (p)	7.6	8.4	7.4	7.8	8.7
PER (x)	15.1x	15.0x	16.4x	15.3x	13.9x
Dividend yield (%)	3.1%	3.5%	3.0%	3.2%	3.6%
EV/EBITDA (x)	9.7x	7.6x	8.1x	7.7x	7.1x

Source: Company Information and Progressive Equity Research estimates.

Rental and regeneration strategies remain on track

Minimal changes to current estimates except major upgrade to net cash in both forecast years

The trading statement, in our view, supports our previous themes of growing demand for institutional BTR, emphasised in our note last week and new data on falling supply (page 4), and the continuing investor appetite for PBSA, reinforced by the growing accommodation management division and potential from refocusing Residential on urban regeneration and affordable housing. The only changes we have made to our current estimates (Figure 1) are:

- **FY21E revenue, profit and EPS.** We have reduced BTR revenue by £50m to reflect the land sale referred to in the update, which slipped into FY22E. Land sales typically have lower margins than development, so our operating margin for the year represents a modest improvement, based on the mix. Our FY21E EPS and dividend estimates are unchanged.
- **FY22E revenue and profit.** In theory we envisage a slight increase in FY22E revenue, due to the land sale, but will await greater 'granularity' at the preliminary results in January before we make any changes.
- **Net cash.** The year-end FY21F pre-IFRS 16 net cash position of c.£125m beat our estimate of £85m. We had previously expected FY22E to remain at a similar level to that of FY21E, with growth in operating cashflow invested in growth in the development pipeline. We maintain that view, albeit with a higher starting point entering FY22E. Our now single-digit post-IFRS net debt estimates continue to assume lease liabilities of £130m and £125m for FY21E and FY22E, respectively.
- **FY22E EPS and dividend.** We have kept EPS at 17.4p, but slightly increased the dividend to 8.7p to reflect 2.0x cover.

We plan to introduce estimates for FY23E and FY24E after the FY21 results, scheduled for January.

Capital Markets Day

CMD to focus on markets, growth targets and ESG strategy

The Group will host a virtual Capital Markets Day today from 2pm to 4pm. CEO Richard Simpson will be joined by newly appointed Chairman Alan Giddins, incoming CFO Sarah Sergeant and members of the Executive Management team to provide an update on the Group's markets, its sustainability strategy and the ongoing refocusing of its existing Residential division on the affordable homes market.

A recording of the event will be available via the Group's investor relations website: www.watkinjonesplc.com.

The Group has today updated its sustainability strategy and targets across the three themes of 'people, places and planet'.

More details on http://www.watkinjonesplc.com/ESG.

Figure 1: FY and HY divisional performance

Year-end September	2017	2018	2019	2020	2021E	2022E	H1 2020	H2 2020	H1 2021	H2 2021E
Revenue										
Student accommodation	256.1	312.7	246.1	226.0	288.2	273.8	120.8	105.3	104.8	183.4
Change (%)	*8.0%*	*22.1%*	*-21.3%*	*-8.2%*	*27.5%*	*-5.0%*	*-6.2%*	*-10.3%*	*-13.3%*	*74.3%*
Build-to-rent	1.2	3.8	77.4	94.0	100.6	233.1	41.2	52.8	59.1	41.5
Change (%)		*na*	*na*	*21.4%*	*7.0%*	*132%*	*na*	*-23.2%*	*43.3%*	*-21.4%*
Residential	18.1	30.0	34.3	26.3	32.8	34.5	19.6	6.7	10.7	22.2
Change (%)	*-31.3%*	*65.8%*	*14.4%*	*-23.4%*	*25.0%*	*5.0%*	*12.5%*	*-60.5%*	*-45.6%*	*233.1%*
Accommodation management	6.1	7.3	7.5	7.6	8.0	8.0	4.1	3.4	3.8	4.2
Change (%)	*Na*	*19.2%*	*2.2%*	*1.7%*	*5.5%*	*0.0%*	*7.5%*	*-4.6%*	*-8.0%*	*21.7%*
Corporate	20.4	9.3	9.5	0.3	0.3	0.3	(0.1)	0.3	0.1	0.2
Group revenue	**301.9**	**363.1**	**374.8**	**354.1**	**429.8**	**549.6**	**185.7**	**168.4**	**178.4**	**251.4**
Change (%)	*13.1%*	*20.3%*	*3.2%*	*-5.5%*	*21.4%*	*27.9%*	*16.7%*	*-21.9%*	*-3.9%*	*49.3%*
Gross profit										
Student accommodation	56.6	60.7	54.9	54.3	52.2	49.6	29.6	24.7	25.2	26.9
Margin (%)	*22.1%*	*19.4%*	*22.3%*	*24.0%*	*18.1%*	*18.1%*	*24.5%*	*23.5%*	*24.1%*	*14.7%*
Build-to-rent	0.7	1.0	13.8	14.9	20.3	30.3	6.6	8.2	12.4	7.9
Margin (%)	*56.3%*	*27.1%*	*17.8%*	*15.8%*	*20.2%*	*13.0%*	*16.1%*	*15.6%*	*21.0%*	*19.1%*
Residential	3.0	4.4	7.2	4.0	5.4	5.2	3.7	0.3	1.5	3.9
Margin (%)	*16.7%*	*14.6%*	*20.9%*	*15.4%*	*16.5%*	*15.0%*	*19.1%*	*4.5%*	*14.0%*	*17.7%*
Accommodation management	3.8	4.5	4.6	4.5	4.8	4.8	2.6	2.0	2.2	2.6
Margin (%)	*61.9%*	*61.8%*	*61.5%*	*59.8%*	*60.0%*	*60.0%*	*61.9%*	*57.4%*	*58.4%*	*61.5%*
Corporate	(0.5)	1.8	(0.3)	(1.8)	-	-	(0.2)	(1.6)	0.0	(0.0)
Gross profit	**63.5**	**72.4**	**80.0**	**75.9**	**82.7**	**89.8**	**42.3**	**33.6**	**41.3**	**41.4**
Margin (%)	*21.0%*	*20.0%*	*21.4%*	*21.4%*	*19.2%*	*16.3%*	*22.8%*	*20.0%*	*23.2%*	*16.5%*
AM admin	(1.7)	(3.2)	(3.2)	(3.4)	(3.5)	(4.0)				
Group admin	(19.1)	(19.6)	(21.3)	(20.8)	(24.4)	(26.0)	(12.7)	(11.6)	(12.3)	(15.6)
EBIT, group only	**42.7**	**49.6**	**55.6**	**51.7**	**54.8**	**59.8**	**29.6**	**22.1**	**29.1**	**25.7**
Share in op profit of JVs	1.4	1.1	0.3	0.2	-	-	-	0.2	-	-
Total operating profit	**44.1**	**50.8**	**55.9**	**51.9**	**54.8**	**59.8**	**29.6**	**22.2**	**29.1**	**25.7**
Exceptionals	-	4.3	(2.6)	(20.4)	-	-	-	(20.4)	-	-
Net interest	(0.9)	(0.7)	(5.4)	(6.1)	(4.8)	(4.8)	(2.9)	(3.2)	(3.2)	(1.6)
PBT	**43.3**	**54.3**	**47.9**	**25.3**	**50.0**	**55.0**	**26.7**	**(1.4)**	**25.8**	**24.2**
Add back exceptionals	-	(4.3)	2.6	20.4	-	-	-	20.4	-	-
Adj PBT	**43.3**	**50.1**	**50.4**	**45.8**	**50.0**	**55.0**	**26.7**	**19.0**	**25.8**	**24.2**
EBITDA	**43.8**	**50.9**	**64.8**	**61.1**	**64.0**	**69.6**	**34.2**	**26.9**	**33.4**	**30.6**
Adj EPS (p)	**14.0**	**16.0**	**16.1**	**14.7**	**15.8**	**17.4**	**8.4**		**8.1**	
DPS (p)	**6.60**	**7.60**	**8.35**	**7.35**	**7.80**	**8.70**	**0.0**	**7.4**	**2.6**	**5.2**
Net debt, post-IFRS 16	41.0	80.2	(60.7)	(39.6)	(4.7)	(3.2)	(100.1)	(39.6)	(100.0)	(4.7)
Net cash, post-IFRS 16			**88.4**	**94.8**	**125.3**	**123.5**	**37.5**	**94.8**	**31.7**	**125.3**

Source: Company Information and Progressive Equity Research estimates

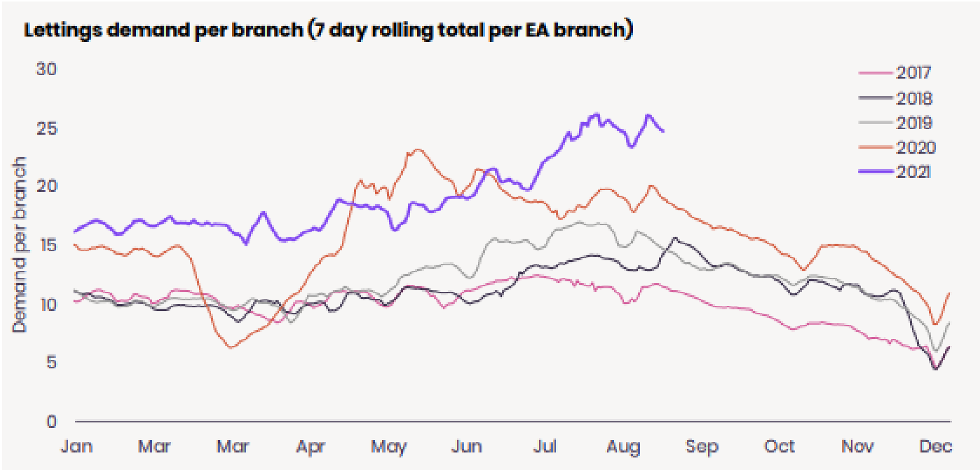
Recent data from estate agents highlights the retreat of buy-to-let investors - opening the way for BTR to supply growing demand for rental

BTR: demand-supply imbalance growing wider

In our 29 October note, Demand grows in rental and student markets, we highlighted growing demand and rental expectations, particularly a recovery in the long-depressed London market, which we believe will fuel the market for and returns for WJG's institutional investors in BTR. Further data from Zoopla Research graphically highlights the widening gulf between demand and supply in estate agent (EA) branches.

Demand is normally seasonal, generally peaking in the summer, but has steadily increased through 2021 with the number of lettings applicants tracked by the UK's second largest residential portal now at a record high as the economy reopens.

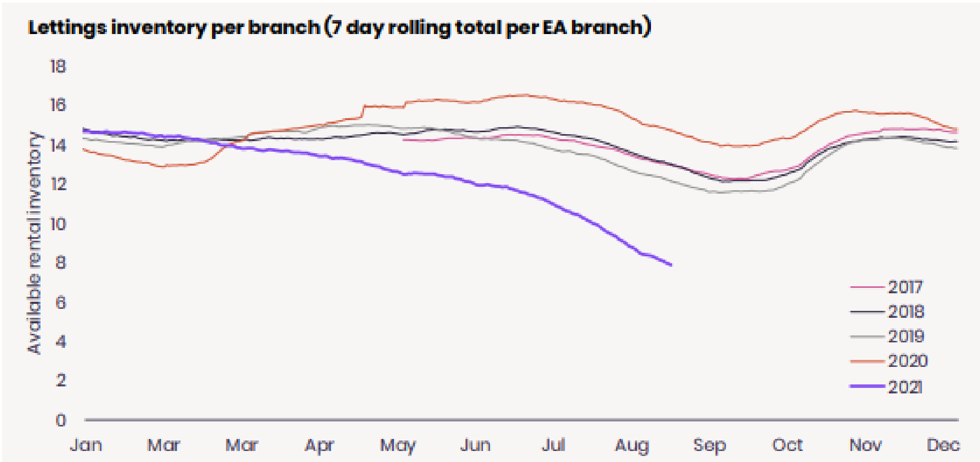
Figure 2: Rising demand …



Source: Zoopla Research

Meanwhile, supply has fallen sharply due to renters staying put and traditional buy-to-let investors leaving the market, due to tax and regulatory changes in recent years. In our view, this presents a major opportunity for the 'professional' alternative of institutional BTR.

Figure 3: … shrinking supply



Source: Zoopla Research

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'*.

Themes: addressing growing rental markets

- **Opportunities in land market – aided by planning changes.** 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.
- **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. Demand has remained robust for both BTR and PBSA due to 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 has registered a new record in the number of applications from both home and abroad. Whilst 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.
- **Co-living: a new string to the company's bow.** The interim results included WJG securing planning permission for its first co-living scheme, for 133 beds in Exeter. We see co-living, in which tenants have a private studio with shared communal facilities, as a potentially vibrant 'half-way house' between student life and 'full' private rental. We believe that, by extending the management by Fresh, WJG can further extend the 'virtuous circle' model by introducing new generations to WJG-built facilities.
- **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	**2018**	**2019**	**2020**	**2021E**	**2022E**
Revenue	363.1	374.8	354.1	429.8	549.6
Adj EBITDA	50.9	64.8	61.1	64.0	69.6
Adj EBIT	49.6	55.6	51.7	54.8	59.8
Reported PBT	54.3	47.9	25.3	50.0	55.0
Fully Adj PBT	50.1	50.4	45.8	50.0	55.0
NOPAT	40.7	41.1	37.6	40.5	44.6
Reported EPS (p)	17.3	15.2	8.2	15.8	17.4
Fully Adj EPS (p)	16.0	16.1	14.7	15.8	17.4
Dividend per share (p)	7.6	8.4	7.4	7.8	8.7
CASH FLOW & BALANCE SHEET	**2018**	**2019**	**2020**	**2021E**	**2022E**
Operating cash flow	66.6	38.9	54.9	75.0	39.6
Free Cash flow	54.1	23.8	38.0	60.4	23.9
FCF per share (p)	21.2	9.3	14.9	23.6	9.3
Acquisitions	3.0	0.2	0.8	0.0	0.0
Net cash flow	41.3	9.0	18.9	34.9	3.1
Overdrafts / borrowings	26.5	176.3	174.1	174.1	174.1
Cash & equivalents	106.6	115.7	134.5	169.4	172.6
Net (Debt)/Cash, pre-IFRS 16	80.2	88.4	94.8	125.3	123.5
IFRS 16 Lease liabilities		(149.0)	(134.5)	(130.0)	(125.0)
Net (Debt)/Cash post-IFRS 16		(60.7)	(39.6)	(4.7)	(1.5)
NAV AND RETURNS	**2018**	**2019**	**2020**	**2021E**	**2022E**
Net asset value	153.0	161.1	167.8	182.9	206.7
NAV/share (p)					
Net Tangible Asset Value	138.6	147.3	154.6	170.2	194.5
NTAV/share (p)					
Average equity	114.5	139.6	157.1	164.5	175.4
Post-tax ROE (%)	38.6%	27.8%	13.4%	24.6%	25.4%
METRICS	**2018**	**2019**	**2020**	**2021E**	**2022E**
Revenue growth	9.3%	3.2%	(5.5%)	21.4%	27.9%
Adj EBITDA growth	6.7%	27.2%	(5.7%)	4.7%	8.8%
Adj EBIT growth	16.7%	12.1%	(7.1%)	6.1%	9.2%
Adj PBT growth	11.2%	0.8%	(9.3%)	9.3%	10.1%
Adj EPS growth	NA	0.7%	(8.5%)	7.5%	10.1%
Dividend growth	NA	9.9%	(12.0%)	6.1%	11.5%
Adj EBIT margins	13.7%	14.8%	14.6%	12.7%	10.9%
VALUATION	**2018**	**2019**	**2020**	**2021E**	**2022E**
EV/Sales (x)	1.4	1.3	1.4	1.1	0.9
EV/EBITDA (x)	9.7	7.6	8.1	7.7	7.1
EV/NOPAT (x)	12.1	12.0	13.1	12.2	11.1
PER (x)	15.1	15.0	16.4	15.3	13.9
Dividend yield (%)	3.1%	3.5%	3.0%	3.2%	3.6%
FCF yield	8.8%	3.9%	6.2%	9.8%	3.9%

Source: Company information and Progressive Equity Research estimates

2 November 2021

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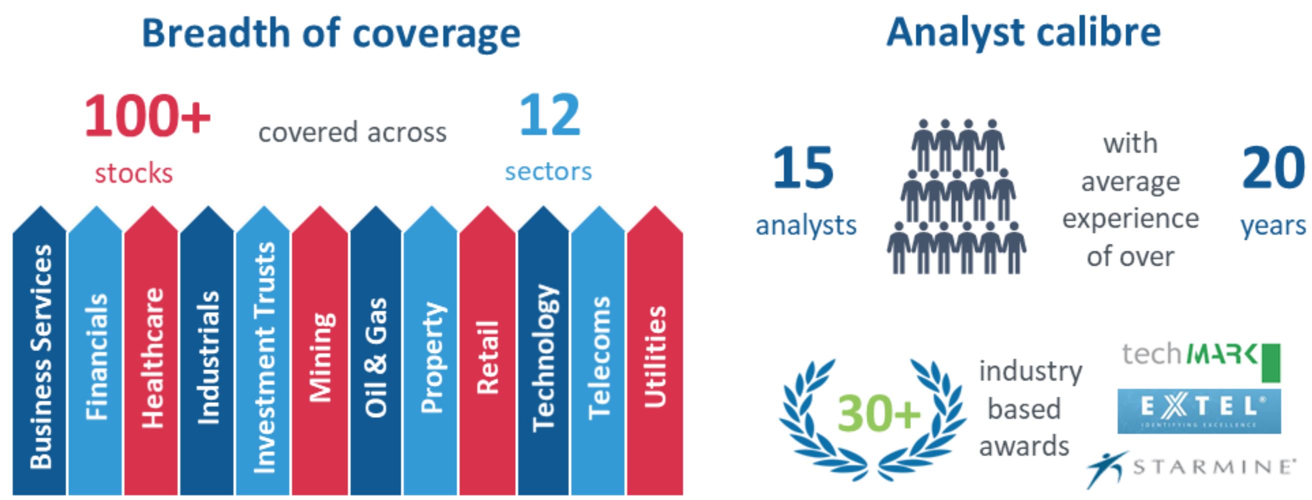

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