WATKIN JONES
HOME CONSTRUCTION

11 October 2023

WJG.L

34.9p

Market Cap: £89.3m

SHARE PRICE (p)

12m high/low	115p/35p

Source: LSE Data (priced as at prior close)

KEY DATA

Net (debt)/cash	£43.0m *(at 30/09/23)*
Enterprise value	£46.3m
Index/market	AIM
Next news	FY results, January
Shares in issue (m)	256.2
Chairman	Alan Giddins
Interim CEO	Alex Pease
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

Alastair Stewart

+44 (0) 20 7781 5308

astewart@progressive-research.com

FY23E outlook dips slightly; FY24E unchanged

Watkin Jones's FY23E year-end trading update is broadly in line with our expectations, albeit with slightly higher costs than previously signalled but significantly better net cash and no change to the remedial works provision. Encouragingly, guidance for FY24E is unchanged, with progress in forward sales of student and private assets to institutional investors. Data from both student and private rental markets continues to show huge under-supply.

- **FY23E: modest cost increase; much stronger cash.** The update, for the 12 months to September, confirmed the group was successful in achieving its operational objectives for the second half, with practical completion on four schemes in the final quarter and the previously announced sale of its three non-core private rental sector (PRS) operational assets. At the 19 July trading update we significantly downgraded FY23E estimates to breakeven at adjusted PBT level. Since then, Watkin Jones has incurred further additional costs, leading us to make a more modest cut, to a loss of £3.5m. However, pre-IFRS16 net cash guidance is significantly stronger, at c.£43m against our estimate of £20.1m – only partly explained by the £9m inflow from the disposals. Importantly, there was no change to the group's exceptional provision for remedial works for legacy properties.

- **FY24E: no change to profits; cash benefit feeds through.** While accepting that challenging market conditions are set to continue into the start of FY24, the group states 'there is no change to the FY24 guidance provided in the July trading update', pointing to secured revenue of c.£330m. The group is making progress with its forward sales and remains active, but highly selective, in the land market. We maintain our profitability and dividend forecasts but lift our net cash estimate to £49.9m from £29.6m.

- **Booming demand continues in end-markets.** A steady stream of data highlights what most observers view as a structural under-supply of institutional grade private rental homes, as well as student accommodation. For PRS, Zoopla's Q3 Rental Market Report reported a 10.5% Y/Y increase in rents for new lets, buoyed by over 32 enquiries per available home for rent. Purpose-built student accommodation (PBSA) is supported by strong growth in student numbers and under-supply underpinning more modest but positive rental growth, underpinned by full-term occupation, according to Knight Frank research. This now also appears to be supporting an early revival in large-scale institutional deals. We intend to explore these themes in more detail in due course.

FYE SEP (£M)	2020	2021	2022	2023E	2024E
Revenue	354.1	430.2	407.1	419.4	400.0
Fully Adj PBT	45.8	51.1	48.8	-3.5	11.5
Fully Adj EPS, dil (p)	14.7	16.3	14.8	-1.1	3.4
Dividend per share (p)	7.4	8.2	7.4	1.4	1.7
PER (x)	2.4x	2.1x	2.4x	N/A	10.4x
Dividend yield (%)	21.1%	23.5%	21.2%	4.0%	4.8%
EV/EBITDA (x)	0.8x	0.7x	0.7x	4.6x	1.8x

Source: Company Information and Progressive Equity Research estimates.

WJG in brief: Rental need underpins long-term growth

Unique investment model for student and private rental – strengthened with management and urban regeneration skills

The group, admitted to AIM in 2016, in our view offers a unique 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 Progressive's Watkin Jones research hub.

Key current themes: addressing growing rental markets

- **Institutional investment key to capital-light business model.** Institutional investors have underpinned the group's capital-light growth model by acquiring developments on a forward-sales basis, in which they pay for the land and the development works as they progress. Despite the repricing referred to in the recent trading 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.** We expect long-term growth in BTR, fuelled by demand from renters, either economically or for 'lifestyle', and from investors, attracted by income prospects, while outsourcing the development function to WJG.
- **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. We believe WJG could exploit significant opportunities from landowners in challenged sectors such as retail and leisure. WJG could also benefit from recent changes to planning rules, allowing vacant office and retail properties to be fast-tracked for residential use.
- **Housebuilding 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 indicated at the results that growth would slow down slightly in the near term.
- **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	**2020**	**2021**	**2022**	**2023E**	**2024E**
Revenue	354.1	430.2	407.1	419.4	400.0
Adj EBITDA	61.1	65.9	63.1	10.0	25.1
Adj EBIT	51.7	57.3	54.7	0.0	15.0
Reported PBT	25.3	51.1	18.4	(40.5)	11.5
Fully Adj PBT	45.8	51.1	48.8	(3.5)	11.5
NOPAT	37.6	41.9	38.0	(2.7)	8.6
Reported EPS (p)	8.2	16.4	5.2	(15.4)	3.4
Fully Adj EPS (p)	14.7	16.3	14.8	(1.1)	3.4
Dividend per share (p)	7.4	8.2	7.4	1.4	1.7
CASH FLOW & BALANCE SHEET	**2020**	**2021**	**2022**	**2023E**	**2024E**
Operating cash flow	54.9	76.3	(19.6)	(32.0)	3.1
Free Cash flow	38.0	61.3	(15.3)	(22.5)	8.1
FCF per share (p)	14.9	23.9	(6.0)	(8.8)	3.2
Acquisitions	0.8	0.1	0.0	0.0	0.0
Net cash flow	18.9	1.8	(25.5)	(37.7)	6.6
Overdrafts / borrowings	174.1	141.2	77.4	77.4	77.4
Cash & equivalents	134.5	136.3	110.8	73.2	79.8
Net (Debt)/Cash, pre-IFRS 16	94.8	124.3	82.6	43.3	49.9
IFRS 16 Lease liabilities	(134.5)	(129.3)	(49.1)	(47.5)	(47.5)
Net (Debt)/Cash post-IFRS 16	(39.6)	(4.9)	33.5	(4.2)	2.4
NAV AND RETURNS	**2020**	**2021**	**2022**	**2023E**	**2024E**
Net asset value	167.8	184.8	176.5	121.8	129.0
NAV/share (p)	65.5	72.1	68.8	47.5	50.3
Net Tangible Asset Value	154.6	172.1	164.3	110.2	118.0
NTAV/share (p)	60.3	67.2	64.1	43.0	46.0
Average equity	164.5	176.3	180.9	149.4	125.4
Post-tax ROE (%)	12.8%	23.8%	7.4%	(26.5%)	6.9%
METRICS	**2020**	**2021**	**2022**	**2023E**	**2024E**
Revenue growth	(5.5%)	21.5%	(5.4%)	3.0%	(4.6%)
Adj EBITDA growth	(5.7%)	7.9%	(4.3%)	(84.1%)	149.6%
Adj EBIT growth	(7.1%)	10.8%	(4.5%)	(100.0%)	(153188.3%)
Adj PBT growth	(9.3%)	11.7%	(4.6%)	(107.2%)	(428.4%)
Adj EPS growth	(8.5%)	11.2%	(9.4%)	(107.1%)	(418.1%)
Dividend growth	(12.0%)	11.6%	(9.8%)	(81.1%)	20.4%
Adj EBIT margins	14.6%	13.3%	13.4%	0.0%	3.8%
VALUATION	**2020**	**2021**	**2022**	**2023E**	**2024E**
EV/Sales (x)	0.1	0.1	0.1	0.1	0.1
EV/EBITDA (x)	0.8	0.7	0.7	4.6	1.8
EV/NOPAT (x)	1.2	1.1	1.2	-17.0	5.4
PER (x)	2.4	2.1	2.4	N/A	10.4
Dividend yield (%)	21.1%	23.5%	21.2%	4.0%	4.8%
FCF yield	42.7%	68.6%	(17.1%)	(25.2%)	9.0%

Source: Company information and Progressive Equity Research estimates

11 October 2023

Disclaimers and Disclosures

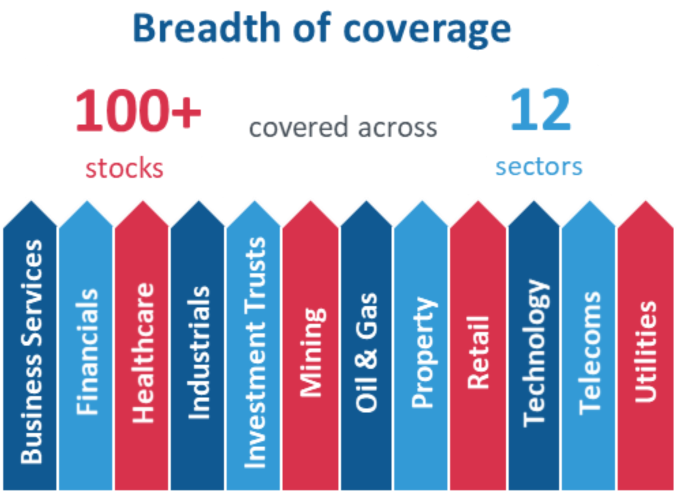
 Progressive’s research is commissioned by the subject company under contract and is freely available to the public and all institutional investors. Progressive does not offer investors the ability to trade securities. Our publications should not, therefore, be considered an inducement under MiFID II regulations. PERL provides professional equity research services, and the companies researched pay a fee in order for this research to be made available. This report has been commissioned by the subject company and prepared and issued by PERL for publication in the United Kingdom only. All information used in the publication of this report has been compiled from publicly available sources that are believed to be reliable; however, PERL does not guarantee the accuracy or completeness of this report. Opinions contained in this report represent those of the research department of PERL at the time of publication, and any estimates are those of PERL and not of the companies concerned unless specifically sourced otherwise. PERL is authorised and regulated by the Financial Conduct Authority (FCA) of the United Kingdom (registration number 697355).

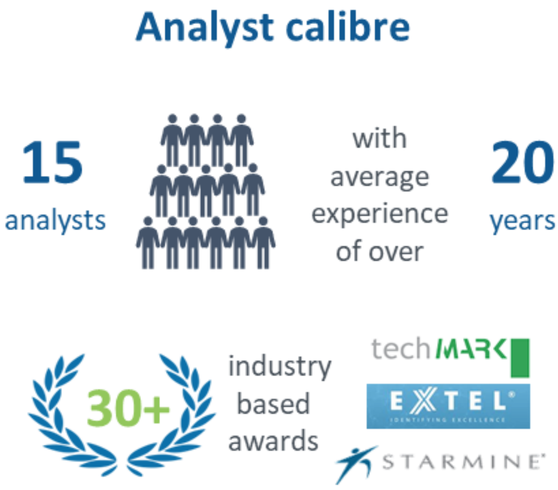
This document is provided for information purposes only, and is not a solicitation or inducement to buy, sell, subscribe, or underwrite securities or units. Investors should seek advice from an Independent Financial Adviser or regulated stockbroker before making any investment decisions. PERL does not make investment recommendations. Any valuation given in a research note is the theoretical result of a study of a range of possible outcomes, and not a forecast of a likely share price. PERL does not undertake to provide updates to any opinions or views expressed in this document.

This document has not been approved for the purposes of Section 21(2) of the Financial Services & Markets Act 2000 of the United Kingdom. It has not been prepared in accordance with the legal requirements designed to promote the independence of investment research. It is not subject to any prohibition on dealing ahead of the dissemination of investment research.

PERL does not hold any positions in the securities mentioned in this report. However, PERL’s directors, officers, employees and contractors may have a position in any or related securities mentioned in this report. PERL or its affiliates may perform services or solicit business from any of the companies mentioned in this report.

The value of securities mentioned in this report can fall as well as rise and may be subject to large and sudden swings. In addition, the level of marketability of the shares mentioned in this report may result in significant trading spreads and sometimes may lead to difficulties in opening and/or closing positions. It may be difficult to obtain accurate information about the value of securities mentioned in this report. Past performance is not necessarily a guide to future performance.





To arrange a meeting with the management team, or for further information about Progressive, please contact us at:
+44 (0) 20 7781 5300
info@progressive-research.com