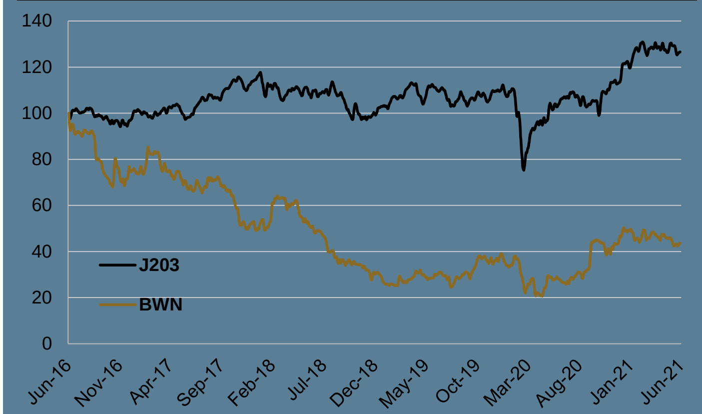
BWN – Balwin Properties Limited FY21 Results Equity Update

Valuation: Undervalued

BWN released full year results on 17 May 2021 for the period ended 28 February 2021

Price (R)				4.25
PE Fair Value (R)				5.50
DCF Value (R)				5.28
Upside(Downside) to DCF (%)				24.2%
DY %				8.4%
Price Performance				Relative
		Absolute		to JALSH
1 month		-1.2%		4.5%
3 month		-0.8%		-5.9%
YTD		-3.0%		-4.1%
12 month		High		Low
(SA Rands)		5.34		2.45
No. of shares (m)	469		Price (R)	4.25
NAV per share	6.83		Mkt cap (Rm)	1996
EV (Rm)	3506		Price/Book (x)	0.62

Financial Year	2020	2021	2022F	2023F
Turnover (Rm)	2914	2701	3064	3455
EBITDA	580	470	589	769
EBIT	574	462	582	760
PAT	411	336	418	543
HEPS (cents)	87.8	71.5	89.0	115.9
P/E ratio	3.5	5.9	4.7	3.6
EV/EBITDA	2.1	4.0	3.1	1.9
EBITDA margin (%)	19.9%	17.4%	19.2%	22.2%
EBIT margin (%)	19.7%	17.2%	19.0%	22.0%
ROCE (%)	17.9%	14.6%	15.1%	17.5%
ROE (%)	14.7%	10.9%	12.4%	14.5%



RESULTS COMMENTARY

BWN released a set of results which saw the demand for its apartments remain strong, despite challenging economic conditions and constrained consumer spend.

- Revenue declined 7.3% to R2.7bn as a direct result of construction delays caused by the hard-lockdown period.
- The operating margin declined to 17.2% from 19.7%, owing to the loss of rental income earned on the Greenpark apartments as well as higher input costs from increased activity in Balwin Fibre.
- Cash on hand declined by R140.0m to R336.5m due to delays in the registration of apartments and the expansion of the Group's pipeline.
- HEPS decreased 18.6% to 71.5 cents, outperforming our previous forecast. A final dividend of 16.2 cents per ordinary share has been declared for FY21.

OUTLOOK FOR NEXT REPORTING PERIOD

The Construction industry in South Africa has been on a steady decline. Reduced government spending, a fragile economy and the rising price of materials have resulted in difficult trading conditions. The impact of Covid-19 saw the already struggling industry contract ~16% in 2020. The outlook for the Construction industry remains subdued as it is expected to face continued obstacles to recovery, caused by an unsupportive financial landscape, higher government debt and ratings downgrades.

Although a development company by definition, the heart of BWN comprises a mix of both its construction and selling activities, the former of which was adversely impacted by an approximate three-month production delay necessitated by the hard lockdown period. BWN caters to the residential sector, which demonstrated robust demand for apartments throughout the period. The launch of an end-to-end online sales platform facilitated BWN's ability to cater to the demand in less than normal trading circumstances. Healthy sales recorded during the period were complemented by the new sales strategy, which will be kept in place to adjust to the "new normal" and support traditional business operations.

BWN provides innovative and affordable lifestyle products to the South African market. Its service offering comprises three apartment models. The Classic Collection business model focuses on providing a build-to-sell product to the middle-income market. BWN's Green Collection model targets a lower LSM (living standards measure) market while their Signature Collection apartments are built to higher specifications. The Group also generates annuity income through the management and ownership of infrastructure within its developments. This includes the provision of high-speed fibre connectivity and solar installations which generate renewable energy.

Solutions implemented by management to deal with disruptions during the period, which include accelerated construction upon the easing of lockdown restrictions and the launch of an online sales platform, resulted in minimised losses in both revenue and the number of apartments handed over to clients. Revenue declined 7.4% to R2.7bn as the number of apartments handed over declined 6.2% to 2 546 (FY20: 2 715). BWN's Classic collection accounted for 70% of the apartments handed over during the period, while the Green and Signature Collections contributed 23% and 7%, respectively. Encouragingly, a further 2 499 apartments pre-sold for FY22 (FY21: 644), indicative of BWN's resilient business model. The pre-sold apartments have not been included in revenue for FY21.

The Group's development pipeline grew during the period and currently consists of 62 288 apartments across 28 developments, representing a ~15-year development pipeline. Management has advised that the Group is not currently on a strategic drive to acquire more land but will reconsider should a fruitful opportunity present itself. The Group currently targets an average profit margin of ~35% over the lifecycle of each project.

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The gross profit margin remained unchanged at 27%. This remains below the management's target margin but is expected to increase in the short-to-medium term upon market recovery and the materialisation of cost cutting initiatives. Margin pressure is owed to strategic marketing initiatives implemented during the period. Although these campaigns are margin dilutive, the price incentives offered to clients have proven successful in driving sales and have therefore been absorbed by existing margins. The gross margin was also negatively impacted by the Signature Collection development, specifically Paardevlei Lifestyle Estate, which experienced lower than expected sales at a reduced margin when compared to the Classic and Green Collection models. Gross profit margin excl. Signature Collection developments was 29%.

BWN continues to experience strong demand for its one and two bedroom apartments and has increased its rollout of its Green Collection in response to positive market reaction. The Green collection's contribution to the number of apartments handed over increased by 8% alone in FY21 to 23%, demonstrating the potential of this service offering as a growth driver for the Group.

BWN continues to engage with the Government on its MooiKloof Mega City project which is commonly hailed as South Africa's largest sectional title development. Both BWN's MooiKloof Mega City and Tshwane East projects were designated as Strategic Integrated Projects (SIP's) during the period by the Presidential Infrastructure Coordinating Commission Council in an attempt to create employment and prompt economic recovery post Covid-19. The Mega-city is set to be worth R84bn and aims to construct and deliver approximately 16,000 residential apartments (potentially increasing to 50,000 residential apartments) with prices ranging from R500k to R800k per apartment over a period of 10 to 15 years. BWN will phase the initial 16,000 apartments over 5 developments. Sales have commenced on the first portion, estimated to be approximately 2 500 residential apartments.

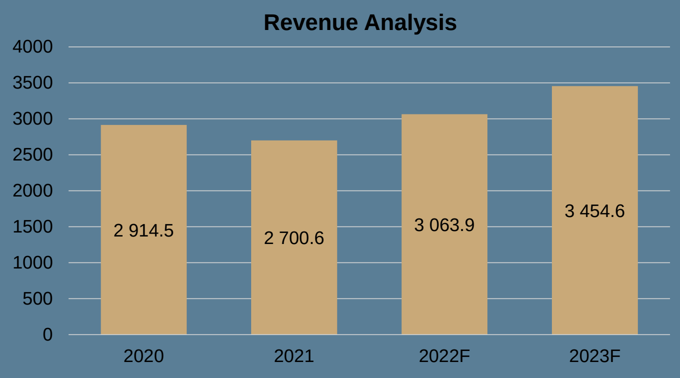
During the period, BWN withdrew from the planned Wedgewood development and announced the discontinuation of its lifestyle collection offering following a disappointing demand-to-sales conversion rate in comparison to other developments in its portfolio. Moreover, the single-phase construction rollout proposed for Wedgewood proved riskier than BWN's proven multiple-phase construction model. Management is confident that the efforts and resources assigned to this development would be better utilised in its core business.

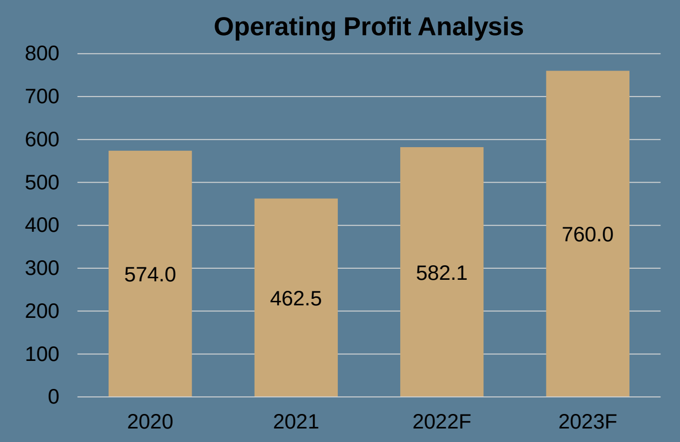
The average selling price of apartments has remained flat at R1.04m. Although the average selling prices are expected to remain flat in the short-term due to the shift in product mix to a higher concentration of Green apartments, overall apartment prices should grow year-on-year. Prices are expected to rise slightly in FY22 as the real estate industry returns to normality. Cash management and capital allocation have remained a focus for management. Management is satisfied with the cash position of R336.5m, despite a reduction of R140m from FY20, largely owed to delays in the registration of apartments and the expansion of the Group's pipeline.

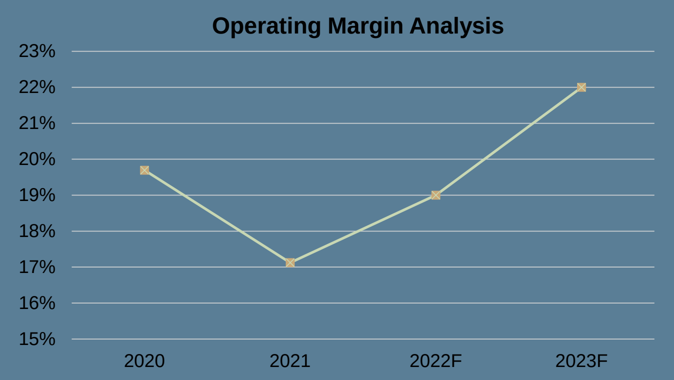
The Group has a healthy debt-to-equity ratio of 29% (FY21: 27%) well below the threshold of 50%. The Group obtains development finance on a phase-by-phase basis, secured against pre-sales of the specific phase being financed. This allows for appropriate risk management at each stage of the development. Top structure financing consists of ~70% loans from major banks with the remaining ~30% being funded with equity. The balance sheet's biggest driver, development under construction, includes a ~R750m cost for land acquired during the period to expand BWN's pipeline. Land financing is secured at ~50% to ~70% of its purchase price.

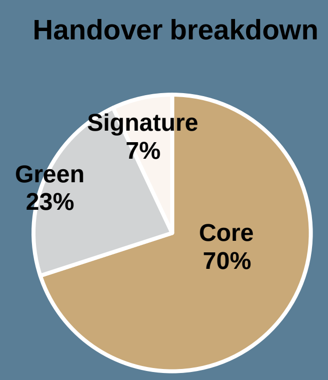
Overall, we forecast revenue to increase by 13.5% to R3.1bn in FY22, a ~5% increase from the normalised figure of FY20, and a further 12.8% to R3.5bn in FY23. We have assumed that the number of apartments handed over will increase by 13% to 2 877 in FY22, a 6% increase from the normalised figure in FY20, and a further 10% to 3 165 in FY23. Additionally, we have assumed that the average selling price will increase slightly by 2% in FY22 and increase by 2.5% in FY23, to R1.06m and R1.09m, respectively.

Operating margins are expected to steadily start increasing as operating expenses begin to stabilise and projects in development move out of the costly introductory phase and into the more profitable growth and maturity phases. The operating margin is forecast to increase by 190 bps to 19% in FY22 before increasing a further 300bps to 22% in FY23. Over the medium to long-term, we expect to see margins approach historic levels of closer to 30%. HEPS is forecast to increase by 24.6% to 89.0 cents in FY22 and a further 30.1% to 115.9 cents in FY23.









VALUATION

BWN has resiliently navigated their way through a very challenging year. Management succeeded in limiting the impact of Covid-19 on the Group's performance through the launch of an online sales platform, cost management initiatives and accelerated construction efforts. Moreover, BWN's marketing efforts and recent decreases in lending rates ensured that demand for its apartments remained steady.

The economic environment will remain deflated in the short-to-medium-term. However, the robust demand for its wide service offering, along with its strong balance sheet and expansion of the Green Collection brand, should propel BWN into achieving, and soon outperforming, pre-Covid growth levels. BWN is currently trading at a ~37.8% discount to NAV, while we believe this gap should narrow as economic conditions improve, it presents investors with the opportunity to acquire an attractive share at a significant discount.

Both our DCF valuation and relative P/E valuations indicate that the share is **Undervalued**.

With reference to the DCF table on the right, we have considered a discounted cash flow analysis with cash flows forecast to FY24. Utilising a terminal growth rate of 6% and a discount rate of 17.8%[1], a value of R5.28 is yielded.

With reference to the relative PE table, we have compared BWN to other housing and construction companies and have applied a 25% discount to the peer group due its high multiples. It should be noted that P/E multiples are largely inflated under the current economic circumstances. The implied forward PE of 5.6x places the share at a valuation of R5.50.

	DCF Discount rate				
Growth rate	**13.8%**	**15.8%**	**17.8%**	**19.8%**	**21.8%**
0%	4.89	4.17	3.61	3.17	2.81
2%	5.66	4.72	4.02	3.49	3.06
4%	6.74	5.46	4.56	3.89	3.37
6%	8.38	6.51	**5.28**	4.41	3.76
8%	11.13	8.09	6.29	5.10	4.26
10%	16.77	10.75	7.81	6.08	4.94
12%	34.72	16.19	10.39	7.55	5.88

Housing	**Price**	**Mkt cap (m)**	**1 year fwd PE**
Raubex*	32.64	5932	10.8
Murray & Roberts*	10.35	4578	8.9
WBHO*	113.00	6730	6.5
Calgro M3	2.83	395	6.8
Balwin	4.25	1996	4.3
Average			**7.5**
*consensus forecasts used			-42%
Balwin	**4.25**	1996	4.3
Premium (Discount) applied to average:			-25%
Balwin: Implied current gain/(loss):	5.50	29%	**5.6**

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[1] The discount rate is based on the average implied discount rate obtained from cash flow forecasts for companies with market capitalisations ranging from R301m to R10bn in our research universe.