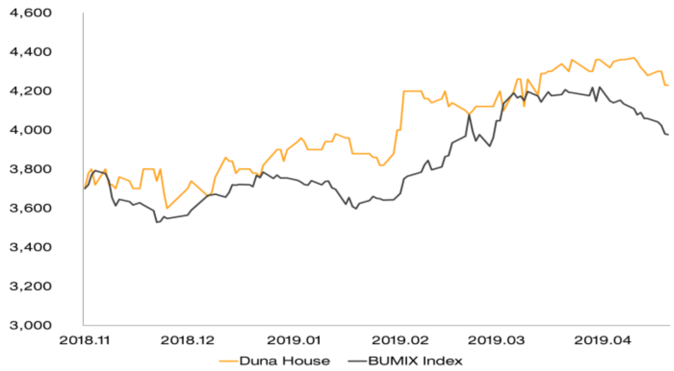
CONCORDE RESEARCH

CEE Equity Research | Hungary | Real Estate
21 May 2019

Duna House

Recommendation: Accumulate (prev: BUY)
Target price (12M): HUF 4,500 (prev: 4,750)

Cons. simplified P&L	2018	F2019	F2020
Revenues	8,340	8,670	8,813
EBITDA	2,215	2,610	2,486
EBIT	2,115	2,500	2,376
Net profit	1,708	2,063	2,070
Total EPS	494	596	598
P/E	7.7x	6.4x	6.4x
No. of transactions	176,300	180,000	182,000
Int. Loan (HUF bn)	68.3	78.5	86.4



Share price close as of 21/05/2019	HUF 4,200	Bloomberg	DUNAHHOUS HB
Number of shares [million]	3.5	Reuters	DUNAHOUSE.BU
Market capitalization [HUF mn/EUR mn]	14,100 / 43	Free float	30%
Daily turnover 12M [EUR th]	1.46	52 week range	HUF 3,450-4,600

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Slower pace of growth?

- In light of the development of the fundamentals *(ie. slower growth profile for the Polish operation and the crippled home-saving account segment*) and the positive share price performance this year (+13% YTD), we think the stock provides less attractive risk-return profile at current prices thus we downgrade our recommendation to **Accumulate from Buy** and cut our target price from **HUF 4,750 to HUF 4,500 per share.**

- We reviewed our estimates following the FY18 results and fine-tuned our model to account for the changes in investment properties, the outlook for Polish operation and the almost disappearing profit from home savings account (LTP). Now, we foresee a consolidated profit of HUF 2,063 million (+21% y-o-y) for 2019 and HUF 2,070 million for 2020, boosted mainly by completion of the development projects. We continue to expect material DPS from 2019 and 2020 profit which could be as much as HUF **410 (9.5% div. yield) in our best case scenario.**

- The main changes in our forecast and valuation are the **exclusion of gross profit of home-saving account** related to the Hungarian Core operation (lowered FY 2019 Total Hungarian Core profit by ca. 20%), and **muted growth for the Polish operation** *(the growth may come predominantly from M&A from now on)*. On the bright side, we **valued and added Panorama project** (ca. HUF 150 per share) to the development

ANALYST CERTIFIATION AND REQUIRED DISCLOSURES BEGIN ON PAGE 7.

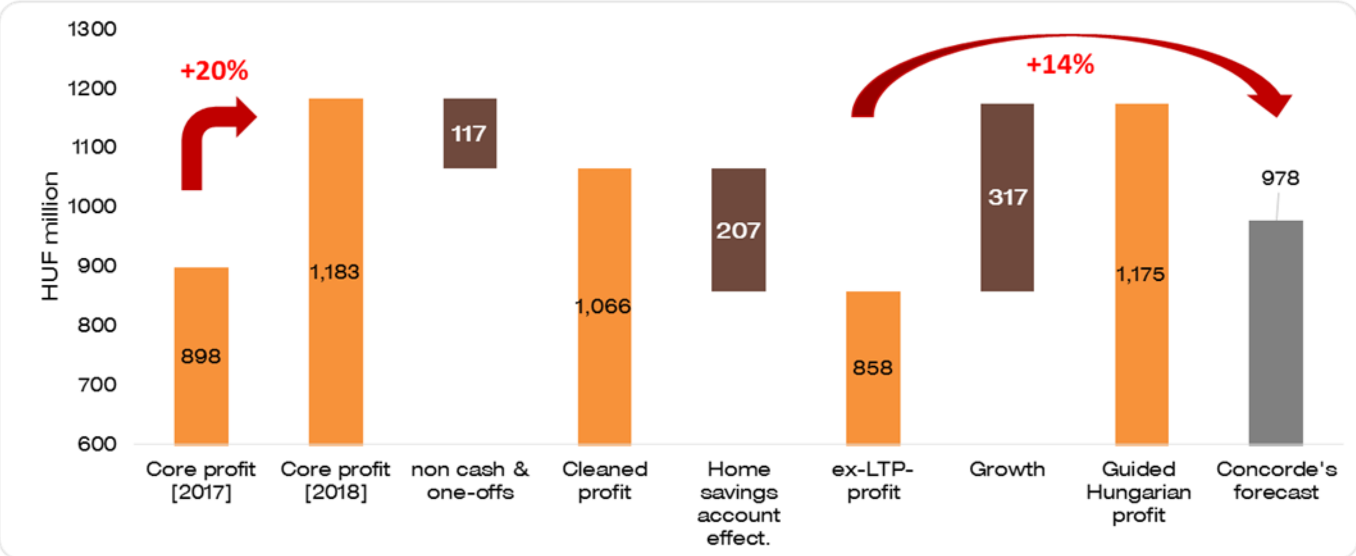
arm (total of HUF 770 per share) of Duna House Group, and increased the value of the **real estate portfolio by ca. HUF 40 per share to HUF 417 per share due to asset acquisition** in 2018.

- Valuation-wise, Duna House is trading at an adjusted P/E of 9.5x in our view vs. BUX of 10x. We adjusted both the numerator and the denominator of the P/E multiple in order to see the valuation related to the sustainable operation. In the denominator, we modified the share price that represents the underlying operation *(current share price – value of development – value of real estate's hold for investment purposes)* / EPS *from Hungarian and Polish operation excluding revaluation gains.*

2018 profit and management guidance for 2019

Duna House FY 2018 profit arrived to HUF 1.7 billion out of which HUF 1.2 billion is related to Core Operation, the remaining ca. HUF 0.5 billion came from the development arm of the Group. Stripping the profit of Core Operation from the one-offs, we could arrive to HUF 1.066 billion (HUF 177 million lower – mainly non-cash items). This number (HUF 1.066 billion) should be further adjusted with almost entirely disappearing profit of the home saving account (HUF 207 million) resulting in a clean profit of HUF 860 million *(please find below our waterfall chart).* Thus, assuming no growth we would arrive to HUF 860 million profit in 2019.

UNTANGLE THE KNOT - HUNGARIAN OPERATION



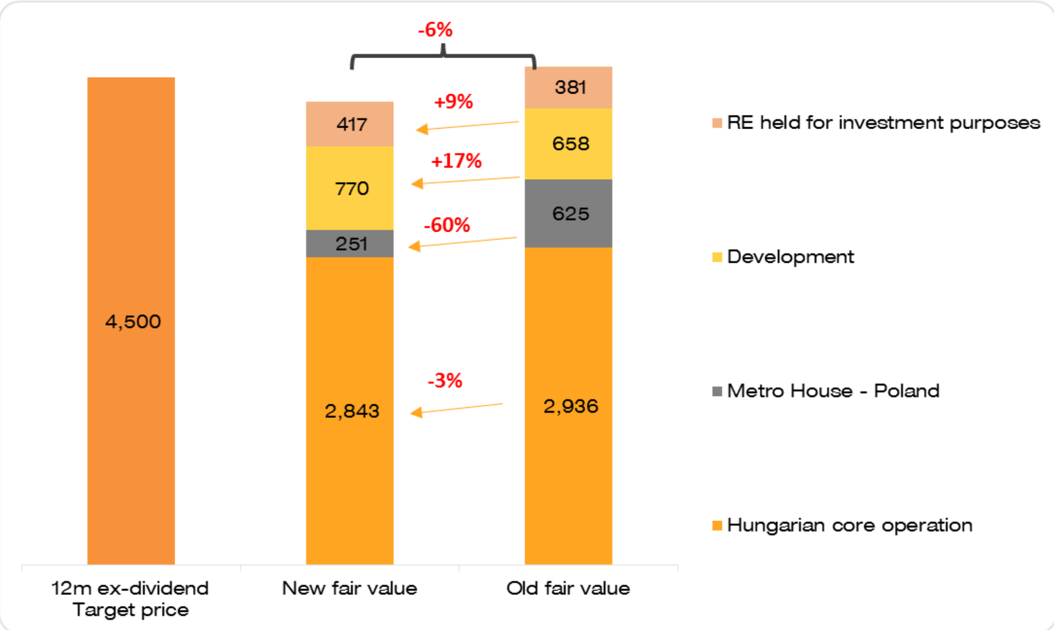
Source: Concorde

This should be compared to the management's profit guidance for the relevant segment (HUF 1.175 billion), which implies a 35% growth in relative terms and ca. HUF 317 million in absolute value. **Similarly to last years, guidance includes revaluation gains, this times we expect ca. HUF 130 - 150 million** ***(assuming ca. 10% increase in house price)*****, leaving ca. HUF 160 million growth from the underlying operation, implying 17% y-o-y improvement.** This growth is similar to last year's EBIT of HUF 210 million.

Major changes in our assumptions:

- We improve our assumptions for the **development arm of the group**, originally, we valued to HUF 658 per share (HUF 2,300 million), which seems relatively conservative after only the first project with 86 flats (out of 400) returned HUF 680 million, and there are ca. 310 flats remained to be sold, albeit at those projects should have lower profit margins (ca. 15% vs. 34% - Reviczky project). **Now we expect HUF 2,700 million – 770 per share** (for the remaining three projects – Forest Hill, Forest Hill Panorama, MyCity Residence).
- We lowered our forecast and consequently our valuation for the **Polish operation** by 60% as a result of aligning our forecast with management expectation. In a nutshell, we no longer expect organic growth of the segment as it has faced with obstacles, based on the development of the operational KPI's of Metro House. We used DCF and multiple valuation method to arrive to the fair value – *please see our approach later in the report*.
- For the **Hungarian Core Operation** we slightly lower the valuation - assuming that the missing gross profit from home saving account (*ca. HUF 230 million; 25% of the gross profit of the segment*) will be difficult to replace and the profit of the core operation may end up lower than in 2018 excluding revaluation gains.
- Last but not least, we increased the value of **Investment prop. to HUF 1,443 million** after asset appreciation and asset additions, translating to ca. HUF 417 per share.

SUMMARY OF THE CHANGES IN THE SUM OF THE PARTS VALUATION



Source: Concorde

Earnings Forecast

We attempted to give an earnings forecast on a consolidated level, which includes the Hungarian, Polish operation and the development arm of the group. We see HUF 2,063 million profit in 2019, a 21% y-o-y growth in the bottom-line on the back of:

1. Completion and the sale of ca. 50% of Forest Hill and MyCity residence (ca. HUF 1,090 million profit in 2019 and 2020 as well).
2. turnaround in the Polish operation as a result of achieving better economies of scale with the recently acquired loan intermediation entity; broadly in line with management guidance but at the lower end of the range.
3. Continuation of supportive environment in the real estate sector in Hungary *(low interest rate environment, more powerful government subsidy programs, increasing wages at double digit pace)* helps to mitigate the missing gross profit from home-savings-account (LTP) business.

With this forecast, we are 6% below the lower end of management's profit forecast for 2019 of HUF 2,190 – 2,490 million, mainly because we did not incorporate revaluation gain on real estates which would add ca. HUF 100 – 150 million to the bottom line reaching the low end of mgmt. forecast.

EARNING FORECAST

Consolidated profit and loss [HUF million]

	2017	2018	F2019	F2020	CAGR from '18
Revenue	**4,820**	**8,340**	**8,670**	**8,813**	***3%***
Operating revenue	4,685	7,985	8,500	8,613	*4%*
Other income	135	355	170	200	*-25%*
OPEX	3,955	6,225	6,170	6,437	*2%*
EBITDA	**952**	**2,215**	**2,610**	**2,486**	***6%***
EBIT	865	2,115	2,500	2,376	6%
- Franchise	*158*	*259*	*330*	*350*	*16%*
- Own segment	*77*	*79*	*90*	*95*	*10%*
- Financial intermediary	*571*	*602*	*580*	*620*	*1%*
- Other	*70*	*147*	*200*	*221*	*23%*
- Real estate mgmt	*3*	*1,095*	*1,300*	*1,090*	*0%*
- Elimination	*0*	*-67*	*0*	*0*	
EBT	1,092	2,014	2,399	2,275	*6%*
Income taxes	-173	-310	-336	-205	*-19%*
Clean Net income	**943**	**1,708**	**2,063**	**2,070**	***10%***
mgmt guidance			*2,350*		

KPI					
Transaction numbers [HU]	165,800	176,300	180,000	182,000	*2%*
House Price increase [HU]	17%	13%	10%	4%	
Intermediated loans [HUF m] [HU]	54,617	68,271	78,512	86,363	*12%*
growth	*37%*	*25%*	*15%*	*10%*	
No of franchise office [HU]	234	250	260	265.2	*3%*
growth	*-1%*	*7%*	*4%*	*2%*	

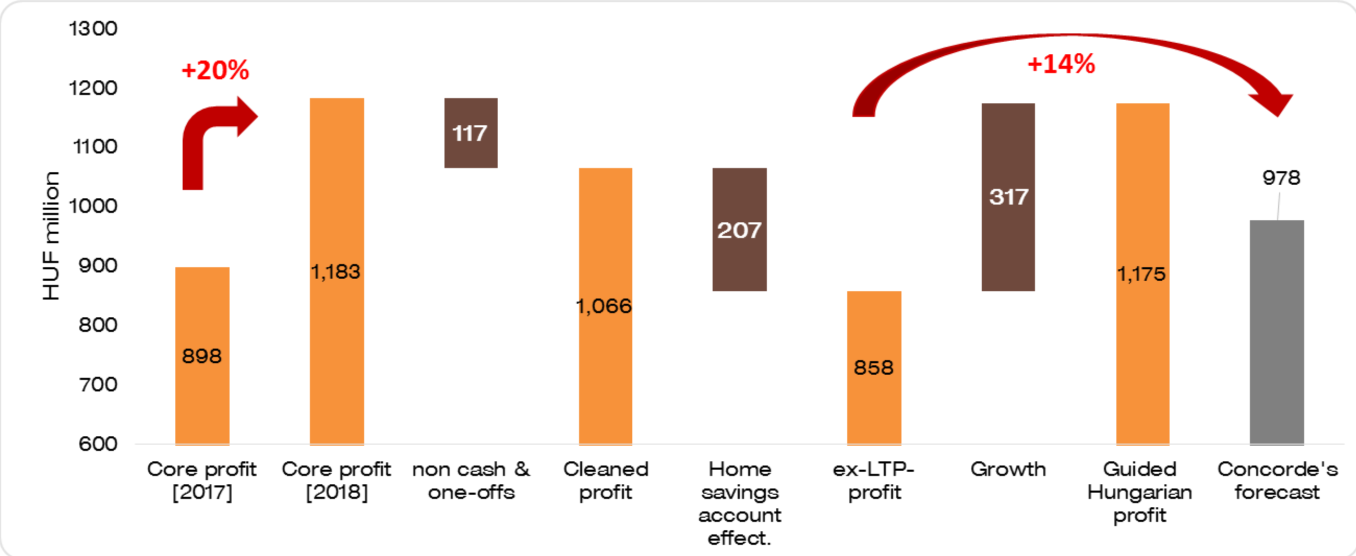
Source: Concorde estimation

Core operation - will be difficult to replace the missing profit stemming from Home-savings account business

We expect lower profit (-17% y-o-y) from the Hungarian operation for 2019 predominantly because we expect zero gross profit from the intermediation of home-savings-account and also because we exclude the revaluation gains from profit (ca. HUF 100 - 150 million) and concentrate purely on sustainable underlying operation, thus we expect HUF 980 million profit for 2019 from the Hungarian Operation.

Below, we split the profit of 2018 to have a better year-over-year comparison. If we strip 2018 profit from non-recurring items DH profit would have been ca. HU 860 million compared to that we expect 14% growth by the end of 2019.

UNTANGLING THE KNOT - HUNGARIAN OPERATION



Source: DH, Concorde

Notes: Management expects flattish profit from Hungarian operation, which does not seem a big deal at first, but we would like to highlight that an entire business segment's profit will evaporate (ie. home savings account) as government ceased the supportive regulatory environment for home savings account (ca. HUF 207 million ca. 17-18% of 18FY profit).

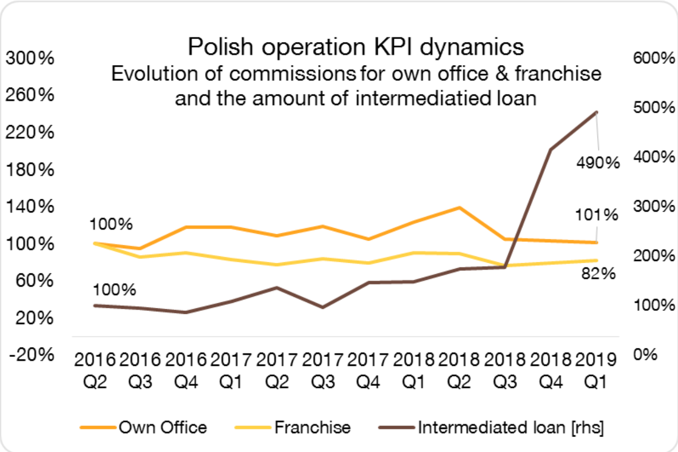
Management guidance implies ca. HUF 320 million growth Y-o-Y. We are of the view that this figure includes non-cash revaluation which should be as high as 50%, thus the remaining HUF 100 – 150 million growth should come from the underlying operation fuelled by the continuing rise in house price, the growth in number of franchise partners in Hungary. That is the reason why we expect only HUF 980 million profit for 2019 from the Hungarian operation.

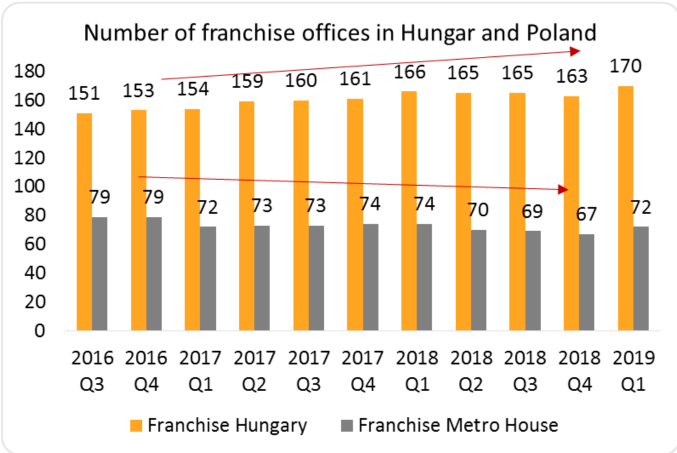
Polish operation – Let's see the other way!!

We lowered our profit forecast and growth potential for the Polish operation as the organic growth has been disappointing in the last few years resulting in a drop of equity value of the Polish operation from HUF 625 per share to HUF 250 per share.

Growth measured by the number of franchise offices which are down by 7 from '16 Q3; commission from franchise is down by -18% since '16 Q3; commissions from own offices has remained flat – see charts of the KPI below. On the other hand, intermediated loan volume skyrocketed *(+490% since '16 Q3)* partly due to the acquisition in 2018 Q3 but still failed to lift the Polish Operation profit out of the red *(profits of the Polish op. were HUF -11 million in '17 and HUF -55 million in '18).*

POLISH OPERATION'S KPI FROM '16 Q3





Source: DH, Concorde

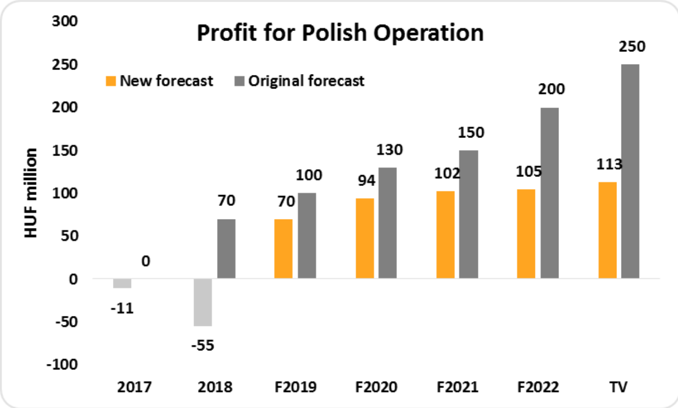
Seeing that expanding organically is more difficult than previously thought, management turned to the other solution of chasing growth, namely to M&A. As first step, DH acquired Gold Finance (6th largest loan intermediation agency) for ca. HUF 300 million to get closer to the optimum economies of scale. Indicatively, management expected the investment' payback period in 3-4 years implying a 20-25% return on equity which is way above Duna House cost of equity (ca. 10%). A possible reason for the decent return is that the combined entity becomes the 5th largest loan intermediation company in Poland and therefore may achieve better commission terms with banks, also it may give a boost for investors to join the Metro House franchise as the new terms with banks have been improved, and last but not least there may be some synergies across the operation. As a result, management gave an optimistic outlook for the Polish operation and guides a HUF 75 million FY profit which is expected to increase in 2020.

Retrospectively, it is clear that organic growth that we had forecasted for the Polish Operation in our coverage research was excessive, and it is more difficult to generate a similar growth story in Poland as Duna House achieved in Hungary. We believe that Metro House will need acquisitions to expand which is obviously more capital intensive, compared to organic growth (*when investors join the franchise business)* that barely requires capital.

As a result, we cut our expectation for the Polish operation and estimate only low single digit growth post 2020 based on the last two years' experience of organic growth. From now, the segment's main growth potential would stem from M&A activity in our view, though we have to admit that after the latest acquisition the incentives to join the Metro House franchise might improve. However we would like to remain cautious.

As for financials, we expect a more cautious growth trajectory for the segment, and forecast HUF 70 million profit for 2019 and HUF 94 million for 2020, slightly lower than management's segment guidance. The HUF 20-30 million increase from 2019 to 2020 mainly comes from the lack of integration cost of Gold Finance which will materialise in Q1 according to Mgmt. After that growth rate decline to low single digit stemming mainly from inflation and 1-2 office openings.

PROFIT EXPECTATION FOR POLISH OPERATION



Source: DH, Concorde

Based on our simplified DCF model that assumes ca. 3% capex / sales ratio and 2.5% growth at terminal value (*targeted polish inflation rate),* the current value of the segment should be ca. HUF 270 per share. We would like to note that it is extremely difficult to estimate inorganic growth as we should anticipate the price of the acquisition as well, to assess the overall effect on shareholder value. Thus we expect no inorganic nor organic growth for this segment.

As a back check, we used P/E valuation which arrived to ca. HUF 230 per share with 10 x P/E ratio (*Given the lack of comparable listed company we took the P/E valuation of the Polish index and apply a 10% discount, WIG20 current P/E ratio is at 11.2x*).

Thus all in all, we set the equity value of the Polish Operation at the average of the two methods at **HUF 250 per share.**

Development – two are almost done, one more to go!

Duna House has three development projects running with a total flat of 310 which will be completed within the next 1-2 years. Two out of them are in advanced phase (Forest Hill with 154 flats and MyCity Residence with 103 flats) and close to completion, ca. 70% of the flats have already been sold, thus management could already see the bottom line of these projects with relatively high certainty. They guide a total profit of HUF 2.2 billion (HUF 635 per share w/o discounting) from the two projects, equally spread in 2019 and 2020. As for the latest project called Panorama (57 flats), it received building permit in last September thus eligible for the special 5% VAT. As the project name might imply, the project targets high-end costumers and will be located on the same plot as the Forest Hill, but on the middle of the hill thus providing a gorgeous view to Budapest. We calculated that the project could add 150 per share assuming 1 million HUF/sqm sales price and ca. 15% profit margin.

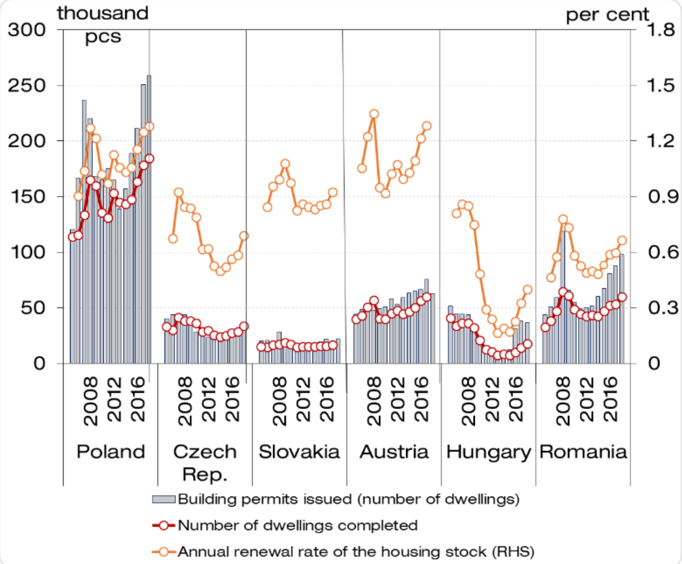
PANORAMA project	
number of flats	57
average size [sqm]	80
price / sqm [HUF]	1,000,000
Total revenue [HUF]	4,560,000,000
profit margin	15%
Profit [HUF]	684,000,000
per share profit	198
discounted 2yr.	149

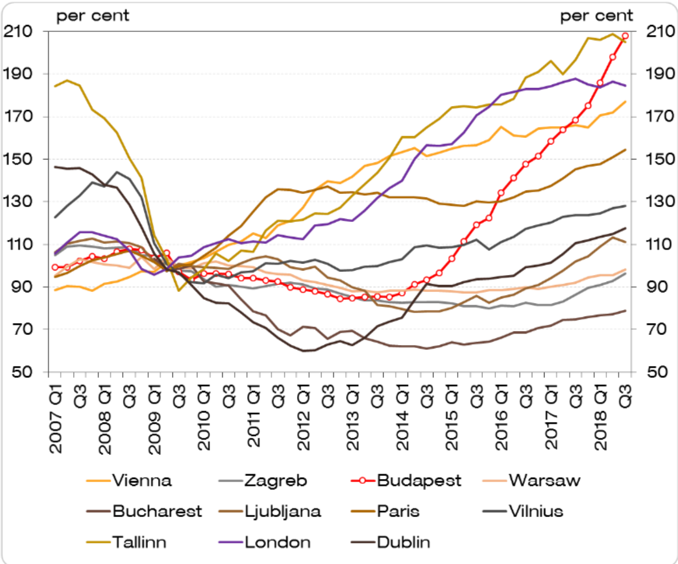
Source: Concorde

To sum it up, we valued the development segment at **HUF 770 per share.**

Hungarian Real Estate sector in charts

EXTREMELY LOW RENEWAL RATE IN HUNGARY AND HOUSE PRICE INCREASE IN CEE CAPITALS

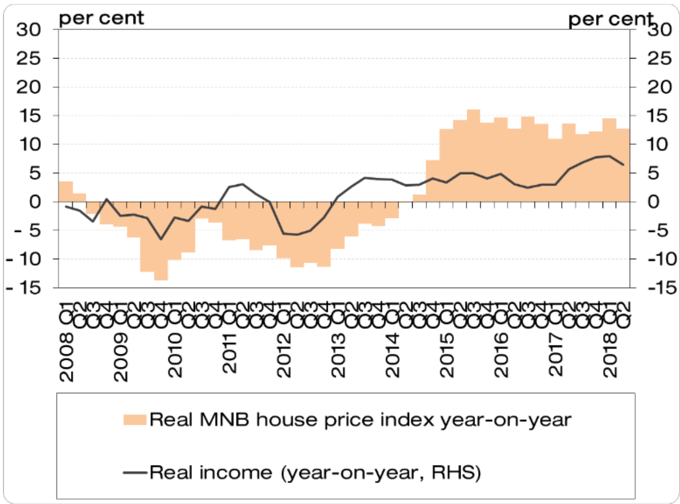


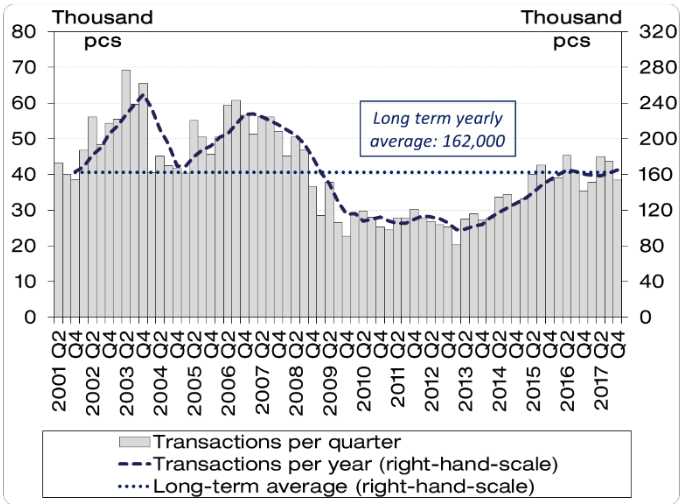


Source: MNB, Concorde

Note: *Budapest seems to be overpriced after house prices have doubled in 6 years but the rest of the country still has upward potential. We are in a view that government will aim to push renewal rate higher as this would provide stability if global economy turns sour and it is the lowest in the region*

HOUSE PRICE INDEX AND TRANSACTION NUMBERS

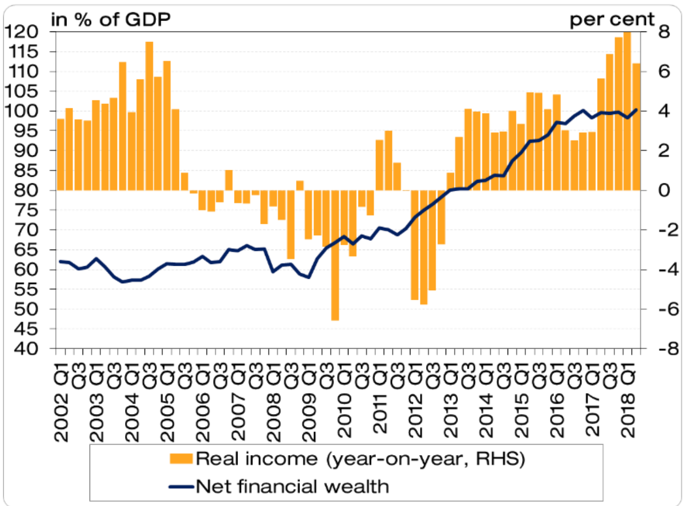


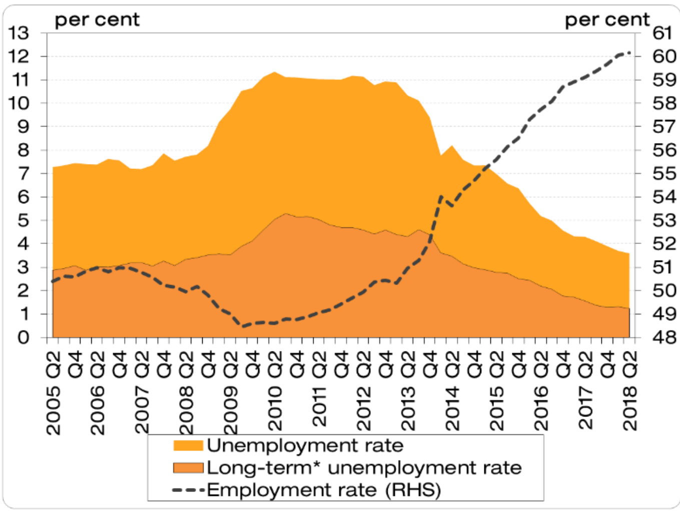


Note: *Transaction numbers were still slightly above the long term average number of 160,000 in 2018 according to DH's estimation.*

Source: MNB, Concorde

REAL INCOME AND UNEMPLOYMENT RATE





***Note**: Despite the several years of increase in house prices, demand is supported by high single digit real wage increase and the record low unemployment rate coupled with extra loose monetary environment. Since we do not expect significant change in either of those house price increase will continue, though at a more moderate pace.*

Source: MNB, Concorde

Effects on house prices in 2019:

1. Government plans to issue a **new bonds for retail investors** which may carve out attention from real estate investment that could also moderate the house price increase in the upcoming years. Since the average 5yr return on this risk free bond would allegedly hover around 5% it will compete with expected return on residential real estate investments. This may put downward pressure on prices on the back of shrinking demand from local investors.

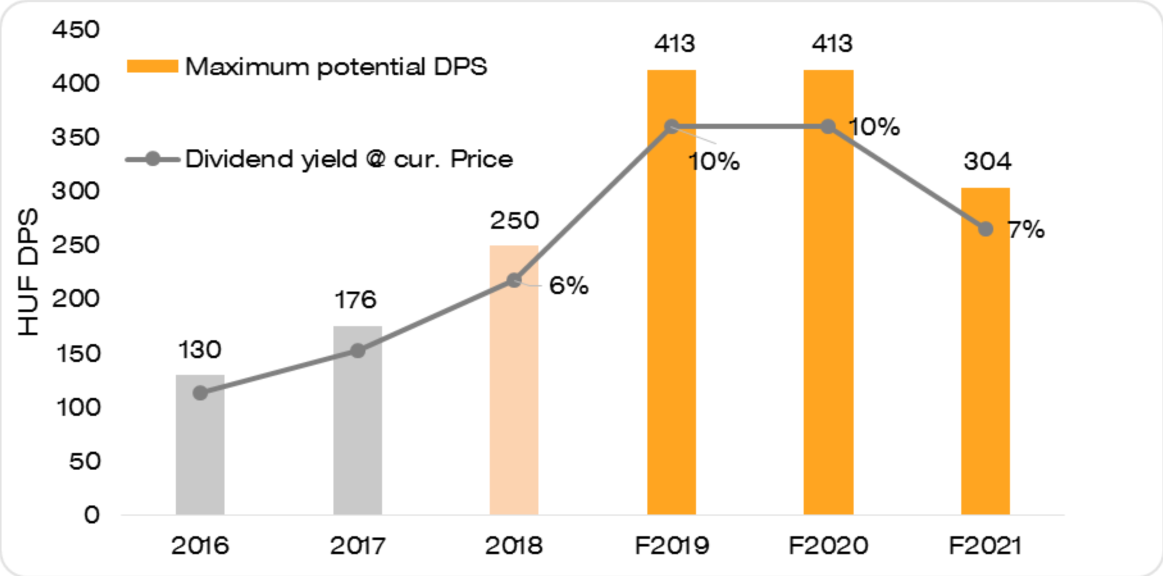
2. The **more generous version of government** subsidy will take into effect from July, which entails with even higher level of loan origination, in our view thus consequently more demand.

The two effect may counterbalance each other, however we would like to highlight that ca 40% of the demand comes from investors and the remaining 60% stems from “normal” demand according to the latest survey from Duna House.

STRATEGY AND DIVIDEND OUTLOOK

The Hungarian operation remains the cash cow of the group given its relatively low CAPEX need and ability to reap profit from the general positive macro environment in the upcoming years in Hungary. We are in a view that the core operation (*excluding foreign operation and developments*) can generate an avg. annual HUF 850 - 950 million FCFF (HUF 245 - 270 per share) in the next years, assuming benign macro environment. Out of this amount, investors should expect an annual ordinary DPS of ca. 110 – 130 which may be boosted significantly by the profit from the developments in the next three years (total of 770 per share). Management indicated that if there is no value accretive investment opportunities, *(ie. M&A transaction to further build the economies of scale both in the Czech Republic or in Poland)* they are willing to share the total profit with investors coming from the development. If it was the case, patient investors could receive generous DPS in the next three years. **However, we are in a view that this outcome belongs to the optimistic scenario, as management aims to further strengthen its foreign operations both in the Czech Republic and Poland. Realistically, we would expect similar DPS than this year in the next few years as this solution allows management to strengthen its war chest by not distributing all of the cash at disposal, but prepare for opportunistic inorganic growth opportunities, while at the same time provide a decent return for investors.**

EVOLUTION OF DIVIDEND PER SHARE VIA AN OPTIMISTIC SCENARIOS



Source: DH, Concorde

Note: In this chart we reflect the MAXIMUM DPS potential for DH in the next year. For 2018, DPS was announced but not yet paid out.

All in all, **we slightly decrease our 12m ex-dividend target price by 6% from HUF 4,750 to HUF 4,500** as a result of aligning our profit assumptions for the Polish operation, and account for the regulatory change that affect home savings account business. Also, we **downgrade our recommendation of Duna House from Buy to Accumulate.**

Risks to our target price mainly related to slowdown in the main drivers of the Hungarian economy (ie. consumption, low interest rate environment, loan origination slowdown etc.).

APPENDIX

Consolidated profit and loss [HUF million]

	2017	2018	F2019	F2020	CAGR *from '18*
Revenue	**4,820**	**8,340**	**8,670**	**8,813**	***3%***
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Income taxes	-173	-310	-336	-205	*-19%*
Clean Net income	**943**	**1,708**	**2,063**	**2,070**	***10%***
mgmt guidance			*2,350*		

Ratios

	2017	2018	2019F	2020F
EPS (HUF)	201	402	596	598
EPS growth (%)	-22.1%	100.0%	48.4%	0.3%
DPS (HUF)	176	250	251	252
BVPS (HUF)	829	1028	1018	1030
Market capitalisation (HUF mn)	9,557	13,148	13,148	13,148
Number of shares (mn)	3.5	3.5	3.5	3.5

Valuation [cons. Group level]

	2017	2018	2019F	2020F
P/E	18.9x	9.5x	6.4x	6.4x
P/BV	5.4x	4.4x	4.4x	4.4x
EV/EBITDA	9.5x	5.5x	4.7x	4.9x
Net debt/EBITDA	1.0x	0.7x	0.2x	0.0x

Other ratios [cons. Group level]

	2017	2018	2019F	2020F
EBITDA margin (%)	19.8%	11.4%	11.0%	10.8%
EBIT margin (%)	20.3%	27.7%	30.7%	28.9%
Net profit margin (%)	19.6%	20.5%	23.8%	23.5%
ROE (%)	32.8%	47.9%	58.4%	58.0%
ROA (%)	10.0%	15.4%	20.7%	21.8%

CASH FLOW FOR VALUATION PURPOSES

Duna House Valuation [HUF MILLION]

Hungarian CORE	2017	Base Year	2019E	2020E	2021E	2022E	Terminal
Sales			**3,342**	**3,506**	**3,592**	**3,724**	**3,836**
Sales growth			*1.7%*	*4.9%*	*2.5%*	*3.7%*	*3.0%*
EBITDA margin			34%	35%	33%	34%	34%
EBITDA	1,027	1,431	**1,153**	**1,223**	**1,190**	**1,267**	**1,305**
NOPLAT	856	1,230	920	977	945	1,007	1,040
(+) Depreciation	86	95	83	87	92	96	96
Working capital/Sales	*0%*	*0%*	*0%*	*0%*	*0%*	*0%*	*0%*
(+/-) Working capital	0	0	0	0	0	0	0
CAPEX/SALES	*3%*	*4%*	*4%*	*4%*	*4%*	*4%*	*4%*
(-) CAPEX	121	131	147	154	158	164	169
FCFF	821	1,194	**856**	**910**	**878**	**939**	**967**
Discount factor	1.00	1.00	0.92	0.84	0.76	0.70	0.63
DCF			784	761	670	654	7,434
Enterprise value DH Core	10,303						
Net debt	-117						
Metro House - Poland	857						
Development	2,666						
Real Estate Portfolio & Land	1,443						
Dividend [DPS 250]	-865						
Equity value - Dec 31 2018	**14,510**						
Number of shares (mn)	3.46						
cost of equity	14%						
Liquidity discount	5%						
12M ex- div. Target price	**4,523**						
Current price	4,200						
Upside/Downside	8%						
TR Upside/Downside	14%						

Source:Concorde's forecast

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Accumulate	Total return is expected to be in the range of 10-20%
Neutral	Total return is expected to be in the range of 10%-(-10%)
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