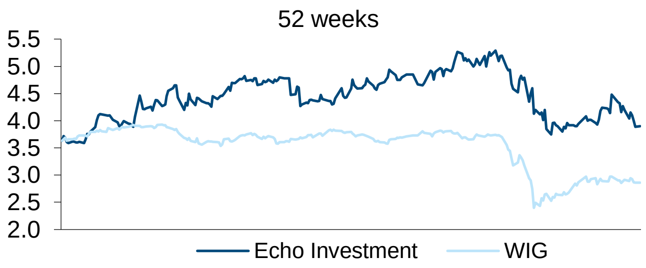
Echo Investment

from Accumulate to Reduce

PLN mn	2019	2020e	2021e	2022e
Net sales	880.1	1 019.8	691.2	554.3
EBITDA	458.9	360.5	203.0	232.3
EBIT	450.2	351.5	193.8	223.0
Net result after min.	299.5	226.0	127.6	151.8
EPS (PLN)	0.73	0.55	0.31	0.37
CEPS (PLN)	0.70	0.53	0.29	0.35
BVPS (PLN)	3.79	4.33	4.29	4.44
Div./share (PLN)	0.50	0.00	0.35	0.22
EV/EBITDA (x)	7.3	8.1	13.6	12.6
P/E (x)	6.4	7.1	12.6	10.6
P/CE (x)	6.6	7.4	13.6	11.3
Dividend Yield	10.7%	0.0%	9.0%	5.6%



Performance	12M	6M	3M	1M
in PLN	4.6%	-15.0%	-25.0%	-3.0%

Share price (PLN) close as of 18/05/2020	3.90
Number of shares (mn)	412.7
Market capitalization (PLN mn / EUR mn)	1,609 / ,352
Enterprise value (PLN mn / EUR mn)	2,925 / ,640

Reuters	ECH.WA	Free float	12.5%
Bloomberg	ECH PW	Shareholders	Wing-Griffin (66.0%)
Div. Ex-date	14/10/20		NN OFE (13.6%)
Target price	**3.80**	Homepage:	www.echo.com.pl

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Earnings and NAV outlook uninspiring, no dividend this year

We cut our 12M TP for Echo Investment by 23% to PLN 3.80 p/s, which now implies 3% downside and we trim the rating on the stock to Reduce from Accumulate.

Given the material spread between government bond and CEE prime RE yields, we expect the latter asset class to continue attracting investor interest going forward. Nonetheless, given the Covid-19 outbreak and the related anticipated material global macro slowdown this year, we expect property investment volumes across Emerging Europe (including PL) to show a clear y/y decline in 2020E (especially visible in the retail segment), followed by only a gradual recovery in 2021E, with investors likely becoming more aggressive in their bids. Factoring this in and despite dovish central bank policies likely remaining in place in the short to medium term, we now assume some 20-30bp increase in prime office cap rates in PL on average in 2020E, followed by another 10-25bp pickup in 2021E-22E (vs. 10-15bp decompression forecast for all three years earlier) and even more pronounced expansion in shopping mall cap rates in the period. At the same time, we expect more visible than originally assumed downward pressure on office and retail rental rates in 2020E-21E.

Taking the above-mentioned factors into account and after an application of 6-15M postponements (vs. original schedule) in the launch of Echo's selected pipeline projects (in both commercial and housing, in answer to the uncertainty concerning the impact of Covid-19 on demand for office space and dwellings), as well as more conservative assumptions regarding housing prices in the country going forward (a 5-10% decline on average in 20E, followed by stabilization in 2021E-22E), we cut our NI estimates for the firm by 13-54% for 2020E-22E and now forecast contraction of 25% to PLN 226mn this year, before another 44% fall to PLN 128mn in 21E and only a moderate 19% y/y pick-up in 2022E, while the revised NAV outlook for the period also looks not much inspiring.

Moreover, while in our base case scenario we assume that Echo will manage to finalize the exit from its Brewery K and Moje Miejsce 1 office projects this year and release around PLN 320mn in free cash from the deals, we now expect the firm to focus on building up a liquidity cushion (with an eye on increasingly challenging access to external funding, especially on the corporate bond market) and no longer count on a dividend payment in 2020E (vs. the PLN 0.45 DPS forecast originally).

As a sweetener, given the firm's decent balance sheet at end-2019 and assuming the above-mentioned property divestments, withdrawal from dividend distribution this year, and slowdown in development pipeline realization, we expect it to face no liquidity constraints in the quarters ahead.

Valuation

Our revised 12M target price for Echo Investment stands at PLN 3.80 per share (down from 4.94), implying a 3% downside. This reflects a 40% weighting for our truncated pipeline scenario and a 60% weighting for our extended pipeline scenario (valuation methodology described in the front section of the report). We also carry out a peer multiple valuation for comparison purposes (0% weighting).

VALUATION SUMMARY (PLN)	
Truncated pipeline scenario	3.33
Extended pipeline scenario	4.10
Average (40:60 weight)	**3.80**

Source: Company Data, Erste Group Research

VALUATION (PLN mn) - TRUNCATED PIPELINE SCENARIO	
Value of standing properties	**1 269**
Value of properties under construction	**2 500**
- Commercial property value	1 259
- Residential property value	1 242
Cost for properties under construction	**1 800**
- Commercial property costs	836
- Residential property costs	964
TOTAL	**1 969**
PV of TOTAL	**1 940**
Secured land bank for pipeline projects	696
LT financial investments	254
Current tax liability	97
ENTERPRISE VALUE (PLN mn)	**2 793**
Net debt*	1 485
EQUITY VALUE (PLN mn)	**1 308**
Per fully diluted number of shares (PLN)	3.17
12M Target Price (PLN)	**3.33**

**adjusted for the remaining payment related to the plots acquired by end-19*

VALUATION (PLN mn) - EXTENDED PIPELINE SCENARIO	
Value of standing properties	**1 269**
Value of properties under construction	**2 500**
- Commercial property value	1 259
- Residential property value	1 242
Cost for properties under construction	**1 800**
- Commercial property costs	836
- Residential property costs	964
Value of properties in the pipeline (till 2022)	**806**
- Commercial property value	368
- Residential property value	438
Cost for properties in the pipeline (till 2022)	**658**
- Commercial property costs	299
- Residential property costs	358
Terminal value for development business (beyond 2022)	546
TOTAL	**2 664**
PV of TOTAL	**2 509**
Secured land bank for pipeline projects (to be completed beyond 2022)	428
LT financial investments	254
Current tax liability	97
ENTERPRISE VALUE (PLN mn)	**3 094**
Net debt*	1 485
EQUITY VALUE (PLN mn)	**1 609**
Per fully diluted number of shares (PLN)	3.90
12M Target Price (PLN)	**4.10**

**adjusted for the remaining payment related to the plots acquired by end-19*

Source: Company Data, Erste Group Research

Key risks to investment case

- more pronounced than anticipated decline in property investment volumes in Poland, putting stronger than expected upward pressure on real estate cap rates in the country
- earlier than anticipated increase in EU interest rates putting upward pressure on real estate yields in the region
- stronger than expected negative impact of anticipated COVID-19 related macro slowdown on demand for modern office space in the country, putting more pronounced than assumed downward pressure on rental rates in the sector
- significant and sustainable increase in the popularity of remote working, affecting demand for modern office space and pushing rental rates down in the sector
- stronger than expected downward pressure on retail rental rates in the country due to COVID-19 turbulence and its negative impact on tenant business activity
- more pronounced than anticipated increase in the vacancy rate in retail assets, due to the coronavirus crisis
- material difficulties in the commercialization of development projects going forward due to expected macro slowdown this year/weaker than anticipated macro recovery in the years ahead
- difficulties/delays in planned exits from completed/pipeline commercial projects after completion; exit from completed/pipeline commercial schemes at lower than anticipated prices
- more pronounced than expected difficulties in planned debt refinancing/difficulties in the securing of external funding on acceptable terms, on time, or at an amount sufficient to finance expansion plans, affecting the pipeline project realization schedule and dividend potential
- weaker than anticipated softening to construction costs in the country, hitting the developer margin on future projects
- delays in launch of pipeline projects vs. assumed schedule/difficulties in obtaining administrational permits
- stronger than expected softening in demand for new dwellings in the country, on the back of the spread of COVID-19 and the related restrictions, as well as the anticipated negative impact on the country's real economy and consumer confidence
- heavier than anticipated decline in average new dwelling prices across the country's main agglomerations in the quarters ahead
- difficulties in the purchase of attractively located land plots at reasonable prices
- unfavorable FX movements (PLN is accounting currency, while yielding properties are valued in EUR)
- unfavorable changes in company strategy following the recent switch in the main shareholder post (not expected in our base case scenario)
- unfavorable changes in management after the switch in the post of key owner, affecting effective strategy implementation (not expected in our base case scenario)