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Balwin Properties

ANCHOR STOCKBROKERS

Time to sweat the land bank

Date: 11 December 2023

- Balwin Properties (Balwin) is South Africa's largest residential developer. Established in 1996 it has sold approximately 60 000 apartments, with a future pipeline of 40 125 units. It's renowned for its build quality and lifestyle offerings that have evolved consistently to make it unique in its primary target market of low to middle income buyers & investors. It's establishing numerous complimentary businesses that leverage off its developments, earning annuity revenue – including fibre installation, mortgage origination, rental and power generation.
- Development focuses on high density, high growth nodes of Gauteng, Cape Town (CT) and Kwazulu-Natal, with Gauteng being dominant with 76% of the pipeline. More recently, strong growth in the coastal nodes, particularly in CT has been achieved on the back of semigration and this will continue in the medium term.
- Its offering is spread across three distinct Collections, with units from R599 900, an ave sales price of R1 270 000 in 1H24. Each Collection offers 1, 2 and 3-bed units, the mix depending on the location and the underlying market conditions. Phase sizes reflects market demand ensuring alignment of construction tempo to sales rates and can constitute a single block of 8-14 apartments only.
- Development sizes have risen to achieve greater economies of scale, ensuring affordability, and offering an appealing range of lifestyle and leisure facilities. Unfortunately, this has increased the duration of developments to 15-20 years with land, infrastructure and facilities costs being recovered and financed over longer timeframes, placing pressure on working capital and free cash flow. FY24E will see another year of investment as Mooikloof Smart City is serviced and further land is acquired in CT, thereafter development cost growth rates should decline.
- CT land banking is favourable as land is generally serviced and there is strong residential demand, resulting in development pipelines of 4 years vs 21 in Gauteng. We therefore favour such developments continuing with a focus to completing the existing longer dated projects in Gauteng and KZN, easing working capital.
- FY24E will be a challenging year given affordability pressure due to higher interest rates and inflation. Investors (circa 50% of buyers) are likely to pause given high debt servicing costs. Consequently, we see a sharp decline in sales volumes from 2788 in FY23 (in line with the 5-year average of 2690) to 1812, down 35%. We anticipate a modest 4.5% increase in average sales prices as promotional activity will intensify and buyers shift to smaller more affordable units. We forecast a decline in GP margins after a recovery in FY23. Revenue will see some support from the annuity businesses where we forecast 46% growth in FY24E.
- We anticipate a 40% decline in recurring HEPS in FY24E to 55c, declining to 50c in FY25E given low sales growth and declining GP margins with improved growth in FY26E (+40%). Unwinding its working capital in FY25E onwards is key to achieving improved returns and we see management committed to achieving this, even if margins are compromised via promotional activity. Our outlook on the stock is premised on a decline in the value of developments under construction.
- Balwin trades on an attractive 12m forward P/E of 4.2x, an EV/EBITDA of 8x. Evidence of improved working capital could be a catalyst for a re-rating. In our DFCF valuation we calculate a value range of R2.03-R3.09, a mid-point of R2.50.

ZAR'm (to February)	FY21	FY22	FY23	FY24E	FY25E	FY26E
Revenue	2,659	3,074	3,244	2,203	2,244	2,710
EBITDA	477	526	605	441	379	495
Recurring headline earnings	336	391	426	254	229	317
Recurring HEPS (ZAc)	72	83	91	55	50	70
PE Ratio	5.9	3.7	2.4	3.9	4.3	3.1
Dividend (ZAc)	0	21	24	0	10	17

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Price (08/12/2022):	R2.15
Market cap	R1117mn
Shares in issue	519.4mn

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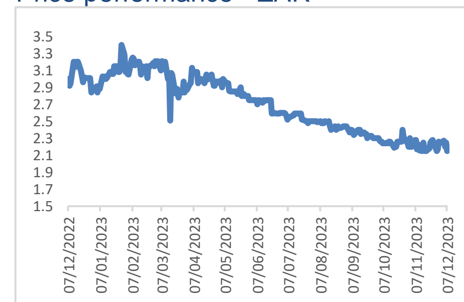
Price performance - ZAR



Source: FactSet

Figure 1 Financial summary – R'mn

Year Ending	FY2020A	FY2021A	FY2022A	FY2023A	FY2024E	FY2025E	FY2026E
Income Statement							
Revenue from sale of apartments	2,843	2,659	3,074	3,244	2,203	2,244	2,710
Sales growth (%)	*9.4%*	*-6.5%*	*15.6%*	*5.5%*	*-32.1%*	*1.8%*	*20.8%*
Gross profit	718	680	781	877	557	572	702
GP margin %	*25.3%*	*25.6%*	*25.4%*	*27.0%*	*25.3%*	*25.5%*	*25.9%*
Annuity revenue	72	41	52	83	121	149	177
EBITDA	586.1	477.0	526.4	605.1	440.9	379.4	495.2
EBITDA Margin (%)	*20.6%*	*17.9%*	*17.1%*	*18.7%*	*20.0%*	*16.9%*	*18.3%*
EBIT	574.0	462.1	504.8	578.4	412.0	342.7	457.8
EBIT Margin (%)	*20.2%*	*17.4%*	*16.4%*	*17.8%*	*18.7%*	*15.3%*	*16.9%*
Profit before tax	575.4	467.1	519.0	597.4	395.6	315.6	435.5
Net profit	411.4	336.4	363.3	437.3	288.0	229.8	317.9
Net profit post minorities	411.4	336.2	362.8	436.2	287.3	229.2	317.1
Group headline earnings	411.4	335.9	356.4	425.6	287.3	229.2	317.1
Growth %	*-9.0%*	*-18.4%*	*6.1%*	*19.4%*	*-32.5%*	*-20.2%*	*38.4%*
Recurring headline earnings	411.4	335.9	390.5	425.6	254.4	229.2	317.1
Growth %	*-9.0%*	*-18.4%*	*16.3%*	*9.0%*	*-40.2%*	*-9.9%*	*38.4%*
Reported EPS (ZAR)	0.87	0.72	0.77	0.94	0.62	0.50	0.70
HEPS Group (ZAR)	0.88	0.72	0.76	0.91	0.62	0.50	0.70
EPS Growth	*-8.1%*	*-18.6%*	*6.0%*	*20.4%*	*-32.4%*	*-19.3%*	*39.9%*
HEPS Recurring (ZAR)	0.88	0.72	0.83	0.91	0.55	0.50	0.70
EPS Growth	*-8.1%*	*-18.6%*	*16.2%*	*9.9%*	*-40.1%*	*-8.9%*	*39.9%*
DPS (ZAR)	0.00	0.16	0.21	0.24	0.00	0.10	0.17
Payout ratio (%)	*0.0%*	*22.6%*	*27.5%*	*26.2%*	*0.0%*	*20.0%*	*25.0%*
Balance Sheet							
Cash and Cash equivalents	477	368	667	772	363	453	367
Current asset (ex – all cash)	4,031	4,905	5,611	5,980	6,718	6,407	6,027
Net Fixed assets	0	100	259	481	612	622	771
Intangible assets	9	15	17	23	20	20	20
Investments	0	2	6	0	0	0	0
Other assets	91	12	36	42	16	15	17
Total assets	**4,608**	**5,401**	**6,596**	**7,298**	**7,729**	**7,517**	**7,202**
Debt excl lease liabilities	1,420	1,902	2,541	2,957	3,342	2,942	2,342
Lease liabilities	4	3	126	1	1	1	2
Current liabilities	133	135	175	230	212	216	260
Other liabilities	100	160	239	274	274	274	274
Total liabilities	**1,657**	**2,199**	**3,080**	**3,462**	**3,830**	**3,433**	**2,877**
Shareholders' equity	2,952	3,203	3,515	3,835	4,034	4,210	4,430
Minorities	0	0	1	2	2	3	4
Total shareholders' equity	**2,952**	**3,203**	**3,516**	**3,837**	**4,037**	**4,213**	**4,434**
BVPS (ZAR)	*6.3*	*6.8*	*6.8*	*7.4*	*7.8*	*8.1*	*8.5*
ROE (%)	*14.7%*	*10.9%*	*11.6%*	*11.6%*	*6.5%*	*5.6%*	*7.3%*
ROIC (%)	*10.7%*	*7.7%*	*7.1%*	*7.3%*	*4.6%*	*3.6%*	*5.1%*
Debt ex leases							
Debt: Ebitda	*2.4*	*4.0*	*4.8*	*4.9*	*7.6*	*7.8*	*4.7*
Interest Cover	*574.0*	*90.6*	*22.8*	*57.8*	*9.9*	*8.1*	*14.2*

Year Ending	FY2020A	FY2021A	FY2022A	FY2023A	FY2024E	FY2025E	FY2026E
Cash Flow							
Reported net profit	**411.4**	**336.2**	**362.8**	**436.2**	**287.3**	**229.2**	**317.1**
Change in net working capital	-29.1	-894.3	-586.3	-84.3	-755.5	315.1	423.5
Other adjustments	8.8	73.3	82.5	-106.6	28.8	35.5	39.5
Dividends paid	-120.3	-92.2	-111.6	-107.1	-63.7	-23.6	-66.9
Cash flow from operations	**270.8**	**-577.0**	**-252.6**	**138.2**	**-503.1**	**556.1**	**713.2**
Net Capex	-15.3	-32.2	-75.5	-95.6	-194.1	-49.4	-182.5
Capex/sales (%)	*0.5%*	*1.2%*	*2.5%*	*2.9%*	*8.8%*	*2.2%*	*6.7%*
Other investing cash flows	-4.4	-11.7	0.0	-177.1	26.1	0.0	0.0
Cash flow from investing	**-19.7**	**-43.9**	**-75.5**	**-272.7**	**-168.0**	**-49.4**	**-182.5**
Equity raised/(bought back)	0.0	0.0	0.0	-20.1	-15.0	-15.0	-15.0
Net inc/(dec) in borrowings	-103.9	481.8	639.1	98.2	369.5	-400.0	-600.0
Other financing cash flows	0.0	-1.0	18.1	-1.8	0.0	0.0	0.0
Cash flow from financing	**-103.9**	**480.8**	**657.2**	**76.3**	**352.6**	**-417.0**	**-617.1**
Net cash flow	**147.2**	**-140.1**	**329.1**	**-58.2**	**-318.5**	**89.8**	**0.0**
Free cash flow	**437.2**	**-510.5**	**-191.1**	**292.1**	**-616.3**	**559.2**	**618.6**
Lease payments	**0.0**	**-1.0**	**-1.9**	**-1.8**	**-1.9**	**-2.0**	**-2.1**
Net free cash flow	**437.2**	**-511.5**	**-193.0**	**290.3**	**-618.2**	**557.3**	**616.5**
Valuation Summary							
Share Price (ZAR)	3.50	4.25	3.09	2.15	2.15	2.15	2.15
P/E (Underlying) (x)	4.0	5.9	3.7	2.4	3.9	4.3	3.1
P/BV (x)	0.6	0.6	0.5	0.3	0.3	0.3	0.3
EV/EBITDA (x)	5.6	6.9	6.3	5.5	7.5	8.7	6.7
EV/EBIT (x)	5.8	7.2	6.5	5.7	8.0	9.6	7.2
FCF Yield (%)	39.2%	-45.8%	-17.3%	26.0%	-55.4%	49.9%	55.2%
Dividend Yield (%)	0.0%	3.8%	6.8%	11.2%	0.0%	4.6%	8.1%
Net Debt	947	1,537	2,000	2,186	2,980	2,490	1,977
Debt/Equity	0.32	0.48	0.57	0.57	0.74	0.59	0.45
Net Debt (excl lease liabilities)	943	1,534	1,874	2,185	2,979	2,489	1,975
Debt/Equity (excl lease liabilities)	0.32	0.48	0.53	0.57	0.74	0.59	0.45

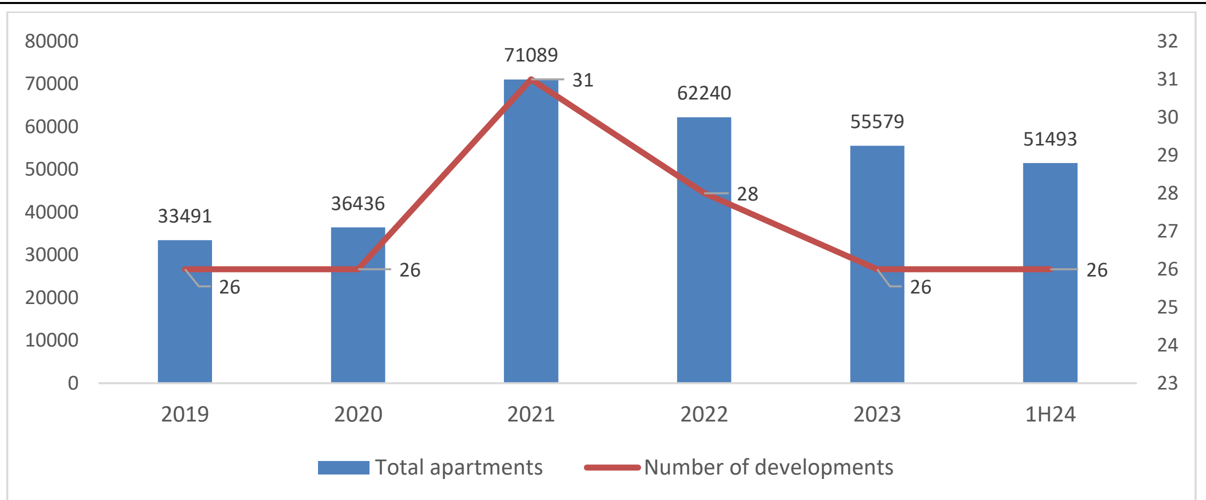
Source: Company data, ASB research, FactSet

Overview

Founded in 1996, Balwin Properties (Balwin) is SA's largest residential property developer and was listed on the JSE in October 2015. It delivers a high quality range of 1 to 3-bedroom sectional title apartments in secure lifestyle estates, finding favour from home buyers and investors alike, the latter comprising circa 50% of sales. The scale of its developments has grown significantly in the past five years from 33 491 apartments in FY19 to 51 493 in 1H24, peaking at 71k in FY21 when the number of developments peaked at 31, now 26.

The Balwin brand is aspirational in SA and is synonymous with a high standard of workmanship and a quality lifestyle offering, not rivalled in its market. There is a drive in the company to diversify the revenue streams into higher annuity revenue generation from activities that leverage off the developments. This includes the provision of internet fibre connectivity, energy solutions, security, lifestyle centres, rentals and mortgage origination. Off a low base these operations are gaining good traction and enhancing operating margins.

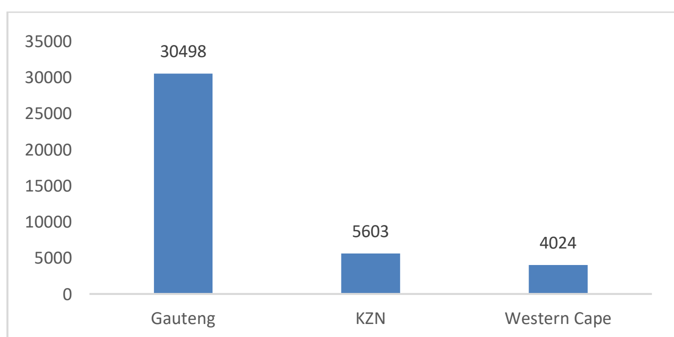
Figure 2 Scale and number of developments (RHS)



Source: Company data, ASB Research

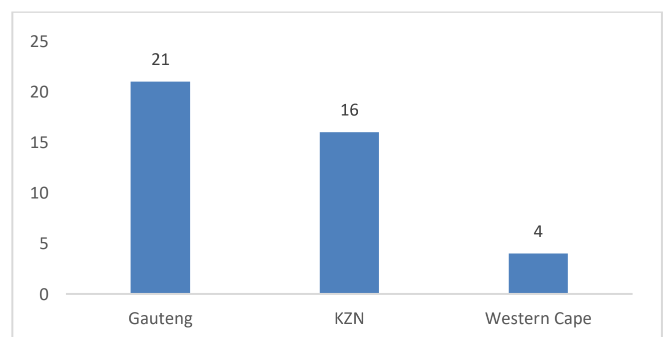
Regional Focus

Figure 3 Pipeline of apartments by region – 1H24



Source: Company data, ASB Research

Figure 4 Average project duration (years) – 1H24



Source: Company data, ASB Research

The company focuses on the larger economic nodes like Johannesburg, Tshwane, the Western Cape (Cape Town and surrounds) and KZN (largely Umhlanga and Ballito). Gauteng has traditionally remained the dominant driver of revenue (48% in FY23) from apartment sales, however, this changed in 1H24 given a weaker Gauteng market and strong demand for its Western Cape developments, which have a more limited offering in terms of numbers. Gauteng still remains dominant in terms of the pipeline at 76%. Gauteng has more recently been supported by the highly successful Waterfall City development in which Balwin has launched three developments of circa 7 600 units (around 45% are sold, including the entire Kikuyu development of 1 270 units). Mooikloof Smart City in Tshwane is a circa 10 200 apartment development that will go live in FY24E, the biggest in the group with a long duration.

Balwin is capitalising on the semigration occurring out of Gauteng as it is creating strong demand for its offering in KZN and Western Cape. There are currently two developments underway in KZN (a further two in the pipeline) and five in the Western Cape with sales in the latter very strong as indicated by its increased share of group sales from 32% in FY22 to 48% in 1H24. The Western Cape developments are favourable from a duration perspective as land is generally serviced when acquired. Gauteng and KZN can take several years for zoning and services to be finalised. As per figure 4, the Western Cape pipeline is currently 4 years compared to 21 and 16 in Gauteng and KZN respectively, and therefore land banking will continue in the province whilst the other regions are envisaged to develop their existing land parcels.

The offering

Figure 5 Fynbos – Western Cape

Source: Company data

Figure 6 Munyaka – Waterfall City

Source: Company data

Figure 7 Greenkloof - Tshwane

Source: Company data

Figure 8 De Aan-Zicht – Western Cape

Source: Company data

Figure 9 Sport facilities

Source: Company data

Figure 10 Gym facilities

Source: Company data

The offering encompasses a quality apartment at an affordable price, in a lifestyle estate offering numerous amenities focused on convenience and leisure. We have visited numerous developments over the past few years and the quality has been consistently high across all price ranges, whilst lifestyle centres have been enhanced to provide greater convenience and leisure facilities for residents. The common areas are immaculately presented and maintained with attention to the surrounding area's fauna and flora. Smaller independent developers could not provide such an offering at the same price points.

In addition, there is a strong focus on sustainability with all apartments being accredited by EDGE (Excellence in Design for Greater Efficiencies), part of the International Finance Corporation (IFC). The focus of EDGE is to optimise designs to use less energy, water and embodied energy in materials. Balwin has achieved 22 810 certifications in total, 6 154 in the past 18 months. Balwin also holds ten Six-Star Green rated and Net Zero Carbon emissions buildings including its head office.

The above has culminated in over 44 international awards at the Africa and Arabia Property Awards in numerous categories including best apartment in SA, best architecture for multiple residence in SA, best social housing in SA, best leisure development in SA and best sustainable residential development in SA.

There are three defined development brands servicing different target markets, namely:

The Green Collection – prices from R599 900 to R1 519 900, 1 to 3-bedroom apartments are offered. Blocks are large, anywhere up to 40 units, cleverly designed back to back so as to remain aesthetically pleasing but ensuring lower building costs and greater densification. The development includes lifestyle centres and targets a slightly lower income consumer than the Classic Collection.

The Classic Collection- this is the core development offering of the group and accounted for 71% of development revenue in 1H24 (59% in FY23). Based on the future pipeline it remains the dominant category at around 57% (assuming 50% of Mooikloof Smart City is Classic). Prices range from R764 910 to R3 249 900. There are 8-14 apartments in a four story block depending on the mix of 1,2 or 3-bedroom units.

The Signature Collection – there are currently three of these developments, two in Waterfall City and one in Umhlanga. The Paardevlei development in Western Cape was recently sold out. Apartments have higher specifications and luxurious finishes and are priced from R899 900 to R10 999 900. There are a few higher valued units in Munyaka valued at circa R200m, which are yet to be sold.

Within the collections there is flexibility as to the mix of units (1,2 or 3-bedroom) so as to adjust for prevailing market affordability. Blocks are never greater than four stories and therefore don't require elevators – Munyaka Lifestyle Centre apartments being an exception (the balance of Munyaka, representing circa 4 800 apartments in the Classic Collection have no elevators). Apartments include ovens, stove tops, fridges, washing machines, dishwashers and tumble dryers with the specification depending on the Collection.

Key to each development are the lifestyle centres, something that distinguishes Balwin from its competition and makes the offering very appealing for residents. The following amenities and services are on offer depending on each development; however, the bulk are common to most:

- Fibre installation
- Solar installation facilitates cheaper energy costs for residents by selling power into the grid.
- Boardroom facilities
- Restaurants or coffee shops
- Mini supermarkets
- Laundromats
- Private cinemas to book for events – free use with a deposit
- A gym – operated by Training Science – free membership.
- A concierge service to manage deliveries – free service.
- Pool or lagoon in certain instances – the lagoons offer an array of water sports.
- Sports facilities include mini soccer fields, basketball, Padel, skateboarding and mountain biking.
- Schools
- Games room
- Playgrounds
- Wellness spa

All complexes feature state of the art access security (managed by Balwin Technik) with security patrols. Until recently many of the above services were offered and managed by the body corporate of each development. This strategy has been changed in favour of Balwin retaining ownership and management of the lifestyle centres and opening them to visitors (non-residents). Residents benefit from lower monthly levies whilst still maintaining access to all the facilities/services. Residents also gain comfort from the fact that the developer ensures appropriate maintenance and running of the lifestyle centre so as to protect the investment value of their apartments. The benefit for Balwin is that it creates an additional revenue stream via monthly membership fees. This requires the lifestyle centres to be located in a manner that provides visitors and residents separate access and is therefore not a strategy that can be introduced retrospectively for most developments as the lifestyle centres are located centrally in the developments. With Balwin managing the facilities they don't suffer from body corporates looking to cut budgets at the expense of the offering or failing to enforce codes of conduct.

We touch on the revenue streams in more detail in the annuity revenue section on page 17.

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The development process

Figure 11 Phased approach

Source: Company data

Figure 12 Standardised floorplates

Source: Company data

The sheer scale of Balwin's developments, on average each development targets 1 000-3 500 units, allows it to manage unit costs to a level no other competitor can achieve. This whilst still maintaining a very high standard of finish. However, it's not only the scale that ensures efficiencies, Balwin's relationships with its builders and professional teams also provides a competitive edge.

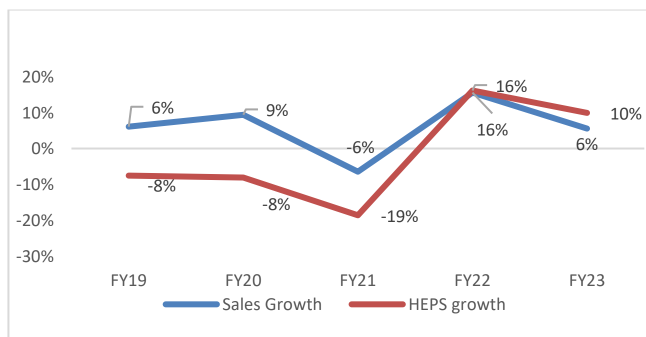
- Land – ultimately the land costs amount to circa 15% of total development costs. Land can be 50-70% financed and is secured through a mortgage bond registered in favour of the lending institution. Zoning and the installation of municipal services can take several years and therefore it's important to ensure a continuous land pipeline. At present there are significant projects underway which have long run off periods and therefore the urgency to land bank is not as high, apart from the Western Cape where quality sites are more difficult to obtain given greater competition and higher prices. The Western Cape benefits from land parcels that are mostly already serviced and therefore it has considerably quicker development durations.
- Design – Balwin has a team of circa 60 external architects, from three different prominent firms. Steve Brookes is integrally involved with the design team given his passion for the final product as well as ensuring zero defects. Meetings with architects are held weekly to drive cost engineering and design efficiencies while ensuring the product remains cutting edge. The design of the blocks in a development are standardised so as to achieve building efficiencies in cost and time.
- Professional consultants - engineers are externally sourced and remunerated on a per apartment basis. This implies that risk is taken by the professional should the development not progress.
- Internal resources – Balwin has its own Quantity Surveyors and construction management teams to overlook the contractors.
- Sales – this is largely dealt with internally. External agencies have been used in isolated cases as it's a practice not favoured given the additional cost. Sales consultants are incentivised on a successful, sales based approach only, i.e., no base salary. Sales must be secured before construction commences as there needs to be a high level of pre-sales for the banks to provide the funding (if no funding is sought construction can commence at risk, i.e. no pre-sales). Sales are secured for the buyer with a R20 000 deposit per apartment for the Classic and Signature range and a R10 000 deposit for the Green Collection apartments. All pre-sales are audited by the banks and three large independent conveyancing firms are contracted to register sales.
- Construction – all builders are externally appointed, and appointments are done on a phase by phase basis, generally 30-50 units at a time. Rates are market related and fixed rate contracts are entered into. Where possible, teams are sourced from the local areas, the onus placed on the contractor.
- Defects – Balwin provides buyers with a 3 month period to identify defects, and these are repaired at no cost to the buyer. Balwin also provides a five year warranty in addition to the NHBRC five year warranty, the latter having never been called upon. Discretion is applied when assessing defects and warranty issues, remembering that developments can take years for final completion and therefore ensuring a well presented and functioning estate is crucial to future sales.

- Body corporate – a body corporate is incorporated on the registration of the first phase and a managing agent is appointed. Balwin retains majority decision making of the body corporate during the development period and for 12 months thereafter. This ensures a well-managed development throughout the sales period. There is a dedicated department within the group dealing with body corporate matters. An opportunity exists to remain involved with the body corporate post the completion on a remunerated basis, a further annuity revenue opportunity.

It is important to note that construction follows sales – the blocks are generally not built at risk, apart from the opening blocks in which the showroom units are included. Phases are circa 50 units at a time but are determined by market conditions, hence a single block of 8-14 units may comprise a phase in challenging conditions as is currently being experienced.

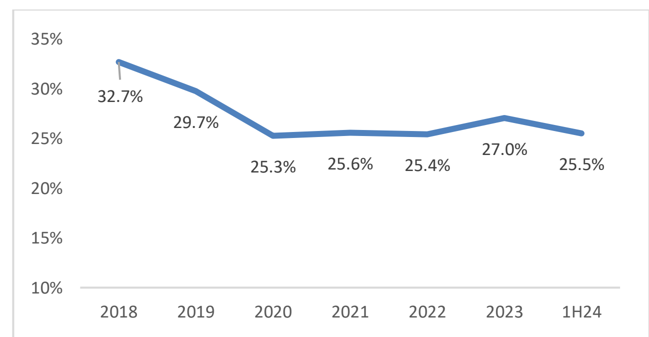
Financial

Figure 13 Apartment sales growth vs HEPS growth



Source: Company data, ASB Research

Figure 14 Development GP Margin %



Excluding the sale of development rights in 1H24

Source: Company data, ASB Research

Despite operating in a subdued economic environment for numerous years, Balwin has been able to grow its revenue consistently as per the chart above. FY21 was an exception (-6%), impacted by Covid lockdowns that delayed construction and sales. In FY23 the 5 year CAGR growth in total revenue was 6.3%, ahead of the average CPI over the period of 4.7%. The number of units sold (and recognised in revenue in that year) has been relatively consistent over the past 5 years – the average is 2 690 units with FY23 delivering 2 788. Revenue is heavily skewed by the sales mix of apartment sizes and Collections.

1H24 has seen a sharp decline in revenue from the sale of apartments, down 31% on 1H23. Interest rates at 14 year highs is taking its toll on affordability and as a result the next 12-18 months will be challenging. Management indicated this is the toughest operating environment in the company's 28 years.

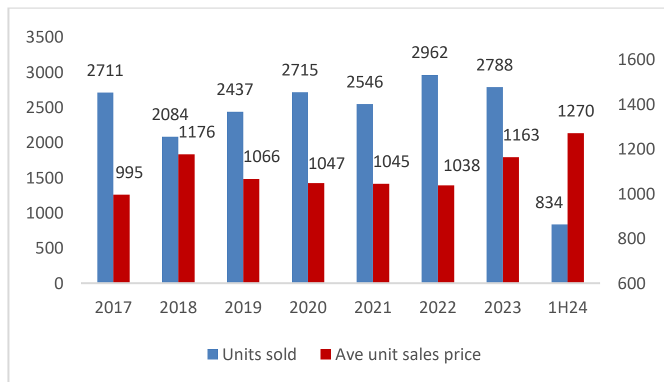
Development GP margins were on a declining trend from FY18 to FY20, declining from 33% to 25% before improving to 27% in FY23. In 1H24 there has been a sharp rise in promotional activity in order to achieve sales and this has put further pressure on GP margins which has reversed the FY23 recovery. Management maintains a target of circa 31%. Margins have largely suffered due to a difficult operating environment (low economic growth) with affordability under pressure and the inability to fully pass on costs in selling prices. Higher interest rates and greater funding for growing developments under construction is also eroding margins. In FY23 development loans and facilities increased by a 5 year CAGR of 18.7%, well ahead of revenue growth of 6.3%.

As a consequence of GP margin pressure, HEPS in FY23 is lower than it was five years ago, with a declining trend going forward. ROE has also come under pressure, declining from 18.2% in FY19 to 11.6% in FY23E. EBIT and PBT are not significantly different as interest costs are largely capitalised to development cost of sales.

We focus on the outlook for revenue, GP and headline earnings separately below:

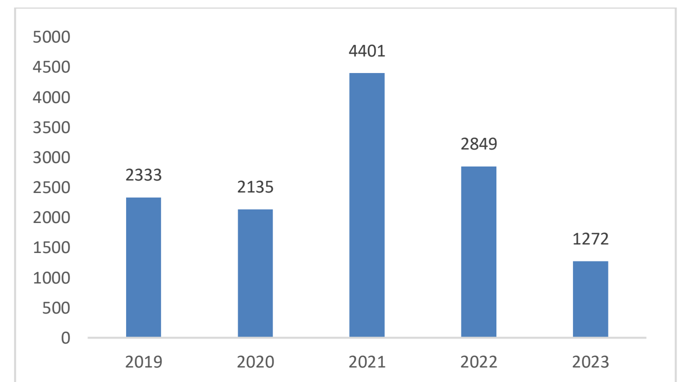
Revenue

Figure 15 Sales recognised vs ave unit sales price (RHS) - R'000



Source: Company data, ASB Research

Figure 16 Sales adjusted for prior year sales not recognised – R'000



Source: Company data, ASB Research

Revenue is a product of the average sales price per unit and the number of units sold and recognised in the year. Each one of these has numerous dynamic factors making it difficult to model revenue growth with high accuracy. In addition, there is annuity revenue from other services provided.

There are two categories of apartment sales disclosed, those recognised as a sale (the earlier of the transfer of the apartment in the deeds office or when the apartment is handed over to the client once all financial guarantees are in place) and those not recognised (under construction, or with the conveyancers for transfer). The former is reocgnised in revenue in that financial period and the latter in a following financial period which may not always be the following financial year if for example it involves the launch of a sizeable development that could take >12 months to register first sales. The unrecognised sales provide a foundation for estimating recognised unit sales in the following year. In FY23 this was 870 units (to be recognised in FY24E), considerably lower than the 2 386 unrecognised sales in FY22. Given recognised sales of 2 788 units in FY23, it suggests total sales in the year of 1 272 ((2 788-2 386)+870), which is low compared to historic trends as per figure 16 above. However, there have been some specific circumstances driving this:

- There were around 448 pre-sales in the Smart City project included in the 2 386 that were all cancelled as the project was delayed given the failure of government to provide the necessary services as initially agreed. Adjusting for this the calculated sales rose from 1 272 to 1 720.
- Some of the 2 386 sales were not recognised in FY23, carrying over to FY24E. Assuming 10% of these (post the 448 above) adds 194 to the adjusted 1 720, totalling 1 914.
- Izinga, Munyaka and De Aan-Zicht were launched in FY22 and were all very popular developments at launch, achieving strong pre-sales and inflating the 2 386. These three developments accounted for 874 pre-sales.
- The average over the past 5 years is 1 350 units sold not recognised.

There are clearly some timing differences and other valid reasons why measuring sales performance on this basis could be misleading. Sales registered is a more comparable methodology and has delivered more consistent sales patterns as per figure 15 above.

In figure 15 we plot the average sales price per unit (sales revenue/units sold) and the number of sales registered in the year. The average sales per unit is heavily distorted by the size of the apartment, the Collection and geography. The average sale price declined from 2018 largely due to the addition of the Green collection that sells at a considerably lower price than Classic. As its popularity grew, it reduced the average selling price per unit, which was part of the strategy to bring a more affordable offering to the market.

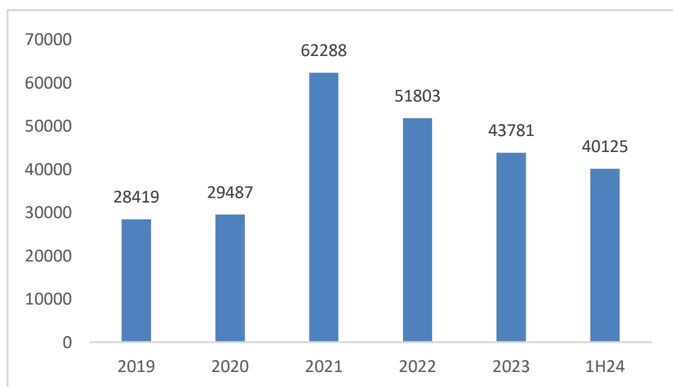
1H24 has seen a sharp deterioration in the market due to elevated interest rates. This combined with the lower number of units carried over from FY23 (870) has seen 834 apartments recognised in revenue (1H23 1 360). There are 688 units sold not recognised in 1H24 revenue that will carry forward.

It must be noted that the future development of internal Balwin rental units are not recognised as sales.

We assess the following drivers of revenue:

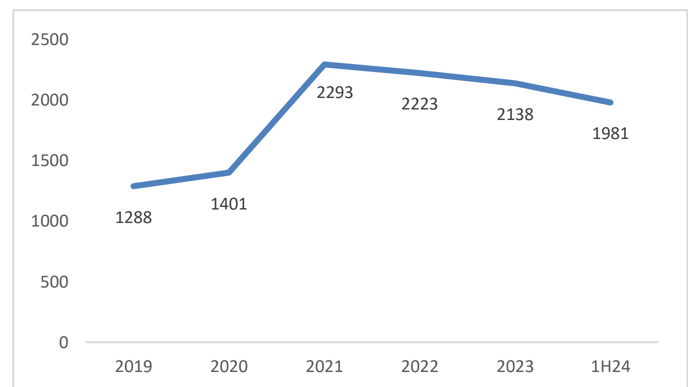
Pipeline and size of projects

Figure 17 Pipeline of apartments



Source: Company data, ASB Research

Figure 18 Ave development size



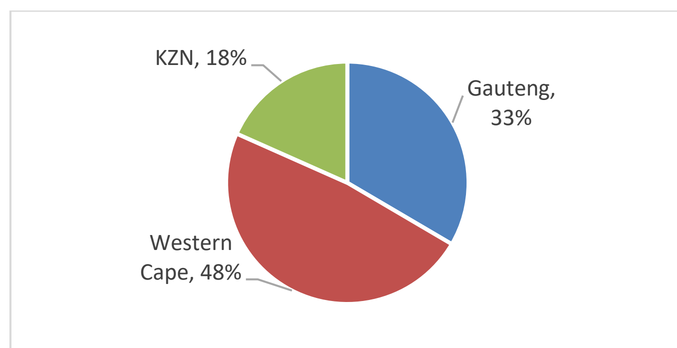
Source: Company data, ASB Research

The development pipeline has grown significantly from 28 419 units in FY19 to 40 125 in 1H24 – 15 to 20 years in duration. The number of developments has declined from a peak of 31 in FY21 to 26 in 1H24, in turn reducing the pipeline from a high of 62 288. The pipeline is heavily skewed towards Gauteng with 76% of future units, the Mooikloof Smart City development accounting for 10 234 units and commencing in FY24E. As a consequence, we believe land banking in Gauteng will be fairly muted going forward, the coastal areas will see more activity for new developments, particularly the Western Cape.

As per figure 18 above, the average development size has also increased significantly over the past 5 years, rising from 1 288 to 1 981. The numbers have been more stable over the past three years but on a steady decline, which is positive for working capital.

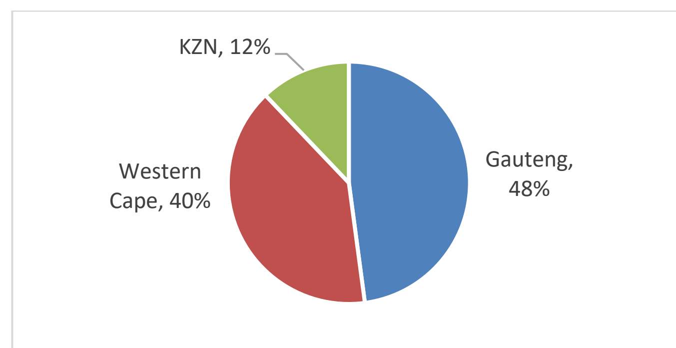
Geographic spread

Figure 19 Geographic mix of apartment sales – 1H24



Source: Company data, ASB Research

Figure 20 Geographic mix of apartment sales – FY23

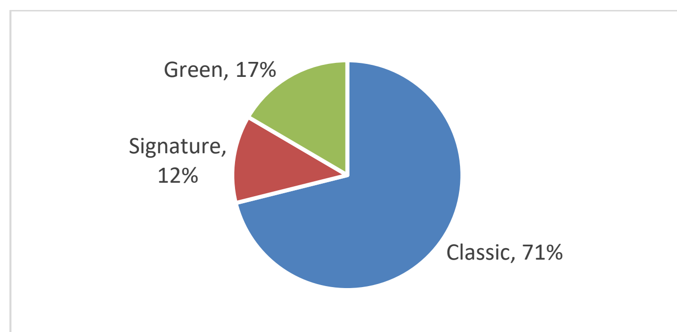


Source: Company data, ASB Research

Whilst sales growth has declined in 1H24 (-31%), KZN and Western Cape have been more resilient, down 16% and 8% respectively compared to -54% in Gauteng. This is partly driven by the semigration to coastal towns. This has resulted in Gauteng's contribution to revenue declining from 48% in FY23 to 33%. The development pipeline in the Western Cape is also far shorter at 4 years compared to Gauteng at 21 and KZN at 16 years. Therefore, ensuring a steady pipeline in the Western Cape is supportive in maintaining revenue growth momentum. At present 42% of the WC pipeline is complete compared to 19% and 17% for Gauteng and KZN respectively, implying that some land banking in the Western Cape is required - three sites are currently being explored.

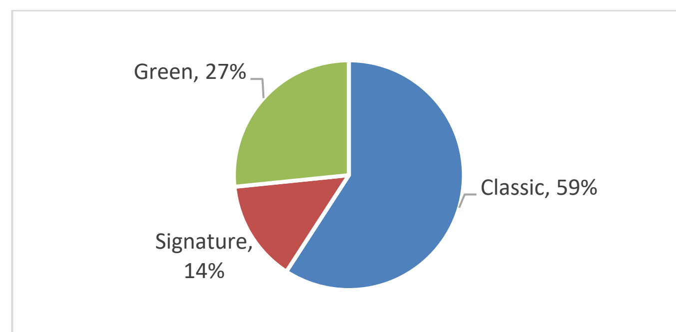
The mix of Collections

Figure 21 Collection mix of apartment sales – 1H24



Source: Company data, ASB Research

Figure 22 Collection mix of apartment sales – FY23



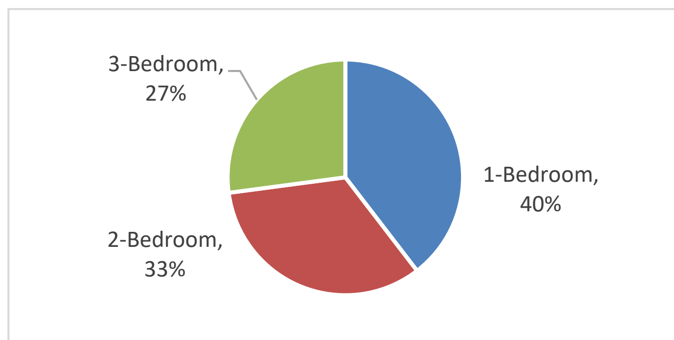
Source: Company data, ASB Research

A shift towards the higher priced Signature Collection developments is positive for revenue growth as was the case in FY23 (10% in FY22), boosted by the Signature apartments at Munyaka Lifestyle Centre. The Green collection attracts the lowest selling prices and therefore a drop in its total contribution is positive for revenue growth. Green declined from 27% in FY23 to 17% in 1H24 largely due to its developments being concentrated in Gauteng, the node most under pressure. Based on the current pipeline, 6% of units are in Signature, well below the 12% sales mix in 1H24. Similarly, Green is at 36% compared to 17% in 1H24. This poses a headwind for revenue growth. However, in the current environment the volumes in Green should be more robust and this could offset the lower selling price shift.

The mix of size of apartments within each of the Collections also plays a key role.

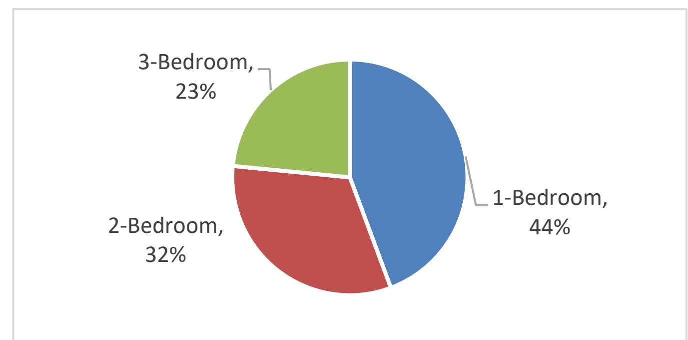
The mix of apartment sizes

Figure 23 Sales mix of apartment sizes – 1H24



Source: Company data, ASB Research

Figure 24 Sales mix of apartment sizes – FY23



Source: Company data, ASB Research

Revenue growth in FY23 benefited from a higher proportion of 3-bedroom sales and lower 1-bedroom sales. This trend surprisingly continued into 1H24 largely due to families choosing to reside in secure Balwin estates but also due to a higher proportion of 3-bedroom pre-sales during a period of lower interest rates now being registered. Given a tougher operating environment this trend is likely to reverse in 2H24E and FY25E with a greater mix of 1-bedroom apartments at the expense of 3-bedrooms, placing pressure on revenue growth. In FY23 the shift towards 3-bedroom units was in the Green Collection and Classic. For Classic its was at the expense of 2-bedroom units and for Green it was at the expense of both 1 and 2-bedroom apartments. This explains the average Green price per unit rising 15.3% compared to Signature at 3.2% in FY23.

New projects

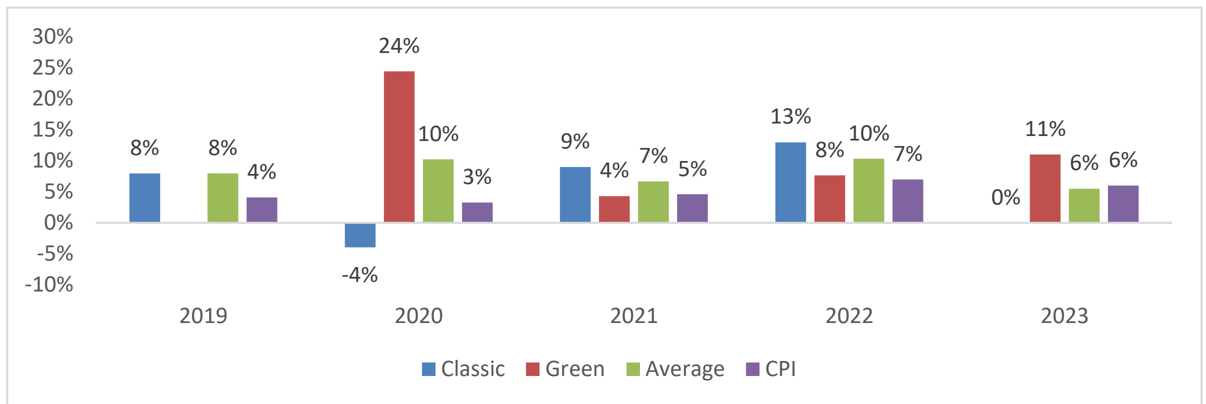
New projects will have high sales to start with given the marketing and hype around the launch as well as promotional activity. Apart from the Western Cape, we don't see a great increase in the number of projects in the medium term given a very strong pipeline. We calculate that there were 2 new developments in FY23, none in FY22 and 11 in FY21, a considerable slow down given the magnitude of the existing pipeline. No new developments were entered in 1H24.

Price increases

Sales prices are driven by the underlying building cost inflation. Balwin's scale, continuity and in-house skills provide it with the ability to contract at more favourable rates, offsetting some of the inflationary pressure. Management believes it can contain this to 3.5% in the current environment. The average sales price per unit is not an indication of sales price inflation. It is heavily influenced by region, Collection and bedroom mix.

In the figure below we highlight the average selling price increases for the 12 month period ending in August in the respective years. We exclude Signature as the product is tailored around specific projects and hence subject to considerable price differentials. There have been consistent price increases ahead of or line with CPI over the past 5 years with Green seeing the greatest price inflation in the past 12 months.

Figure 25 Selling price changes for the 12 months ending August



Green collection only commenced in 2019.

Source: Company data, ASB Research

We note that the selling price has a fixed cost input, namely the land and services, the lifestyle centres and facilities as well as professional fees – these don't escalate as the development progresses (apart from finance charges thereon). For this reason, selling prices don't have to approximate inflation.

It is also important to note that the developments are sold in phases, around one to four blocks at a time. As a consequence, pricing is dynamic ensuring it can adjust to cost pressures.

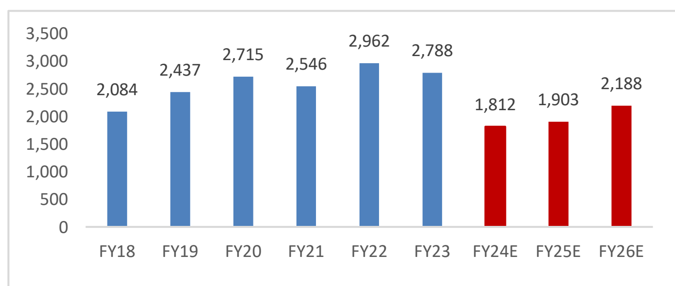
There have been no increases in Classic prices to August 2023 while Green is up 11%. We see pressure on price increases going forward and would not expect an increase in Classic and possible decreases in Green through promotional activity. In the current market, there are likely to be a growing number of sellers in existing developments where Balwin is still active, particularly those that bought when interest rates bottomed out. As a consequence, Balwin units need to be competitively priced.

The level of promotional activity

This increases during difficult economic times such as the present with high inflation and interest rates impacting affordability. There was a considerable amount of promotional activity around the recent Rugby World Cup – these benefited volumes but at the expense of selling prices. There will be mounting pressure on revenue growth from increased promotional activity over the next 18 months or as long as interest rates remain elevated.

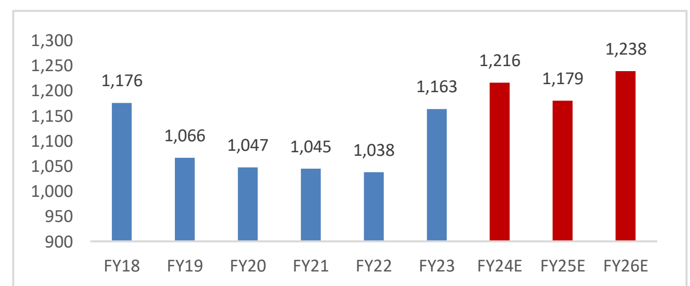
Outlook

Figure 26 Apartments sales



Source: Company data, ASB Research

Figure 27 Average sales price per unit – R'000



Source: Company data, ASB Research

Given the factors above, combined with a 4.75% move in interest rates over the past two years, makes us cautious on the outlook for revenue growth. Affordability for buyers is under pressure and prospective returns for investors (circa 50% of buyers) at current finance rates is also less appealing. As already seen in the 1H24 results, the number of apartments sold has declined significantly, down 39% on the comparable period. We anticipate better 2H24E numbers on the back of high promotional activity, with the Rugby World Cup campaigns being successful and a Black Friday offering that followed. We anticipate 978 apartment sales in 2H24E compared to 834 in 1H24, totaling 1 812 for FY24E, down 35%. With interest rates anticipated to remain elevated going into FY25E, with some relief in 2H25E, we anticipate a modest 2% growth in sales numbers to 1 903. We have volumes rising 15% off the low base in FY26E to 2 188, still well below the 5-year average of 2 690 to FY23.

Constrained affordability will make it difficult to reprice units upwards, particularly the Green collection where prices have increased by 8% and 11% in the past two respective years. The average sales price per unit was 9% up in 1H24 on FY23 - we anticipate 4.5% price growth for FY24E as we see higher promotional activity, a lower overall contribution from Signature and lower 3-bedroom sales playing a role. Average sales price growth is forecast to be negative 3% in FY25E due to mix changes and ongoing promotional activity.

An upside risk to our earnings is the potential sale of the penthouse and two villas at Munyaka - these 3 units could fetch as much as R200m in sales which based on the 1H24 average sales per apartment of R1.27m, equates to 157 units.

Overall, we forecast apartment sales revenue to decline by 32% in FY24E with a slight improvement of +2% in FY25E.

Development GP Margins

GP margins for developments are largely affected by the same factors impacting revenue, but probably to a lesser degree as a circa 31% GP margin is targeted across all developments. The following factors impact GP margins:

Geographic mix

Whilst all developments target similar GP margins, these are more easily achieved in Gauteng where building costs are lower, and projects are bigger. With Gauteng decreasing its group revenue contribution there will be pressure on GP margins in the short term.

Apartment size mix

All units are allocated total development costs (land, infrastructure, professional fees and construction costs) on a participation quotient methodology (based on sqm) and therefore building costs per sqm should be the same. Considerable thought goes into determining the ultimate mix in a block of apartments; too many 1-bedroom units could be negative as it requires additional parking bays that could jeopardise the building density of the site. On balance 1 and 3-bedroom units achieve slightly better margins. In the current environment we are likely to see a drop in the number of 3-bedroom units in favour of 1-bedroom units which should be margin neutral.

Collection mix

The various Collections all target a similar GP margin for the development so there should be no major impact on margins given a change in mix.

New projects

The initial phases of a new development tend to generate lower GP margins as there is an element of fixed upfront development costs and sales price increases are targeted to exceed building cost escalations going forward. With a strong existing pipeline and an envisaged slowdown in large new developments, its positive for GP margins.

Development under construction

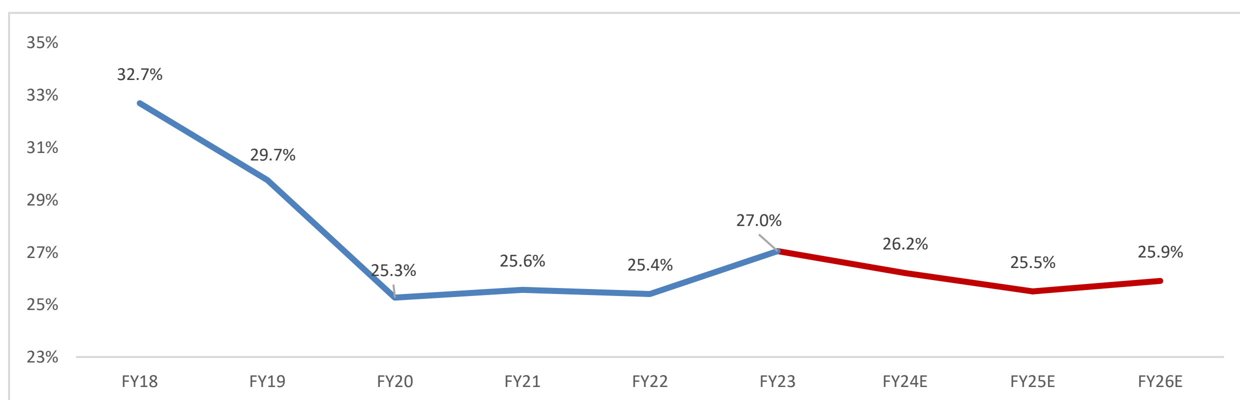
Larger projects like the Blyde, Munyaka and Mooikloof require significant land, services and communal building costs upfront. These are apportioned equally to all apartment sales and can take several years to be released to the income statement. There is a holding cost attached to this as finance is required and this cost is rising due to larger top structure investments (lifestyle centres etc.) and higher interest rates. While factored into the sales prices of the units (as sales are done on a phased basis), higher than anticipated interest rates may not be adequately priced for in pre-sales that occur several months beforehand or at a project launch.

Promotional activity

Given the long life spans of the projects, promotional activity needs to be well managed as the business endeavours not to create a scenario where units are being sold cheaper than those already bought by residents. At best, difficult markets like the present are likely to see little to no price hikes and perhaps some additional benefits offered like fibre, backup power etc. We anticipate margin pressure through increased promotional activity in FY24E and FY25E.

Outlook

Figure 28 Development GP margin



FY24E excludes the impact from the sale of development rights.

Source: Company data, ASB Research

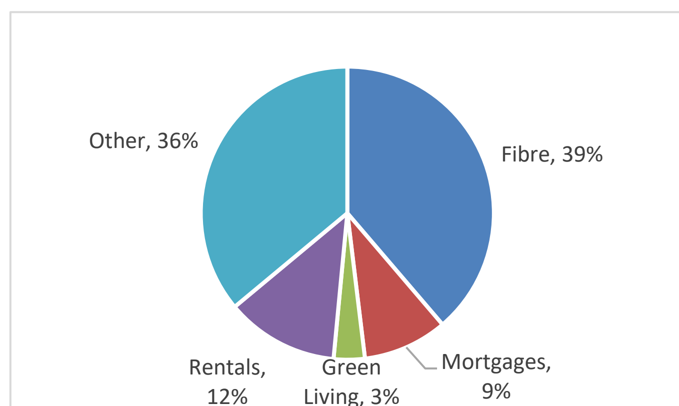
GP margins have come off sharply from levels seen in FY18 and FY19. We attribute this to challenging economic conditions but also significant upfront investment into developments (such as lifestyle centres and lagoons), which is not being fully recovered in selling prices that are only moderately ahead of CPI as per figure 25. These facilities provide appeal to the development and should attract greater volume growth to compensate for margin pressure, yet in a constrained environment it's not the case.

In the current environment of increased promotional activity, higher finance costs on developments under construction and other factors presented above, we see development GP margins falling in FY24E after the recovery in FY23 and 1H24. The 1H24 development GP margin of 27.9% (stripping out the sale of the development rights) was a further improvement on FY23, however, we see the full year margin declining to

26.2% (excluding the sale of development rights). Promotional activity and lower price increases in FY25E, should see the GP margins decline further in FY25E to 25.5%. Margins will gradually recover thereafter given lower interest rates and improved affordability. We believe we are conservative in our estimates in that we don't anticipate a recovery to FY23 margins in the next three years.

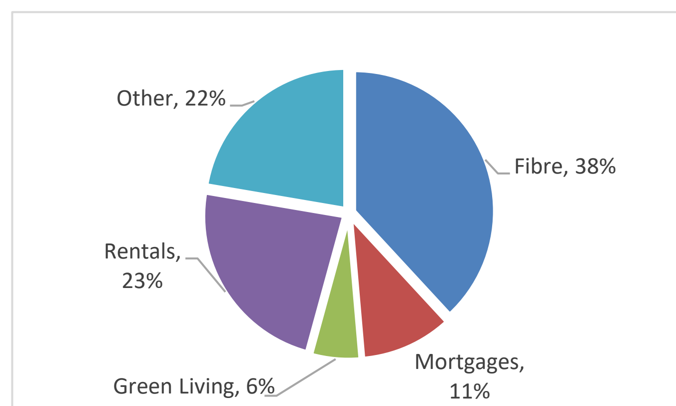
Annuity Revenue

Figure 29 Annuity revenue mix – 1H24



Source: Company data, ASB Research

Figure 30 Annuity EBIT mix – 1H24



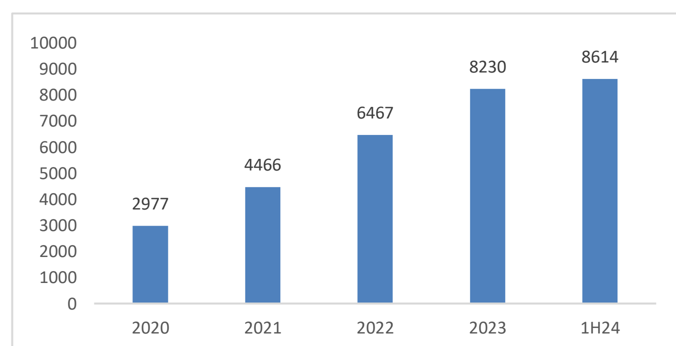
Source: Company data, ASB Research

Figure 31 Annuity operating profit – 1H24

	2022	2023	1H24
Revenue	51.8	83.1	56.3
Costs	-20.7	-59.9	-42.4
Operating Profit	31.1	23.2	13.9
Margin	60%	28%	25%
% of group operating profit	6%	4%	6%

Source: Company data, ASB Research

Figure 32 Fibre subscribers – 1H24



Source: Company data, ASB Research

Balwin has historically been entirely dependent on development sales revenue which is highly correlated to the underlying economy. To reduce the cyclicality of revenue there has been a concerted effort in expanding annuity based revenue. Whilst small in a group context at 5% of 1H24 revenue, its displaying significant growth potential (revenue +42% in 1H24) and will gradually become a greater component of earnings. It currently generates a 25% operating margin, higher than the group's overall margin but down on FY23 given the additional spend in enhancing the offering. FY22 is not directly comparable as it only includes the fibre business.

The primary revenue generator is Fibre followed by mortgage origination. The offering is expanding, and management envisages multiple earnings streams in the future. The following are currently offered or are under consideration:

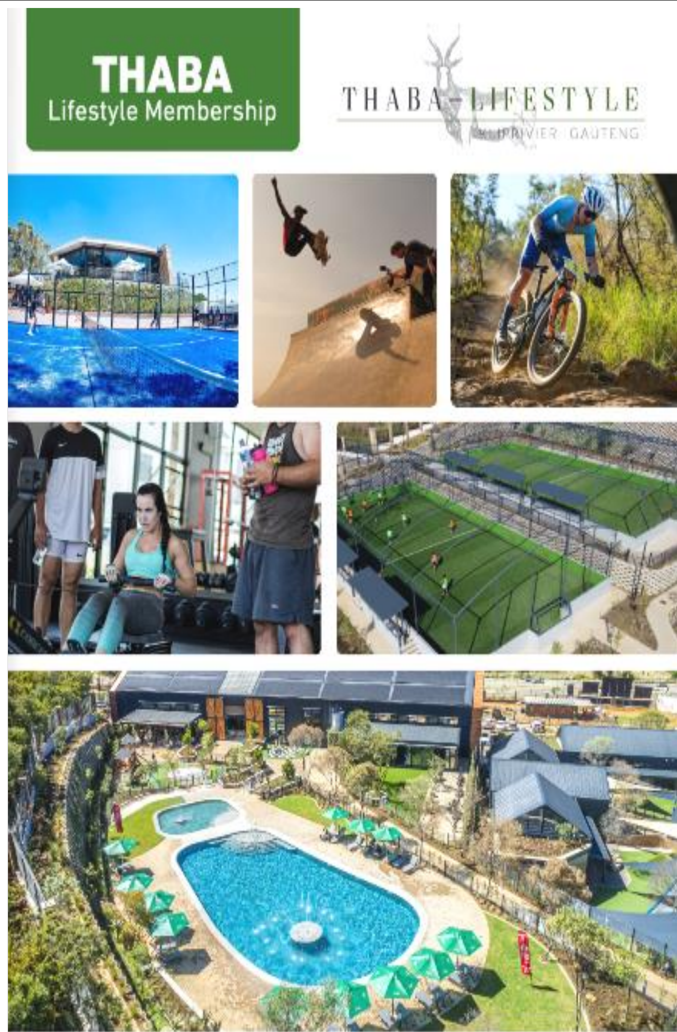
- Balwin Fibre – Balwin owns the fibre network and offers residents a competitively priced fibre package with an independent choice of ISP. There are currently 8 614 customers on the network, approximately a 77% take up rate on apartment sales. Balwin has now become an ISP to ensure it provides the full offering and will include built in routers in new apartments to facilitate a more seamless switch to Balwin Fibre with the hope of increasing the penetration rate further.
- Balwin Mortgages – given the green accreditation of many of its estates, customers are eligible to discounted interest rates from many of the major banks – anywhere from 0.25% to 0.75%. In addition, clients receive sizeable reductions in attorney and bond costs. Combined with its strong service offering this is a considerable saving and a reason to use the in-house mortgage originator. In FY23 1 648 bonds were secured, 59% of sales registered. The offering has been extended to external sales in 1H24 (non-Balwin apartments), resulting in a higher and misleading penetration rate of sales (90%) – 752 bonds originated in 1H24.
- Balwin Green Living – formerly Balwin Energy. Operating on 10 sites it has its own infrastructure of solar panels. The business is responsible for the account for the bulk meter (entire development) and benefits from the delta between the bulk meter account and the utilities recovered from residents through the prepaid wallet system – the difference largely attributed to solar generated electricity. The potential exists for excess generated power to be sold back into the grid, earning additional revenue. Part of the benefit is passed on to residents via an approximate 10% electricity tariff discount. Centralised backup power alternatives are being explored for future developments.
- Balwin Rentals – in 2019 Balwin established a rental portfolio in a joint venture and owned 25%. The venture managed a portfolio of circa 215 units before it was exited, all in the Greenpark development. In FY23 this portfolio was 100% acquired. The portfolio enjoys an average 94% occupancy rate, 92% in August 2023 and achieves a 9.8% operating yield. It targets a 50% gearing ratio. Apart from the yield earned, it also facilitates sales for those tenants looking to acquire at a later stage. There are no plans to grow this residential portfolio.
- Balwin Education – a quality school is a drawcard to a development. There are several options for facilitating this, including building the school and renting it out, selling land or the building to a school operator or forming a joint venture with a school operator. It has partnered Curro and Montessori amongst other operators in the past.
- Balwin Lifestyle – As indicated previously, whilst lifestyle centres have been a feature of the offering for many years, going forward the lifestyle centres are adjacent to the development enabling access to non-residents, thereby monetising the facilities. Residents retain free membership of the facilities, including the gym, pool and sport facilities. The first active site is live with 2 961 members at 1H24. Currently a nominal amount are external members with a focus to grow this membership. Monthly membership fees range from R250 to R700 depending on which facilities are utilised.
- Balwin Insurance – a nominal facilitation fee is earned through referring clients to Telesure Investment Holdings for the provision of insurance (household contents, motor, life products). This is a small revenue contributor with 98 active insurance policies.
- Balwin Technik – the provision of electronic security access - there are 15 active sites. Through this business, Balwin can ensure that the hardware used is leading technology and appropriately maintained. Revenue is earned from the Body Corporate.
- Head Office JHB – the head office was acquired in FY23 for R125.8m with excess GLA (approximately two thirds of the space) being let to third parties. Currently the building enjoys 100% occupancy and targets a 10% yield, supported by future marketing revenue given its location next to the motorway in Melrose Arch. Revenue is included in Balwin Rentals.

Other opportunities include managing body corporates, re-sales and the maintenance of estates.

Whilst not a focus area, Balwin concluded two hotel related transactions in 1H24. At the Blyde it built a R60m, 61 bed hotel to be managed by MINT hotels. Balwin anticipates earning a 19% IRR at a 75% occupancy rate. In a separate transaction it sold development rights for R70m to an operator to develop a

hotel at Munyaka. In this transaction it has no entitlement to future revenue. Within its large resort style developments like the Blyde and Munyaka these initiatives may be repeatable.

Figure 33 Membership brochure



Source: Company data, ASB Research

Figure 34 Membership brochure

THABA
Lifestyle Membership

THABA LIFESTYLE
PRIVIER GAUTENG

LIFESTYLE CENTRE OPERATORS

Summary of the external membership types and benefits are below.
Please contact thabasport@balwin.co.za to enquire about memberships.
Alternatively, you can report to the Concierge located in the Lifestyle Centre.

NUMBER OF PEOPLE	FEES (PER MONTH)	CONCIERGE	PREFERENTIAL BOOKING RATES	GYM	POOL
PLATINUM MEMBERSHIP					
1 Adult incl. 1 Child under 12	R 700			+1V	
Per additional Adult Dependent	R 125			+1V	
Per additional Child	R 75				
GOLD MEMBERSHIP					
1 Adult incl. 1 Child under 12	R 400				
Per additional Adult Dependent	R 100				
Per additional Child	R 50				
SILVER MEMBERSHIP					
1 Adult incl. 1 Child under 12	R 250				
Per additional Adult Dependent	R 50				
Per additional Child	R 50				

MEMBERS	TIME	SOCCER (10 PEOPLE)	PADEL (4 PEOPLE)	SKATE PARK (SINGLE ENTRY)	BASKETBALL HALF COURT (4 PEOPLE)
Standard (Non-Members)	Peak Hour	R500	R500	R100	R400
	Off Peak	R400	R400	R100	R400
Member	Peak Hour	R450	R350	R70	R200
	Off Peak	R400	R250	R70	R200

Source: Company data, ASB Research

In the table below we demonstrate the revenue and earnings growth potential of Balwin Fibre, the largest contributor to annuity revenue.

Figure 35 Balwin Fibre – financial outlook – R'000

FIBRE Business	FY23	1H24	FY24E		FY25E		FY26E	
Revenue	43124	26031	56738	32%	70333	24%	86156	22%
Net profit	7869	4197	9078	15%	11253	24%	17231	53%
Margin %	18%	16%	16%		20%		21%	
Active clients	8230	8614	8983	9%	10505	17%	12256	17%
Ave rate per unit	490	511	526	7%	558	6%	586	5%

Source: ASB Research, company data

If we assume that 80% of new sales take up the Fibre offering (the current level) and the existing average months rental of R511 escalates at 6% per annum, we calculate 32% growth in revenue in FY24E and 24% in FY25E. We anticipate net margins to remain at 16% given ongoing investment, resulting in net profit growth of 15% in FY24E. We forecast margins to widen in FY25E, resulting in net profit growth of 24% in FY25E.

Outlook

We forecast 46% and 23% revenue growth in FY24E (+42% in 1H24) and FY25E, hindered by declining sales growth in apartments, particularly for the mortgage origination business, but boosted by the inclusion of head office rentals.

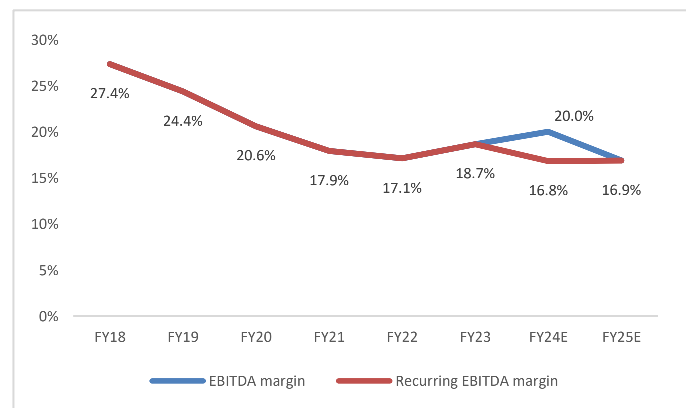
Operating expenses

Figure 36 Operating costs – excl depreciation

	FY22	FY23		1H24
Development Costs	267.6	313.3	17%	110.5
Fixed costs	153.6	161.2	5%	72.5
Performance linked costs	20.1	33.7	68%	0
Variable costs	93.9	118.4	26%	38
Annuity operations costs	20.7	59.9	189%	42.4
	288.3	373.2	29%	152.9
Development cost ratio to sales	8.7%	9.7%		10.4%

Source: Company data, ASB Research

Figure 37 EBITDA margin



Source: Company data, ASB Research

As per the table above, costs are split between the development company and the annuity operations. The latter businesses are being expanded considerably and therefore attracting startup costs. Ignoring the annuity operations, development costs/sales went from 8.7% to 9.7% in FY23 and increased further to 10.4% in 1H24, placing pressure on development operating margins. Management has a medium term target of reducing the operating expense ratio (including depreciation) to 8 -10% of development company revenue. We are more conservative in our estimates.

- A considerable portion of the fixed expenditure in FY23 is staff salaries – circa R100m. Consulting and professional fees including JSE listing fees accounts for R25m. Remaining costs were well managed at 5% growth.
- Performance linked expenditure in FY23 rose significantly by 68%, largely due to a 2 month bonus versus 1 month in the prior year given the improved operational performance in FY23. Short term incentives are paid to staff on pre-approved scorecards including a blend of financial (60%) and non-financial metrics. The maximum bonus was paid in FY23 setting a high base. PBT is the financial determinant followed by cash management and an index profitability performance measure. The scorecard is set to be adjusted to make use of headline earnings and ROIC. Given weaker apartment sales no incentives were paid in 1H24 and this is likely to be the same result for FY24E.

- Variable expenditure increased by 26% in FY23, well ahead of revenue growth. Marketing costs account for circa R40m, elevated due to the tough operating environment. In addition, external sales agents were used in specific cases at considerably higher commissions than internal agents (around 1%). It's not common practice to use external agents, however, from time to time they do bring bulk buyers that are hard to walk away from. Whilst not a favoured option its likely to remain. 1H24 has seen a sharp drop in variable costs due to lower sales and the allocation of project related marketing costs to cost of sales instead of operating costs as in prior periods. Total marketing spend was R28m in 1H24, relative to R40m in FY23.

Given our forecast for a sharp decline in PBT in FY24E we forecast significantly lower performance based remuneration. Salary increases of 10% in July 2023 (excluding directors and prescribed officers that received lower increases) will place some pressure on staff costs. Marketing costs are likely to remain elevated as the sales environment is challenging. However, as indicated, some of these costs are now allocated to cost of sales. Agent sales costs will decline broadly in line with the 32% decline in apartment sales. We see annuity business costs rising by 49% in FY24E. In total we forecast a 13% decline in operating costs in FY24E. We anticipate 10.7% development costs/sales for the development company. We estimate cost growth of 7.5% in FY25E given the low base and ongoing annuity business expansion costs.

EBITDA margins are distorted by the inclusion of the annuity businesses that attract higher operating margins. FY23 also benefited from higher GP margins as evident in Figure 37. However, with costs falling less than sales in FY24E and GP margins declining, EBITDA margins will decline, after stripping out the R70m sale of development rights proceeds. We anticipate some margin improvement in FY25E.

Earnings

FY24E sees a major setback for group headline earnings after having improved in FY23. Declining development revenue of 32% and contracting GP margins will see HEPS down 32% in FY24E to 62c on our estimates. Stripping out the after tax benefit from the non-recurring sale of development rights of R32.9m (R70m of revenue and R25m of cost of sales) in 1H24, reduces 1H24 HEPS from 38c to 31c. Similarly recurring HEPS for FY24E would be 55c, down 40%. Modest growth in sales revenue and declining GP margins will result in FY25E HEPS of 50c, down 9% on FY24E. Stronger sales revenue, improved GP margins and lower cost growth in the annuity businesses should deliver a vast improvement in FY26E HEPS - up 40% to 70c but still well off the 5-year average of 86c in FY23.

Figure 38 Summarised income statement – Recurring earnings

	2022	2023	2024E	%	2025E	%
Revenue from apartments	3,073.5	3,243.8	2,203.4	-32%	2,244.1	2%
Cost of sales	-2,292.7	-2,366.8	-1,620.9	-32%	-1,671.9	3%
Gross profit	780.8	877.0	582.4	-34%	572.2	-2%
Annuity revenue	51.8	83.1	121.3	46%	149.4	23%
Total revenue	832.6	960.1	703.8	-27%	721.7	3%
Total expenses	-280.0	-366.1	-318.5	-13%	-342.3	7%
EBITDA	552.6	594.0	385.3	-35%	379.4	-2%
Depreciation	-21.6	-26.7	-28.9	8%	-36.7	27%
EBIT	531.0	567.3	356.4	-37%	342.7	-4%
Net interest/other income	10.7	18.7	-16.4	-188%	-27.1	65%
PBT	541.7	586.0	340.0	-42%	315.6	-7%
Tax	-155.7	-160.1	-95.4	-40%	-85.8	-10%
PAT	386.0	425.9	244.5	-43%	229.8	-6%
Other	4.5	-0.3	9.9	-3392%	-0.6	-106%
Recurring Headline Earnings	390.5	425.6	254.4	-40%	229.2	-10%
Weighted shares in issue	469.4	465.4	464.6		459.4	
Recurring HEPS	0.83	0.91	0.55		0.50	
DPS	0.21	0.24	0.00		0.10	
Payout ratio	25%	26%	0%		20%	

Source: ASB Research, company data

Additional financial comments:

- 1H24 includes R70m from the sale of development rights – we exclude the profit (post tax) from recurring headline earnings after deducting R25m of cost of sales related to the rights. Recurring HEPS in FY24E is 55c vs non adjusted HEPS of 62c.
- Depreciation is fairly insignificant for the group and largely comprises its head office and right of use of other regional offices.
- Interest paid in FY23 amounts to R32m, R4m of which is for lease liabilities. There are general banking facilities in place for the day to day running of the business and for funding the strong growth in the annuity businesses.
- Interest received on its cash balances (including restricted cash) amounts to R22m. This will decline going forward as term lending based on pre-sales is being shifted into facilities and restricted cash requirements are consequently being reduced. Restricted cash declined from R164m in FY23 to R1m in 1H24. There is a further R13m of occupational interest earned in FY23 - this is for units handed over to residents where registration is yet to happen. There is no visibility on occupational rental.
- FY22 includes a BEE share based payment expense of R34m for its BEE structure. We exclude this from recurring headline earnings.
- The tax rate approximates the statutory tax rate of 27%. We forecast 27.2%.
- For shares in issue, we don't include the dilution of the BEE structure that is 8 years away from being potentially realised. This is because the risk and rewards attached to the shares have not been transferred. In addition, the notional loan interest is in arrears thereby impacting the number of dilutive shares. The shares are treated as treasury stock.

- The company bought back 7m shares in FY23 (approx. 1.5%) given its deep discount to its NAV. We see this continuing albeit at relatively low levels.
- Dividends – we believe the company will not pay a dividend in FY24E – the interim dividend was waived.
- Capex – this is low for the group as it will largely include head office related expenditure. It was inflated in FY23 due to the purchase of the JHB head office. Going forward the capex will be volatile as lifestyle centres are added to fixed assets. In FY24E the Thabo Eco Village and the Blyde hotel will be added. FY24E will benefit from the sale of the previous head office in JHB for around R20m. As a result, we have net Capex of R194.1m forecast for FY24E. There will be ongoing annual capex of circa R35m p.a for the fibre businesses rollout of its infrastructure. Our net capex forecast declines to R49.4m in FY25E before rising again in FY26E for the inclusion of further lifestyle centres.

Working Capital

Figure 39 Developments under construction – balance sheet item – R'm

	2018	2019	2020	2021	2022	2023	1H24	CAGR
Land & infrastructure	888.5	1273.8	1560.2	2014	2203.4	2338	2404	19.8%
Development rights	806.7	527.4	502.2	472	522.5	489.9	486	-8.8%
Cost of construction	891.9	1241.7	1307.5	1635.1	2093.5	2906	3385	27.4%
	2587	3042	3369	4121	4819	5734	6275	18.2%
Land/development rights	66%	59%	61%	60%	57%	49%	46%	
Cost of construction	34%	41%	39%	40%	43%	51%	54%	
As a % of apartment revenue	105%	116%	116%	153%	154%	172%	281%	
Development funding	1251.6	1523.7	1419.7	1901.5	2540.6	2957	3192	18.6%
As a % of development costs under construction	48%	50%	42%	46%	53%	52%	51%	

Source: ASB Research, company data

Of the total assets on the balance sheet, Developments Under Construction accounts for 82% and is a large resource to carry and finance. It comprises construction costs, development rights (mainly the Waterfall development) and land. Land includes the costs of any bulk services and external infrastructure. As units are sold and recognised, each units participation quotient of the development under construction costs (for its development) are released to the income statement via cost of sales.

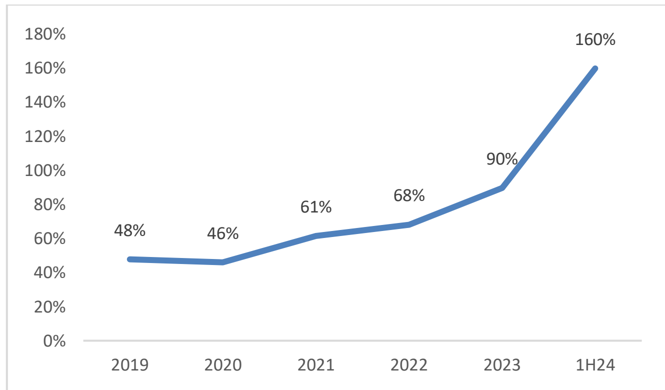
Growth is a factor of the number of projects, the size of the projects, the duration of the projects and the nature of the projects with developments like the Blyde and Munyaka attracting significant upfront costs to create an appealing lifestyle proposition, far greater than what was seen in the earlier Balwin developments. Another significant contributor to the growth is the external services required to be incurred in order to obtain the required council approvals to develop, handover and register apartments.

This asset has doubled in the past five years given the significant projects undertaken (not by number but size), particularly in Gauteng and KZN. As previously noted, the average development size has increased significantly (1 288 units in FY19 to 1 981, +54%). As per figure 39, the greatest growth has come from the cost of construction with a 5.5-yr CAGR of 27.4%. While the land component is up 19.8%, the growth declines to 10.2% if the development rights at Waterfall are included. The costs of construction component has risen from 34% to 54% in 1H24, highlighting the significant investment in services and top

structures such as boundary walls, gate houses, lagoons, lifestyle centres and sports facilities. It should not include a material value of vacant apartment blocks as the rate of construction to sales is actively managed.

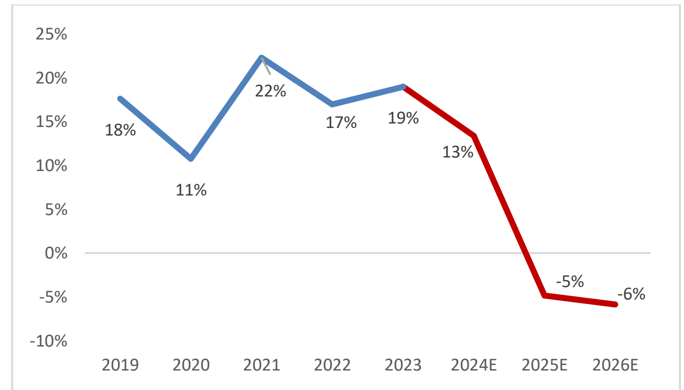
The cost of construction as a % of sales revenue has consistently been rising as per figure 40 below, rising significantly in 1H24 given the sharp drop in apartment sales.

Figure 40 Cost of construction as a % sales



Source: Company data, ASB Research

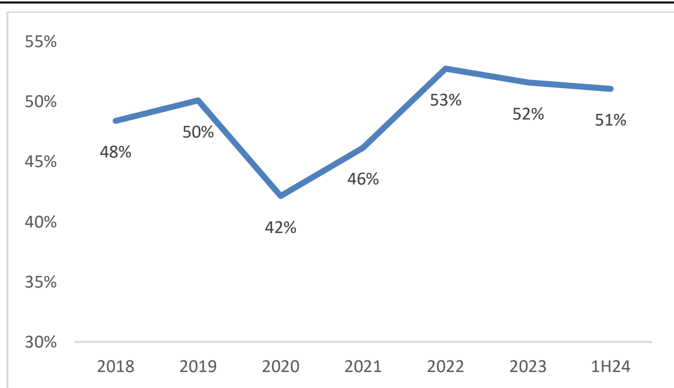
Figure 41 Developments under construction - % growth



Source: Company data, ASB Research

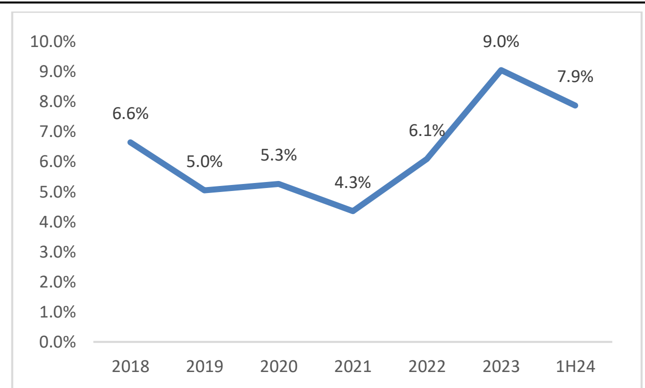
In addition to the absolute growth in the asset (capitalised expenses), finance costs against it are also capitalised. As per figure 42, 51% of development costs are financed, the average over the past 6 years being 48%, so relatively well managed. The duration of the funding is increasing in line with project duration and is also attracting higher interest rates (priced close to the prime rate) placing further pressure on development costs under construction. As per figure 43 below, the average interest rate on development funding has been rising and will continue to do so with the Prime lending rate currently at 11.75%.

Figure 42 Development fundings as a % of developments cost



Source: Company data, ASB Research

Figure 43 Development loan finance costs as a % of average development finance



Source: Company data, ASB Research

A critical view of the above is that there is an over investment in the projects (particularly the amenities) in order to facilitate sales and that the pipeline has become excessive. We would, however, argue that in the overtraded and price sensitive low to middle income apartment market, this offering is what differentiates it and facilitates sales. Theoretically the lifestyle centres and amenities costs are all apportioned to the apartments and the apartments are appropriately priced to generate a consistent GP margin of circa 31%.

However, there are timing issues as the higher upfront costs are apportioned over longer periods of time. A further counter argument is that developments have grown in size and duration to facilitate lower unit costs and leverage the rising upfront land and service costs, both of which can take several years to finalise.

Simply not investing at any stage will impact future profits and therefore a continuous pipeline is required. **It's finding the right balance to ensure well managed working capital and positive free cash flow with an adequately sized development pipeline. We believe there are early signs that management is altering its course on its pipeline and land banking given the burgeoning working capital.** The number of developments has started to decline, as has the average number of apartments per project. We don't anticipate any material further land purchases in Gauteng and KZN as supported by figure 42 below that shows very low completion rates in Gauteng and KZN. The Western Cape expansion is justified given its better fundamentals. **We see the strategy as one of extracting the value from the current pipeline in the short to medium term to strengthen the balance sheet and improve profitability.**

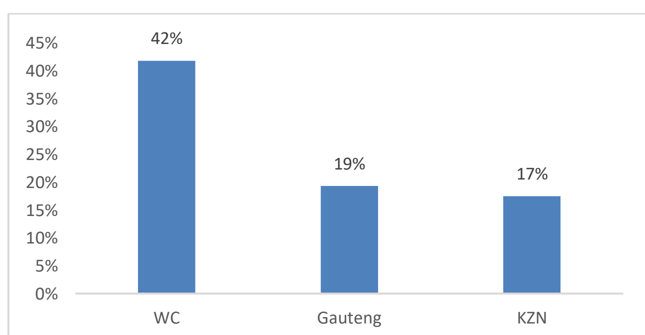
There are large projects that need significant spending in FY24E, namely services in Mooikloof Smart City in Tshwane, expansion at Izinga and land acquisitions in Cape Town. We therefore see this category growing well ahead of revenue in FY24E, an estimated 13% growth. Thereafter we anticipate a negative growth rate as per figure 41. We therefore believe Balwin is close to the peak of its working capital cycle and the benefits to free cashflow will flow through from FY25E.

The current difficult trading conditions are hampering the unwinding of its working capital as evident by construction costs as a % of sales reaching 160% in figure 40. This is attracting additional funding costs. We estimate funding costs being capitalised at circa R300m p.a, or 10%, and recovering these costs in sales prices becomes more challenging. This is the justification to **ease off on expansion and increase completion rates of existing developments**.

Managing working capital over the next 12 months is challenging and improving sales through promotional activity is essential. Voume growth at the expense of margin is necessary.

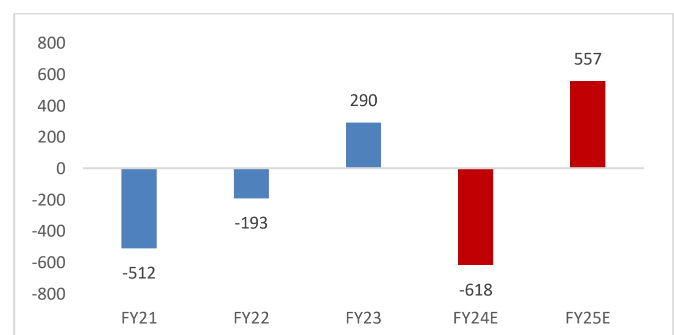
The Mooikloof development is progressing despite the government's non-performance on its commitment to contribute circa R1.4bn towards significant infrastructure work. Already close to 350 pre sales in 2022 had to be cancelled given the non-performance as delivery of the units could not occur. Balwin has incurred R350m of spend in order to proceed with the project that should see units handed over in 2H24E. Numerous attempts have been made to recover this spend, to date to no avail. Any receipt of funds would be positive for cash flow.

Figure 44 Completion rates of developments



Source: Company data, ASB Research

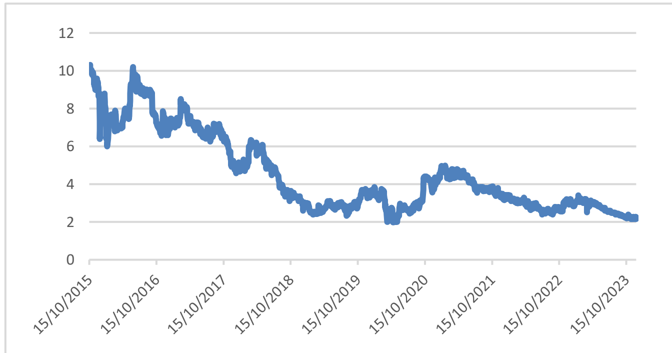
Figure 45 Free cash flow – R'm



Source: Company data, ASB Research

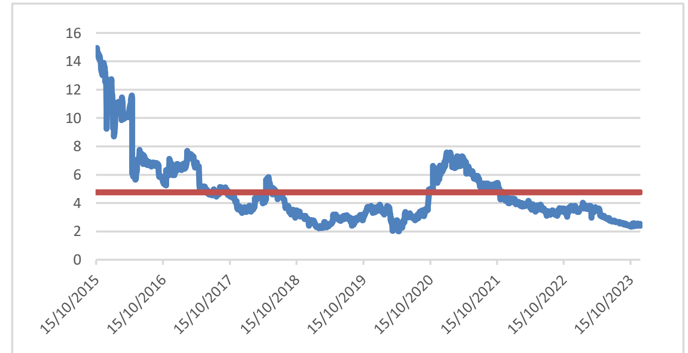
Valuation

Figure 46 Balwin share price



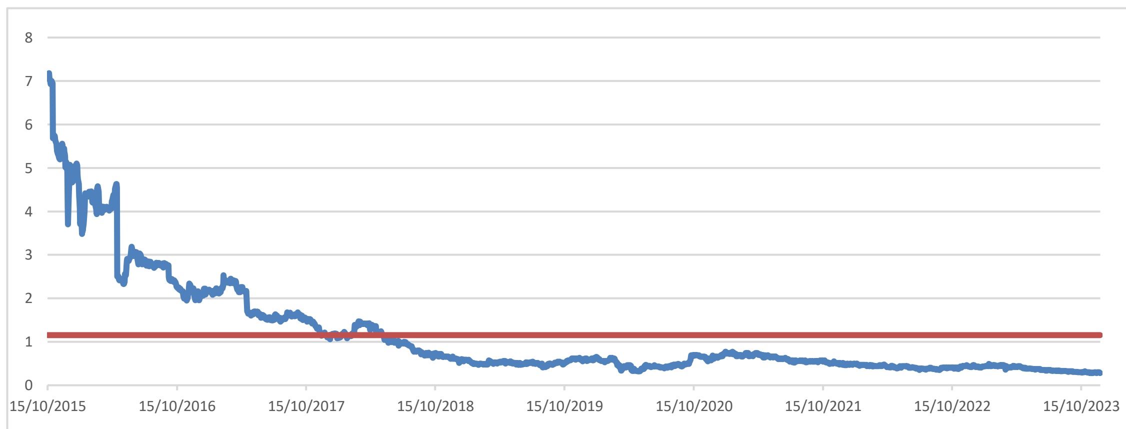
Source: FactSet, ASB Research

Figure 47 Balwin P/E – Ave 4.8x



Source: FactSet, ASB Research

Figure 48 Price/Tangible NAV – Ave 1.15x



Source: FactSet, ASB Research

Figure 49 WACC Calculation

WACC Assumptions	
Risk free rate	11.5%
Beta	1.0
Market risk premium	6.5%
Marginal tax rate	27.0%
Pre-tax cost of debt	11.5%
Cost of equity	18.0%
FY24E debt/value ratio	45.3%
FY24E equity/value ratio	54.7%
WACC	**13.6%**
Growth Rate assumption	
Sustainable long term growth rate	4.0%

Source: Company data, ASB Research

Figure 50 Valuation Sensitivities

		WACC				
		-1%	-0.50%	0%	0.5%	1.0%
	3.0%	295	257	222	191	162
	3.5%	313	273	236	203	172
Terminal Growth	4%	333	290	251	216	183
	4.5%	355	309	267	230	196
	5%	380	330	286	246	210

Source: Company data, ASB Research

We value the group on a DFCF basis, applying a WACC of 13.6%, a risk premium of 6.5%, a beta of 1.0 and a sustainable long-term growth rate of 4%, as highlighted in the table above. The WACC benefits from a high level of gearing. Applying some sensitivities to WACC and terminal growth rates leads to a valuation range of R2.03-3.09/share. This is at a significant discount to our FY24E NAV per share of R7.80. Applying the midpoint of the valuation range (R2.50), values the stock on a 12-month forward P/E of 5.1x, which is broadly in line with its average P/E over the past 8 years.

Based on our HEPS forecasts, the stock trades on a 12M forward P/E of 4.2x, a 12% discount to its 8-year historical average of 4.8x as highlighted in the chart above. It trades on a fwd 0.28x P/TBV, considerably below its 1.15x average over the past 8 years and at a new low. Its closest listed competitor, Calgro M3 trades on a 12m forward 2.1x with the consensus (per FactSet) fair value equating to a 4x P/E. Calgro M3 is on a fwd 0.38x P/TBV. Both stocks trade on similar net debt:equity ratios of circa 0.6x. Calgro M3 has higher dependence on government through subsidies for its buyers of units and infrastructure spend.

Calculating earnings with interest expensed instead of capitalised results in an FY23 HEPS of 53c instead of 91c, a historic 4.1x P/E instead of 2.4x.

Risks

- Our investment case is based on the premise that the existing land bank and development pipeline be developed and realised whilst land banking is minimised apart from the Western Cape. This is to alleviate the working capital strain and generate free cash flow. A material increase in the number of developments or land banking would be negatively perceived as liquidity and financial risk rises.
- Persistently high interest rates and inflation will further erode the affordability of its target market and impact sales. Apart from the earnings impact it could increase the duration of its projects and place further pressure on working capital as the upfront development cost will be carried for longer and at high funding rates.
- Balwin may compete with existing residents looking to sell given their own affordability issues. This is particularly valid for long duration projects. In this case Balwin has less pricing power that may negatively impact GP margins.
- Government assistance in the Mooikloof development was agreed upon from the outset. To date government has not contributed towards any infrastructure costs, delaying the start of the project. The project remains viable and therefore Balwin has proceeded at its own expense, spending R350m on infrastructure, an amount its looking to recover. Government is committed for a further R1bn. There is a high probability government does not contribute. This will alter the nature of the development and potentially its profitability. Balwin owns the land and can therefore adapt the project which could see it selling off parcels of land or going mixed use.
- Deviation from the development model. Whilst none are currently envisaged, management considered the development of a high rise apartment block in Sandton in 2021. This would have increased the risk profile of the group considerably given the inability to develop in small phases and the significant upfront costs that would require funding.
- Expansion into Africa. Whilst nothing is envisaged, we would caution against such a strategy as it involves different risks to SA, particularly around land ownership, zoning, municipal services, building codes and banks providing finance.

- In FY22 the company entered a BEE transaction which saw it issue 10% of its shares (47.2m) to a BEE SPV owned by Reggie Kukama (and related parties), a non-executive director. Pricing was at R3.64, a 20% discount, which seemed excessive at the time. The rationale was that Mr Kukama has extensive experience in various facets of the property industry and could help grow the Balwin brand. The SPV paid a R20m option premium upfront (10 year option) – the total option valued at R58m. The balance of the consideration is funded by a notional loan (the shares pledged as security) from Balwin and interest at the Prime rate accrues. The interest is partly funded by the dividends received. To date the dividends are short funding the interest and the SPV has been unable to fund the difference. Should this persist by the expiry of the contract, Balwin can sell some of the shares to fund the difference or repurchase some of the shares. The expense to the income statement in FY22 was R34m – we strip this out for recurring headline earnings.
- The BEE shares are treated as treasury stock for shares in issue purposes in the HEPS calculation. This is because the full risk and reward has not been transferred to the SPV. Should the scheme be implemented in full it does impose a circa 10% dilution in 8 years' time.
- Free float and tradeability – on diluted shares in issue (i.e., including the BEE SPV), directors hold circa 54% of the shares. Shareholdings have been fairly stable.
- Related party transactions – whilst we don't see any financial loss associated with related party transactions, the existence of these transactions is being flagged. These are well disclosed and are declining in number and value. In FY23 there are sales of units to two directors, namely Steve and Rodney. It's common for them to acquire investment units in the development and given they buy in size a discount of up to 10% is offered – this is available to other large third party investors as well. In addition, Balwin manages these properties for a fee – it's an arm's length transaction approved by the Board. The fee totalled R740k in FY23. It's not possible to ascertain if there is any cost to shareholders. There are also apartments owned by directors (and their spouses) that are used as showroom apartments and a rental is paid – this totalled R1.8m in FY23 and is part of the rental portfolios described above.
- "Construction mafia" – a term referred to community groups (gangs) invading construction sites demanding money or a stake in development projects. Balwin favours the use of local labour, and should these protestors display the appropriate abilities they will be employed – unfortunately this is not their modus operandi. This does lead to construction interruptions.
- Deteriorating government services such as the zoning department, municipal services and the deeds office. All of these result in delays to the realisation of the projects and inability to secure new sites.
- The financial criteria for LTI and STI awards could be more specific by providing defined hurdle rates. At present it's a measure of PBT and cash management. We understand that headline earnings and ROIC will become criteria in the future.

Management

Stephen (Steve) Brookes - CEO

Appointed in 2003 Steve is the founder of Balwin, with approximately 25 years' experience in the position as chief executive officer at the company. Steve has been instrumental in growing the company from a start-up to a successful listed company today. Prior to founding Balwin in 1996, Steve completed an apprenticeship at Group Five spent four years as a civil engineer at Eskom and three years as a project manager at Matrix projects.

Jonathan Bigham – CFO

Appointed in 2022 Jonathan joined the group in 2018 and served as the group finance manager until his appointment as the chief financial officer on 1 April 2022. He has been a member of the executive committee since 2020 and responsible for the group's treasury function. Prior to joining Balwin, he

completed his articles at Deloitte whereafter he continued in the role of an audit manager. He also previously worked for Capital Property Fund as the finance manager and company secretary.

Rodney Gray – MD

Rodney is the managing director of Balwin with 23 years' experience in the position. Prior to joining Balwin, Rodney was the director of a project management company Nostrum, which managed one of Balwin's developments at the time and was appointed in 1997 as a partner to Steve Brookes.

Ulrich Gschnaidtner – Chief projects officer

Ulrich is the chief projects officer of Balwin and has been with the group since 1997. Ulrich held management positions at Spie Batignolles and Bovis Southern Africa before joining Balwin as a partner to Steve Brookes and Rodney Gray. Ulrich manages all construction related activities at Balwin.

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