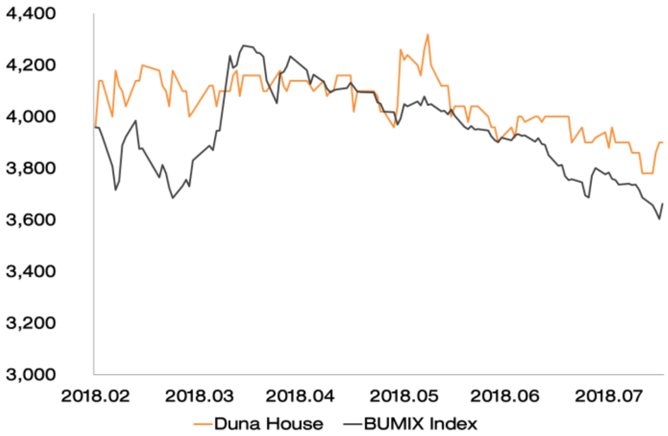
CONCORDE RESEARCH

CEE Equity Research | Hungary | Real Estate
27 August 2018

Duna House

Recommendation: Buy
Target price (12M): HUF 4,751

Hun. Core HUF million	2018 Q2	2017 Q2	Ch (%)
Revenues	2,071	1,268	63%
EBITDA	646	284	127%
EBIT	623	253	146%
Profit	526	266	98%
EPS	148	81	98%
Cummulated EPS	323	162	
P/E *annualized*	6X	12X	
No. of transactions (ths)	77,456	74,666	+4%



Share price close as of 27/08/2018	HUF 3,800	Bloomberg	DUNAHHOUS HB
Number of shares [million]	3,5	Reuters	DUNAHOUSE.BU
Market capitalization [HUF mn/EUR mn]	12,856 / 37	Free float	30%
Daily turnover 12M [EUR th]	1.46	52 week range	HUF 3,550-4,000

Due to delay in project completion, profit guidance may not be reached

Equity Analyst
Gellert Gaal
+361 489 2228
g.gaal@con.hu

50 Alkotás Street,
Budapest
www.con.hu

In short: The most important point is that management flagged that end-year profit guidance may not be reached, due to 3 months delay in completion of the Forest Hill project (estimated profit effect ca. HUF 1.1 billion vs. original guidance of HUF 2.8 billion). Although technical completion will be delivered by year - end, in accounting terms, it might be booked only in 2019 Q1. Therefore, guided profit could fall by 38% to HUF 1.7 billion, from HUF 2.8 billion. According to management, the profit content is intact for Forest Hill. **Also they indicated that the accounting difficulties will not alter original DPS proposal (calculated by the initial guidance), so if no major inorganic growth opportunity arises, HUF DPS 380 is still on the table.** Apart from the delay in Forest Hill, Hungarian core operation is solid, while Polish unit disappoints.

Financials: Profit came at HUF 526 million (+96% y-o-y), boosted significantly by profit from development project Reviczky (EBIT: 336 million), the gain on sale of the Project Zsinor utca (EBIT: +52 million) and revaluation gains. EBIT

ANALYST CERTIFIATION AND REQUIRED DISCLOSURES BEGIN ON PAGE 7.

margin jumped due to the above mentioned to 30% from 20% y-o-y. Management affirmed its year – end guidance for the rest of the business lines. Cumulated EPS reached HUF 323 vs. original guidance excluding Forest hill Project HUF 500 (810 – 310 Forest Hill).

Development: We believe the market will focus on the financial results of this segment, as the underlying operation seems solid.

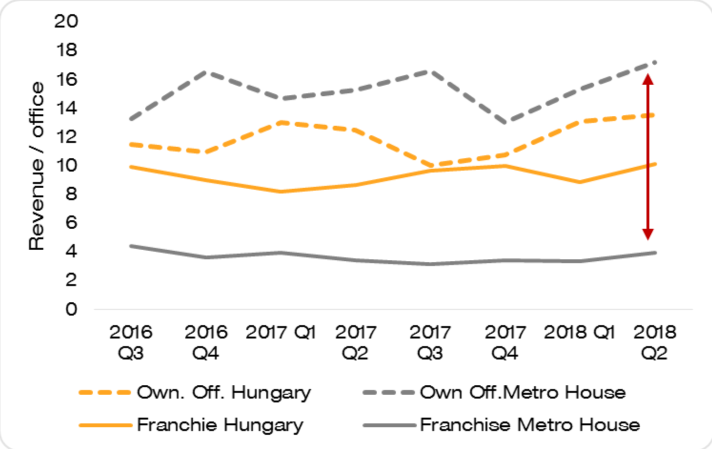
- Duna House has completed project Reviczky and has already sold ca. 92% of the flats from this project and has received HUF 694 million out of the total guided profit of HUF 680 million so far. Thus a 10% overachievement is expected on this project which is undoubtedly positive.
- As for the remaining projects, Forest Hill (59% flats sold) was expected to be completed by year end but due to labour constraints, completion will be delayed by three months. Although the negative news from the delay, management confirmed the profit content of HUF 1.06 billion. We would like highlight that this is only the first phase of the project with 148 flats (out of 196), and management expect to complete and book roughly 80% of this phase in this year (1.06 billion). In our model, we calculated only with the completion of this phase, leaving further upside if management would initiate the second phase (48 flats, currently W/O building permit).
- Last but not least, Project MyCity Residence, the construction has already started, ca. 40% of the flats has already been purchased and the planned completion should be in 2019 end of October.

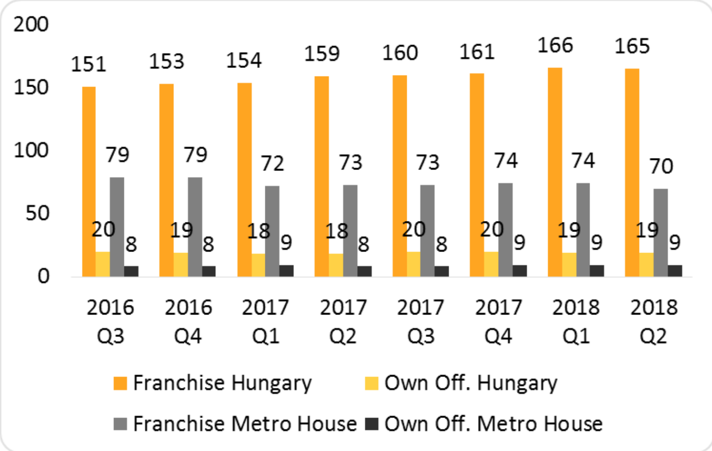
Core operation: This time Franchise segment performed significantly better and was able to offset the decline in financial intermediary and own office segment's EBIT.

- Financial intermediary: Although the strong KPI's and the record volume of intermediated loan, EBIT declined by 10%, and so as the margin by 700 bps. Due to strong non- recurring effect in 2017 Q2 and lower than expected commission on LTP's.
- Franchise: This time, franchise segment performed well, and was able to increase its EBIT by 60% to HUF 69 million. At the same time its EBIT margin improved by 500 bps to 18% on the back of elevated transaction numbers.
- Own Offices: The segment's EBIT fall slightly by 2% to HUF 26 million due to provisioning in Poland.

Metrohouse: Overall, we are a bit disappointed about the financial performance of Metro House as it turned again to red on EBIT level (-HUF 9 million). According to management, receivable write-offs deteriorated the financial performance of this segment.

Revenue / office for segments and for countries and the office breakdown





Source: Company reports

Note: Red arrow shows the upside potential for the Metrohouse's franchise arm. It implies that franchise revenue / office has the potential to quadruple if they would have similar contracts as the own offices have in Poland.

Metrohouse still lags the Hungarian operation in financial performance

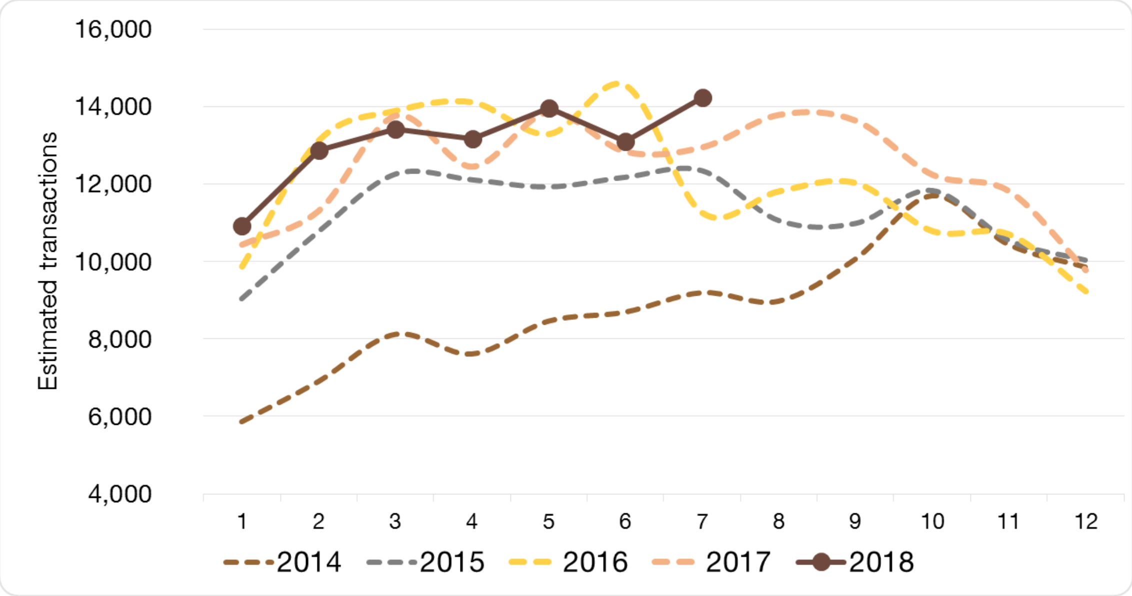
Three conclusion can be drawn from the graphs above. One is the striking difference between the revenue generation of the two operations – Hungarian revenue for a franchise office averages at ca. 9 million while the Metrohoues's stands at half of that level ca 4 million. We expect Metrhouse's revenue generation to improve on the back of contract renewals. Although, the Polish KPI seems to improve from 2017 Q3, as inefficient franchise partners drop out, there is a lot more down the road to catch up the Hungarian peer.

Secondly, there is a huge difference in efficiency between own office and franchise office in Poland – revenue for one own office stands at HUF 15 million while HUF 4 million for franchise. Red arrow in the left graph above, shows the upside potential for the Metrohouse's franchise arm.

Last but not least, the third is related to the development number of franchise partners in the two countries. While in Hungary more and more partners join the franchise, in Poland there is a slow reduction in a numbers of partners, as the know-how implementation is going forward. All in all, we are still waiting for the breakthrough in this segment.

Summer transaction numbers are close to all-time record in Hungary. The development of transaction numbers are in line with our assumptions. We have expected 6-7% higher figures, for 2018 reaching 160,000 after 149,000 in 2017. So far, it reached ca. 92,000 according to Duna House estimates. In our view transaction numbers will only go higher as large new residential development get completed, and families will sell their original flat / houses.

Monthly transaction number according to DH's estimation



Source: Company reports

Other news: In the middle of August, MNB announced a new set of regulation for mortgage loan lending. The new directive aims to steer borrowers to fix interest rate loans by limiting their monthly instalment to income ratio if they want to either choose a variable interest rate structure or short fixed interest rate (<1 year; > 3 year). At the same time MNB allows higher monthly instalment to income ratio up to 60% with 10 year or longer interest rate period.

In our view, this may have slightly negative to borrowers who prefer variable interest rate (typically below 3% for 1 year interest rate period), as they have to face 30% monthly instalment to income ratio vs. 50% prior to the new policy. Nevertheless, the initiative should definitely steer the lending towards a more healthy structure, limiting the borrower's exposure to interest rate risk in the long term.

Opinion: There might be temporary negative market reaction, due to the misinterpretation of not reaching the targeted profit. We would like to stress that this is only due to accounting issues, and management affirmed that the high DPS 380 – *calculated with the original EPS of 810* – is still on the table, if there is no further delay in completions. Also, if they do not see any potential inorganic growth opportunities, prior to the AGM, even higher DPS could not be excluded.

In this point, it is worthwhile to highlight that management intends to reach EUR 100 million size (currently EUR 45m) to gain international investors attention - *as they often have investment policy that restricts to invest in companies with "low market capitalization"* - and at the same time feed yield hungry investors with dividend. In the best case scenario, DH could easily become the highest dividend payer (9-10%) stock on the Budapest Stock Exchange for the next year, if they distribute their profit according to their original plans.

In worst case scenario, excluding the Forest Hill project from EPS, we arrive to EPS 500 and DPS 235 (+33% y-o-y increase in DPS; DY: 6%).

Quarterly P&L

	Q 2018	Q2 2017	Ch (%)
Revenue	**2,071**	**1,268**	**63%**
Operating revenue	1,927	1,231	57%
Other income	144	37	288%
OPEX	**1,448**	**1,015**	**43%**
Cost of materials	15	15	1%
Cost of sold goods and services	386	226	71%
Used services	996	890	12%
Personnel expenses	157	129	22%
Depreciation and amortization	23	31	-25%
Other operating expenses	-130	-276	-53%
EBITDA	**646**	**284**	**127%**
EBIT	**623**	**253**	**146%**
Financial income	21	19	9%
Financial expense	15	17	-14%
Revaluation	-7	108	-107%
EBT	622	363	71%
Income tax expense	89	75	19%
Other	-8	-25	
Non-controlling interests	2	3	-33%
Net income	**526**	**266**	**98%**
Transaction Number	40,245	39143	**3%**
EPS	148	81	**83%**
EBIT margin	30%	20%	

Source: company reports

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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%)
Reduce	Total return is expected to be in the range of -10-(-20%)
Sell	Total return is expected to be lower than -20%
Under Revision	The stock is put Under Revision if covering analyst considers new information may change the valuation materially and if this may take more time.
Coverage in transition	Coverage in transition rating is assigned to a stock if there is a change in analyst.

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