EQUITY RESEARCH

16th February 2018

Calamatta Cuschieri
INVESTMENT ADVISORS & STOCKBROKERS

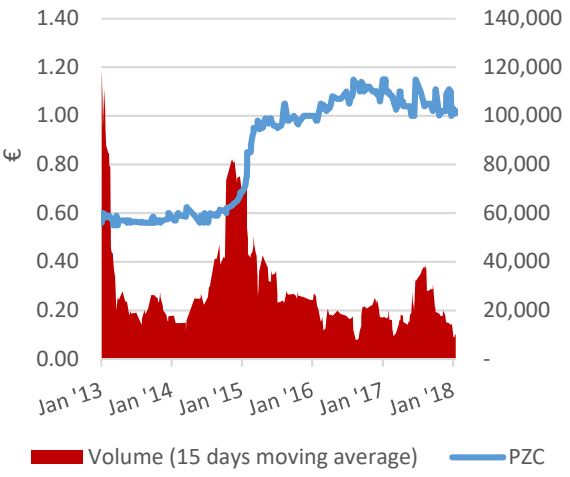
Plaza Centres p.l.c.

Stock Rating	**BUY**
Price target (1Yr)	**€1.14**

Country	Malta
Industry	Real Estate (Commercial)
Ticker	PZC
Price	€1.01
Upside / downside to PT	12.5%
Market Cap	€28.5m
Shares Outstanding	28.2m
Free Float*	55.6%
Gross Dividend Yield	4.5%
Net Dividend Yield	2.9%
Current P/E	22.5x
Forward P/E **	25.6x

* Excluding major shareholders
** CC estimates

Price Movement	Exchange MSE
52-week Range	€1.00 - €1.14



Source: Malta Stock Exchange

Executive Summary:

"We are initiating our coverage with a BUY recommendation on Plaza Centres plc ("PZC"). We expect PZC to continue to strengthen their cash flows and maintain their attractive gross dividend yield of 4.5%. The favourable outlook of the Maltese economy and property market, as well as the prime location of The Plaza Shopping Centre will contribute to these positive forecasts. We see significant growth potential offered by the Tigné Place (the property recently acquired by PZC), which at the time of the acquisition was being rented at rates well below the average rate in the Sliema area. We expect that, once the relevant refurbishment works are completed (expected during 2018), the premises will be possibly rented out at rates more in line with the Sliema area, contributing to a significant increase in the Group's profitability. We do not think that the current price reflects this opportunity. We view a potential threat in the increasing popularity of the online shopping which may negatively impact the performance of the retail outlets, which is, however, off-set by the prime location of the Shopping Centre. In view of the above, we deem the stock to be under-priced in the current market environment and we suggest to add positions in this name up and close to our price target."

Group Overview:

PZC owns and operates 'The Plaza Shopping Centre' located in the heart of the Sliema. The Plaza Commercial Centre is spread over an area of 10,500 sqm hosting a mix of retail, catering and office spaces over nine floors built around a central atrium. The shopping centre host both local and international brands. The office space is occupied mainly by betting companies and small financial / investment firms. Rental agreements for retail tenants have a long-term nature (an average of 16 years in 2016) whilst the agreements for the office space are much shorter (on average 2.4 years). The rental agreements are subject to annual increments of 4%. Most of operating and maintenance costs for common areas are recharged to tenants.

Tigné Place

During 2016 PZC acquired Tigné Place located in Triq Tigné, Sliema, through its fully owned subsidiary Tigné Place Limited. The acquisition was financed partly through a bank loan (€4.5 million) and partly through the issue of a bond (€5 million). The property spreads over 3,279 sqm and comprises two floors and mezzanine level of office space and the ground floor occupied by retail outlets and a language school.

Market Research

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The property also includes 100 car spaces in the underground levels. During 2017 the property has been subject to refurbishment works, which, together with the renegotiation of expired lease agreements, led to lower occupancy rates.

SWOT Analysis

Strengths

- ✓ Very attractive location of the Shopping Centre within the Sliema shopping district.
- ✓ Long term nature of rent agreements for retail spaces at the Shopping Centre.
- ✓ Diversified tenants' base.
- ✓ Constant increase in dividends distributed.

Weaknesses

- × No sector diversification – the Group is only exposed to the Maltese commercial property market.
- × The Plaza Shopping Centre does not offer parking facilities.
- × Short term nature of rent agreements for the office spaces.
- × Very low liquidity of the stock.

Opportunities

- ○ The refurbishment works at Tigné Place as well as the renegotiation of expired rent agreements offer PZC an opportunity to charge higher rental rates.
- ○ Increasing population in Malta and good outlook of the Maltese economy sustaining the growth in the rental rates, especially within prime locations like the Sliema area.

Threats

- ! Fall in occupancy rates.
- ! Overheating of the commercial property market in Malta.
- ! Online shopping hampering traditional shopping.

Investment Stance

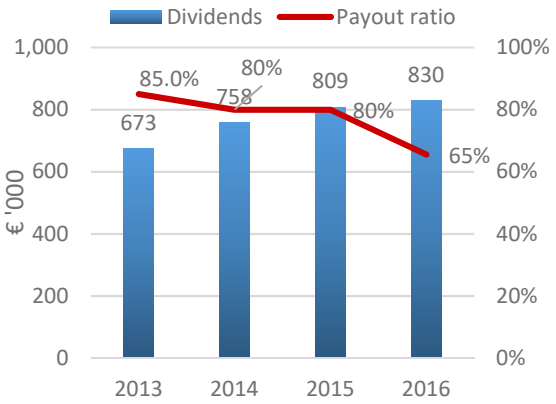
Our initial 12-months price target is €1.14. We are initiating our coverage with a **BUY** recommendation on PZC. Over the past years the Company showed increasing positive financial performances of the Plaza Shopping Centre and we expect similar trends going forward thanks to the favourable outlook of the Maltese economy and property market, as well as the terms of the rental agreements at The Shopping Centre which include a 4% annual increase in the rental rates. Although overall we expect lower profitability levels for FY17 (compared to LTM results) due to the refurbishment works at Tigné Place, we believe that these will result in higher revenue and profits once they are finalised and the premises rented out (expected during 2018).

Furthermore, PZC has constantly increased the amount of dividends paid over the past four years, currently offering a 4.5% gross dividend yield. We expect this trend to continue in future supported by the forecasted higher profitability.

There is an element of concern stemming from the increasing popularity of the online shopping which may negatively impact the performance of the retail outlets. However, this is partly off-set by the favourable location of the properties and the popularity of the Plaza Shopping Centre.

We do not think that the current market price reflects the growth opportunities discussed above and we deem the stock to be undervalued in the current market environment. We suggest to add positions in PZC up and close to our price target.

PZC is currently trading at 22.5x 2017 current earnings and at 25.6x 2017F earnings, which is in line with its five years historical average of 25.4x. We believe that the stock should be trading at 28.7x FY17F estimated earnings due to the growth opportunities offered by the Tigné Place and the positive outlook of the operations at the Shopping Centre.



Source: Group's audited financial statement and HY report

Investment Thesis Variables

FY ending	2015A	2016A	LTM 2017	2017F	2018P	2019P
	€'000	€'000	€'000	€'000	€'000	€'000
Revenue	**2,441.2**	**2,729.3**	**2,940.7**	**2,931.7**	**3,172.0**	**3,469.4**
Operating costs	(356.0)	(474.0)	(508.1)	(516.9)	(532.4)	(548.4)
EBITDA	**2,085.1**	**2,255.3**	**2,432.6**	**2,415.5**	**2,639.5**	**2,921.0**
Depreciation	(364.1)	(366.4)	(425.8)	(461.7)	(510.0)	(563.3)
EBIT	**1,721.0**	**1,888.9**	**2,006.8**	**1,953.8**	**2,129.6**	**2,357.6**
Finance costs	(140.8)	(250.2)	(415.5)	(452.6)	(441.7)	(434.1)
Finance income	11.9	9.7	0.0	10.8	11.0	11.0
Profit Before Tax	**1,592.1**	**1,648.4**	**1,591.3**	**1,512.0**	**1,698.8**	**1,934.5**
Income tax expense	(581.2)	(381.6)	(276.7)	(414.6)	(480.9)	(541.6)
Profit after tax	**1,010.9**	**1,266.8**	**1,314.6**	**1,097.4**	**1,217.9**	**1,392.8**
EPS	**0.036**	**0.045**	**0.047**	**0.039**	**0.043**	**0.049**
Ratios						
Revenue growth	*2.0%*	*11.8%*	*7.7%*	*7.4%*	*8.2%*	*9.4%*
EBITDA margin	*85.4%*	*82.6%*	*82.7%*	*82.5%*	*83.2%*	*84.2%*
EBIT margin	*70.5%*	*69.2%*	*68.2%*	*66.9%*	*67.1%*	*68.0%*
Net margin	*39.6%*	*41.4%*	*44.7%*	*37.7%*	*38.4%*	*40.1%*
Occupancy - Plaza	*96.0%*	*99.0%*	*n/a*	*98.0%*	*95.0%*	*98.0%*
Occupancy – Tigné Place	*n/a*	*100.0%*	*n/a*	*65.0%*	*88.0%*	*98.0%*

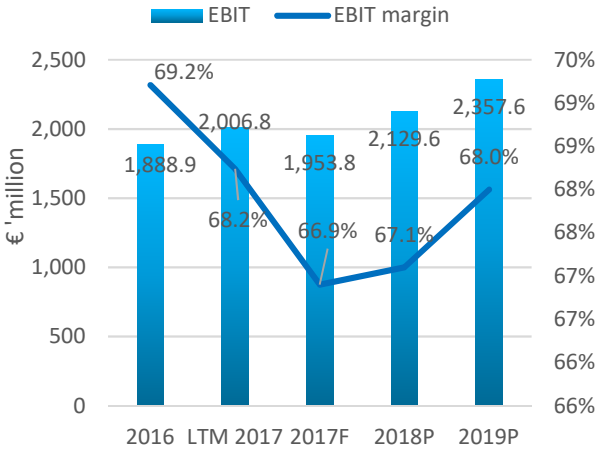
Source: Group's audited financial statement, HY reports and CC estimates

- **Revenue –** expected to slightly decrease by -0.3% to €2.93 million in FY17F with respect to the LTM revenue (€2.94) due to lower occupancy rates at Tigné Place as a consequence of refurbishment works being carried out, partly compensated by expected higher rental rates. Once refurbishment works are completed and higher occupancy is achieved, we expect revenue to grow quite significantly in FY18P and FY19P by 8.2% and 9.4% respectively as a result of the expected higher rental rates achievable at Tigné Place. Average rental rates expected for Tigné Place are summarised in the table below.

Year	FY16	FY17F	FY18P	FY19P
	€	€	€	€
Rate per sqm – commercial space	148	155	180	190
Rent per car space	660	750	900	1,000

Plaza revenue is expected to grow by 4% per annum in line with the relevant rent agreements, whilst a growth rate of 3% per annum was applied to the revenue generated from Tigné Place from FY20P onwards. Occupancy at Plaza is expected to slightly fall to 95% in FY18P as a result of refurbishment works announced by the Group last year.

- **Operating expenses –** assumed to increase by 3% per year less than proportionally to the revenue due to the fixed nature of most of the expenses.
- **Margins:**
  - **EBITDA margin –** expected at 82.4% in FY17F (LTM 2017: 82.7%) due to the lower occupancy of Tigné Place, and increase in FY18P and FY19P to 83.2% and 84.2% respectively thanks to the higher revenue and the fixed nature of most of the expenses.
  - **EBIT margin** – we expect the EBIT margin to decrease to 66.6% in FY17F (LTM 2017: 68.2%) and improve to 67.1% and 68.0% in FY18P and FY19P respectively.



Source: Group's audited financial statement, HY report and CC estimates

- **Finance costs –** During the second half of FY16 the Group issued a 10 year bond of €8.5 million and was granted €5 million bank loan repayable over 10 years to primarily finance the acquisition of Tigné Place. Accordingly we are forecasting higher finance costs in FY17F compared to FY16.
- **EPS** – we expect EPS to decrease in FY17F to €0.039 as a result of the lower revenue and higher interest expenses, and to increase in FY18P and FY19P to €0.043 and €0.049 as a consequence of the higher revenue expected to be generated by Tigné Place.
- **Capital expenditure (CAPEX)** – we estimated a level of CAPEX of approximately €500k for FY17F and FY18P as a consequence of the refurbishment works at Tigné Place and Plaza Shopping Centre. From thereafter we assumed lower CAPEX at approximately €400k per year.

Valuation

Our 1yr price target is €1.14. The price target is calculated using the Discounted Cash Flow Model with a cost of equity of 8.8% and a weighted average cost of capital of 6.9%.

We used a five years free cash flow to the firm ("FCFF") approach with terminal growth of 2.5%.

The discount rates reflect, amongst other factors, the relatively low indebtedness (Net Debt / Equity: 48%) the high exposure of PZC to the Maltese property market and partly the threat stemming from the online shopping.

Key Financial Indicators

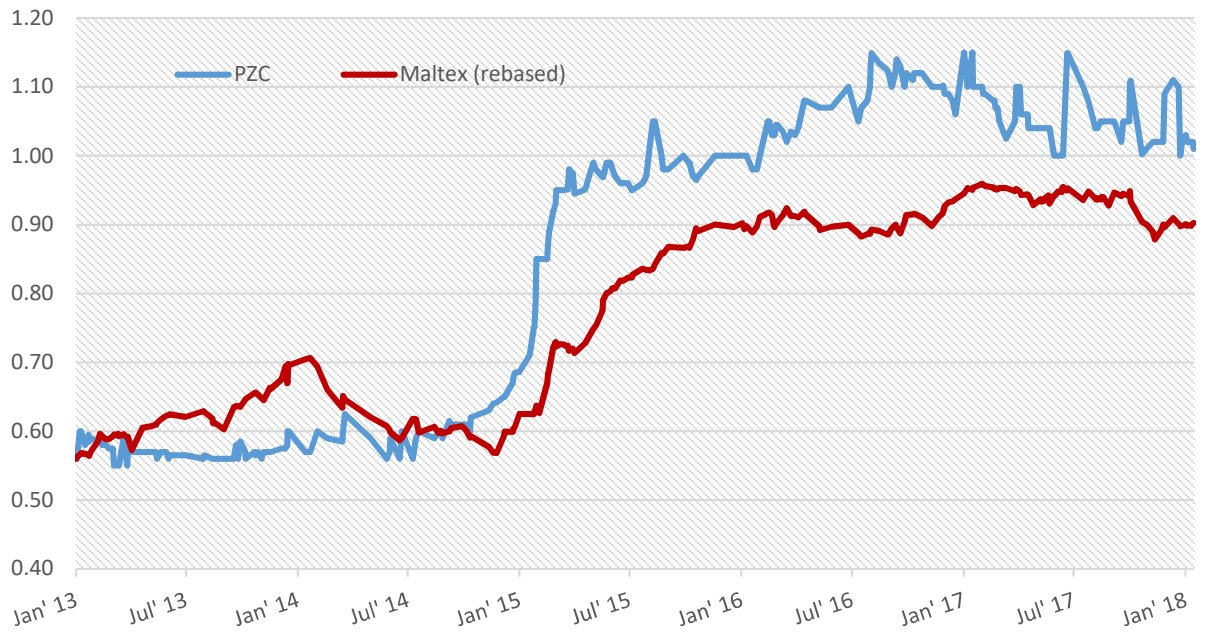
	2014	2015	2016	LTM 2017	H1 2016	H1 2017
	€ 'million	€ 'million	€ 'million	€ 'million	€ 'million	€ 'million
Income Statement						
Revenue	2,393	2,441	2,729	2,941	1,267	1,479
EBITDA	1,971	2,085	2,255	2,433	1,046	1,223
Operating Income (EBIT)	1,641	1,721	1,889	2,007	875	992
Net Income	947	1,011	1,267	1,352	520	605
EPS	0.034	0.036	0.045	0.048	0.018	0.021
Dividend / Share	0.027	0.029	0.029	n/a	n/a	n/a
Growth in Revenue	3.8%	2.0%	11.8%	7.7%	-36.4%	16.7%
EBITDA Margin	82.4%	85.4%	82.6%	82.7%	82.5%	82.7%
EBIT Margin	68.6%	70.5%	69.2%	68.2%	69.0%	67.1%
Net Margin	39.6%	41.4%	46.4%	46.0%	41.0%	40.9%
Dividend Growth	12.5%	6.7%	2.6%	n/a	n/a	n/a
Sustainable Dividend Growth	0.8%	0.8%	1.7%	2.0%	n/a	n/a
Balance Sheet						
Cash and Cash Equivalents	20	15	266	238	(1,649)	238
Current Assets	358	318	757	697	787	697
Non-Current Assets	32,000	31,953	42,667	42,733	31,929	42,733
Total Assets	32,358	32,271	43,424	43,430	32,716	43,430
Current Liabilities	2,264	2,221	1,244	1,671	3,124	1,671
Non-Current Liabilities	6,301	5,383	16,000	15,781	5,190	15,781
Total Liabilities	8,564	7,604	17,244	17,452	8,314	17,452
Net Debt	3,587	3,202	12,458	n/a	n/a	n/a
Total Equity	23,793	24,667	26,180	25,978	24,402	25,978
Return on Common Equity[1]	4.0%	4.1%	4.8%	5.2%	5.2%	5.2%
Return on Assets	2.9%	3.1%	2.9%	3.1%	3.9%	3.1%
Current Ratio	0.2	0.1	0.6	0.4	0.3	0.4
T. Liabilities / T. Assets	26%	24%	40%	40%	25%	40%
Net Debt / Total Equity	15%	13%	48%	n/a	n/a	n/a
Cash Flows						
Cash from Operations	1,302.3	1,484	1,507	1,614	1,127	1,234
CAPEX (recurring)	(530.2)	(342)	(221)	(567)	0	(347)
Free Cash Flow	772.1	1,142	1,287	1,047	1,127	888
Net cash movement	(182.8)	103	1,398	1,887	(516)	(27)
Net Debt/CFO	2.8	2.2	8.3	n/a	n/a	n/a
CFO/EBIT	79%	86%	80%	80%	129%	124%

Source: Group's audited financial statement and HY reports

[1] ROE and ROA for H1 2016 takes into consideration the full year FY16 performance, ROE and ROA for H1 2017 refer to the LTM 2017 performance.

Historical Price

Reference	Date	Price	Price Target	Analyst	Recommendation
PZC	16.02.2018	€1.01	€1.14	Simon Psaila and Elisabetta Gaudiano	BUY



Source: Bloomberg

Glossary and Definitions

Income Statement	
EBITDA	EBITDA is an abbreviation for earnings before interest, tax, depreciation and amortisation. EBITDA can be used to analyse and compare profitability between companies and industries because it eliminates the effects of financing and accounting decisions.
Profit after tax	Profit after tax is the profit made by the Group during the financial year both from its operating as well as non-operating activities.
Profitability Ratios	
Operating profit margin	Operating profit margin is operating income or EBITDA as a percentage of total revenue.
Net profit margin	Net profit margin is profit after tax achieved during the financial year expressed as a percentage of total revenue.
Efficiency	
Return on Equity	Return on equity (ROE) measures the rate of return on the shareholders' equity of the owners of issued share capital, computed by dividing profit after tax by shareholders' equity.
Return on Assets	Return on assets (ROA) is computed by dividing profit after tax by total assets.
Equity Ratios	
Earnings per share	Earnings per share (EPS) is the amount of earnings per outstanding share of a company's share capital. It is computed by dividing net income available to equity shareholders by total shares outstanding as at balance sheet date
Cash Flow Statement	
Cash flow from operating activities	Cash generated from the principal revenue-producing activities of the Company, net of income tax and interest paid.
Cash flow from investing activities	Cash generated from the activities dealing with the acquisition and disposal of long-term assets and other investments of the Company.
Capital expenditure (CAPEX)	Funds used by a company to acquire or upgrade physical assets such as property, industrial buildings or equipment, net of disposals and excluding non-recurring items. It is often used to undertake new projects or investments by the firm.
Free cash flows (FCF)	FCF is a measure of a company's financial performance, calculated as operating cash flow minus capital expenditures. FCF represents the cash that a company is able to generate after spending the money required to maintain or expand its asset base.
Free cash flows to the firm (FCFF)	FCFF is a measure of financial performance that expresses the net amount of cash that is generated for a firm after expenses, taxes and changes in net working capital and investments are deducted. FCFF is essentially a measurement of a company's profitability after all expenses and reinvestments.
Free cash flow to equity (FCFE)	FCFE is a measure of how much cash is available to the equity shareholders of a company after all expenses, reinvestment, and debt are paid. FCFE is a measure of equity capital usage.
Balance Sheet	
Non-current assets	Non-current asset are the Group's long-term investments, which full value will not be realised within the accounting year. Non-current assets are capitalised rather than expensed, meaning that the Group allocates the cost of the asset over the number of years for which the asset will be in use, instead of allocating the entire cost to the accounting year in which the asset was purchased. Such assets include intangible assets (goodwill on acquisition), investment properties, and property, plant & equipment.
Current assets	Current assets are all assets of the Company, which are realisable within one year from the balance sheet date. Such amounts include inventory, accounts receivable, cash and bank balances.
Current liabilities	All liabilities payable by the Company within a period of one year from the balance sheet date, and include accounts payable and short-term debt.
Net debt	Borrowings before unamortised issue costs less cash and cash equivalents.

Non-current liabilities	The Company's long-term financial obligations that are not due within the present accounting year. The Company's non-current liabilities include bank borrowings and bonds.
Total equity	Total equity includes share capital, reserves & other equity components, and retained earnings.
Financial Strength Ratios	
Liquidity ratio	The liquidity ratio (also known as current ratio) is a financial ratio that measures whether or not a company has enough resources to pay its debts over the next 12 months. It compares a company's current assets to its current liabilities.
Interest cover	The interest coverage ratio is calculated by dividing a company's EBITDA of one period by the company's interest expense of the same period.
Net debt / Equity	Net debt / equity ratio is a debt ratio used to measure a company's financial leverage, calculated by dividing a company's net debt by its stockholders' equity. This ratio indicates how much net debt a company is using to finance its assets relative to the amount of value represented in shareholders' equity.

Explanation of Equity Research Ratings

Buy: Based on a current 12- month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus projected dividend yield), we recommend that investors buy the stock.

Sell: Based on a current 12-month view of total shareholder return, we recommend that investors sell the stock.

Hold: We take a neutral view on the stock 12-months out and, based on this time horizon, do not recommend either a Buy or Sell.

Newly issued research recommendations and target prices supersede previously published research

Disclaimer